



# FAO TRADE POLICY TECHNICAL NOTES

on issues related to the WTO negotiations on agriculture

## No. 8. Food aid in the context of international and domestic markets and the Doha Round

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### 1 Introduction

This technical note<sup>1</sup> reviews major developments in the international food aid system and different positions on the effectiveness and impact of food aid. It also attempts to clarify the terminology, definitions and concepts used in discussions on food aid, with a view to improving the process of analysis and to help focus the debate under the World Trade Organization's (WTO) Framework Agreement on Agriculture adopted on 1 August 2004, which has called for negotiations on food aid disciplines. In view of the fact that food aid is not only a trade or market concern but, first and foremost, a complex and contentious developmental and humanitarian issue, any attempts at regulating or disciplining the food aid system in the context of international trade would benefit from direct and active participation of those international agencies with experience and expertise in food aid affairs. In turn, disciplining food aid through a widely accepted international legal instrument that has a well established adjudication process will facilitate legitimate food aid and restrict abuses of food aid.

### 2 What does international food aid mean and what is its role?

Defining international food aid and describing its role continue to be widely debated topics. Generally speaking, the term “food aid” has traditionally been used to refer to international transactions that result in the provision of “aid in

the form of a food commodity in a country deemed in need of receiving such aid”. This description originates in the 1950s when the accumulation of food (mostly cereals) surpluses in some developed countries gave way to the idea that those surpluses could be “disposed of” in such a way as also to improve the food security situation in vulnerable countries. This led in 1954 to the establishment of the FAO Principles of Surplus Disposal (*the Principles*), “a code of international conduct that encourages the constructive use of surplus disposal of agricultural commodities, while at the same time safeguarding the interest of commercial exporters and local producers.”<sup>2</sup>

Subsequently, in 1962 the World Food Programme (WFP), under the joint auspices of the United Nations and FAO, was established, marking the beginning of multilateral food aid. The next milestone in the development of the international food aid regime was the signing of the Food Aid Convention (FAC) in 1967. The treaty aimed at enhancing the capacity of the international community to respond to food aid needs by guaranteeing a predictable flow of food aid every year, irrespective of price or supply fluctuations. The signatories, i.e. the food aid donors, committed themselves to achieving this by agreeing on the minimum level of food aid they were willing to provide. The most recent FAC, agreed to in 1999, sets the minimum aggregate commitments at around 5.5 million tonnes in wheat equivalent.<sup>3</sup>

<sup>1</sup> This technical note is based on discussions at an informal consultation of experts involved in food aid and development issues held on 27-28 January, 2005 at FAO in Rome, but does not necessarily reflect the views of all of those who participated in the consultation.

<sup>2</sup> The latest update of the *Principles* was published in 2001 and takes into account the Uruguay Round Agreement on Agriculture (FAO, 2001).

<sup>3</sup> Konandreas (2005) contains a more detailed background information on the origins.

None of these international instruments dealing with food aid, however, contains an explicit definition. Instead, food aid is usually defined implicitly as an agreed list of international transactions in food that are considered to constitute food aid. Many of the issues surrounding the topic in the current round of multilateral trade negotiations in fact also revolve around what exactly to include within that range, with the main concern focusing on preventing market distortions that could impact on international trade flows of food commodities. Although empirical research identifying the extent to which various food aid transactions could distort international markets is not adequate to provide significant guidance to current multilateral trade negotiations, use of three important concepts could help in identifying broad categories of food aid transactions that would provide a functional classification framework for use in the negotiations. These concepts are: “additionality in consumption”, “tied food aid” and “legitimacy of food aid”.

The concept of additionality is the underlying justification for the Usual Marketing Requirements (UMRs) in the *Principles* and refers to the extra consumption that food aid generates that would not have taken place had it not been provided.<sup>4</sup> Although difficult to measure in practice, the extent to which food aid displaces imports and/or discourages domestic production in the recipient countries depends on the extent to which additionality in consumption can be achieved. It must be recognized, however, that since food aid is at the same time a resource transfer to the recipients and not all of that increase will be spent on food consumption, complete additionality in consumption will not be achieved. In other words, it would be impossible to prevent the “commercial displacement” that food aid causes completely. At best, additionality in consumption can be maximized by “targeting” food aid to vulnerable and food insecure population groups that have limited access to resources to purchase the food that they need in the recipient countries. However, just as it is difficult to measure empirically the amount of additional consumption generated by a food aid transaction, it is also difficult to identify the target groups and to deliver the food to those groups even when it is possible to identify them. Nevertheless, much progress has already been achieved in developing geographic targeting methods for the vulnerable (i.e. poverty maps) and statistical tools to enhance such analyses (Keyzer et al., 2003). Even so, detailed data at the

household level in many countries still need to be collected within a consistent framework in order to make tools operational at the field level.

The concept of “tied food aid” is a donor related one and refers to the practices of requiring the recipient countries to accept either other commercial transactions in parallel to the food aid deliveries, or for the services used for delivering it to be sourced in the donor countries. Although the former practice is already disciplined under Uruguay Round Agreement on Agriculture (URAA), the latter is recognized as reducing the effectiveness of food aid by delaying the delivery of food, increasing the costs of delivery and thus restricting the quantity of food that could be delivered to the beneficiaries, especially at earlier stages of emergencies, when compared to more flexible methods of delivery.

The concept of “tied food aid” as used here should not be confused with that of “tied aid”, which is defined by the Development Assistance Committee of the Organization for Economic Co-operation and Development (OECD) (DAC) as “loans, grants, or associated financing packages with a grant element greater than 25 percent and defined as aid which is in effect ... tied to the procurement of goods and/or services from the donor country and/or a restricted number of countries” (OECD, 1987). Since the form that the “loans or grants” could take is not specifically mentioned in the above definition, food aid is usually considered as “tied aid” if it is provided in the form of a food commodity by the donor, sourced from its own markets. Thus, about 90 percent of food aid can currently be considered to be tied aid (Clay, Riley and Urey, 2005), as it is usually provided in food commodity form rather than in cash, and this has become one of the main issues to be addressed in the current round of multilateral trade negotiations, as noted in the August Framework Agreement (WTO, 2004). As will be argued below, however, as long as such aid is delivered in the form of food to the ultimate beneficiaries who would not otherwise have been able to have access to it, whether the aid is donated in commodity or cash form would not really matter, at least within the context of food aid discussions, making it a non-issue in the negotiations.

The third concept of “legitimacy” dates back to the origin of the food aid system, i.e. to almost five decades ago when the notion of “surplus disposal” was first introduced and when food aid policies were driven, by and large, by the supply availabilities in donor countries. This is also evidenced by a very close and direct association between the size of annual food aid flows and the stocks held by major donors during those earlier years (see Figure 1). The question of legitimacy, while usually absent in the general discussions on food aid, is referred to under paragraph 16 of the

<sup>4</sup> The UMRs for a specific country are the normal levels of commercial imports of the individual cereals and are used to ensure that commercial imports into the recipient countries are not replaced by food aid shipments.

August Framework Agreement and the Marrakesh Decision (WTO, 2002) that adds an obligation on the part of WTO Member donors to “*review the level of food aid...and...to establish a level of food aid commitments sufficient to meet the legitimate needs of developing countries during the reform program*”. Therefore, assessing the legitimate needs of developing countries and adjusting or reforming the international food aid system to address those needs have become an emerging issue that is expected to constitute an important component of any new food aid regime.

### 3 What are the essential features and major trends in food aid flows?<sup>5</sup>

Cereals account, in volume terms, for most (over 80 percent) of total food aid. Shipments of cereals as food aid have declined over the past two decades, especially since the mid-1990s, due mainly to falling apparent surpluses of cereals among the major donors (see Figure 2). Non-cereals are also given as food aid, albeit in smaller volumes than cereals, and similarly their quantities have declined in recent years. Over 90 percent of the total food aid are provided by just five donors. The largest donor has traditionally been the United States, which provides more than 50 percent of total food aid.

The value of food aid shipments expressed as a share of the food import bills of the developing countries, and as a share of Official Development Assistance (ODA) has declined considerably over the past decade (see Figure 3). This development indicates that food aid has largely lost its importance as both a development policy instrument in the recipient countries and as an indirect price support mechanism in donor countries. This point is also supported by the changing nature of food aid modalities. Emergency food aid, which is defined as food aid provided for direct distribution at times of severe food shortages, now constitutes nearly two-thirds of total food aid. Programme food aid, which in large part represents resource transfers in the form of food for balance of payments support, has fallen to 15-20 percent of total food aid flows from a high of 60 percent at the beginning of the 1990s. The remaining portion of food aid is usually in the form of projects, representing transfers of food commodities either for distribution to targeted groups for development purposes or for monetization to fund other food security-related work.

Among these three broad categories, emergency food aid is considered to have the least market distorting impact, because it tends to be delivered directly to those who would not otherwise be able to access the food and, thus, who are most likely to consume rather than sell the food that they receive. Programme food aid, on the other hand, is accepted to be the most market distorting, since all of it is monetized in the open market, augmenting the supply in the recipient countries.<sup>6</sup>

On the recipient side, nearly all food aid has, in most years, been destined exclusively to the developing countries, particularly to the Low-Income Food Deficit Countries (LIFDCs), where many rely on food aid to meet their food needs. On average, the reliance on food aid increased up to the mid-1980s but decreased by about the same rate thereafter. Figure 4 indicates that countries which are relatively more food insecure not only rely on more food aid and are more prone to face food emergencies, but are also under greater economic stress:

- they have much lower GDP and lower levels of development;
- their economic performances are poorer;
- their ability to import their food needs is more constrained; and because of this,
- they, paradoxically, tend to be more food self-sufficient.

<sup>5</sup> Data on food aid shipments/deliveries are compiled by WFP. The source of the estimates of value of food aid and other variables used in this section is FAO.

<sup>6</sup> The proceeds from the sales could, of course, be put to use to alleviate hunger and food security. However, if this is the main aim, it would be more cost-effective to provide the aid in cash rather than as commodities even if, as argued by some, the overall level of aid resource declines (Clay, Riley and Urey, 2005). This is especially so when commercial displacement effects of the open market sales of the commodity are taken into account.

Figure 1: Wheat food aid shipments and opening stocks of major wheat exporters

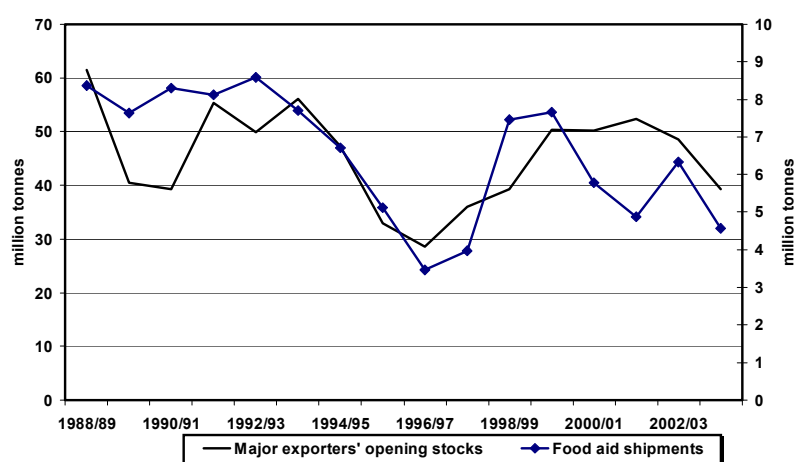


Figure 2: Volume of food aid shipments to developing countries

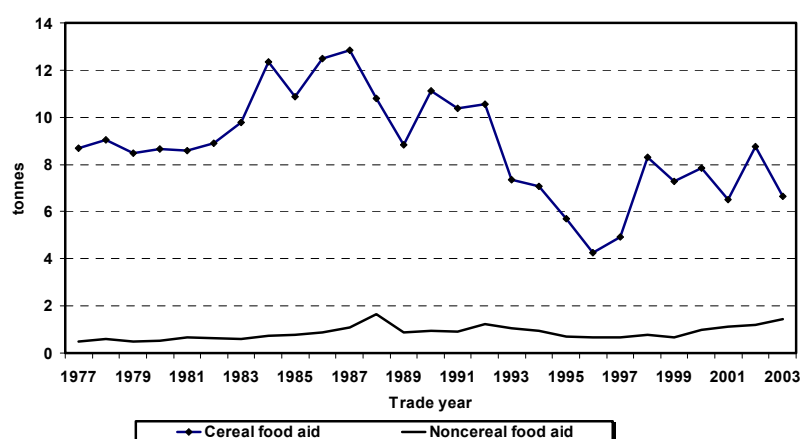
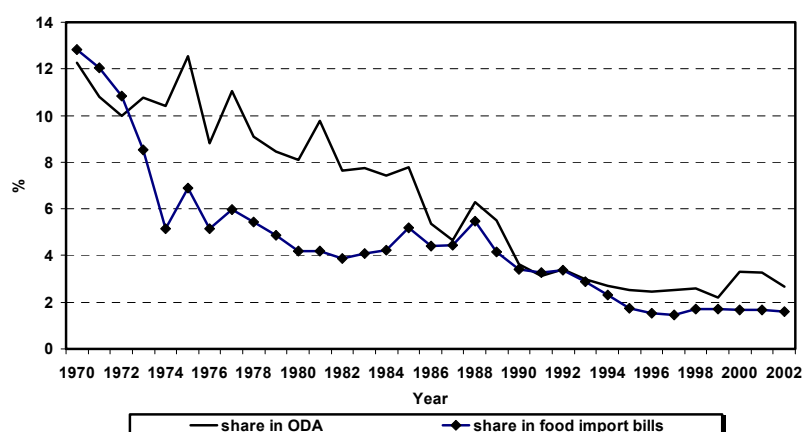
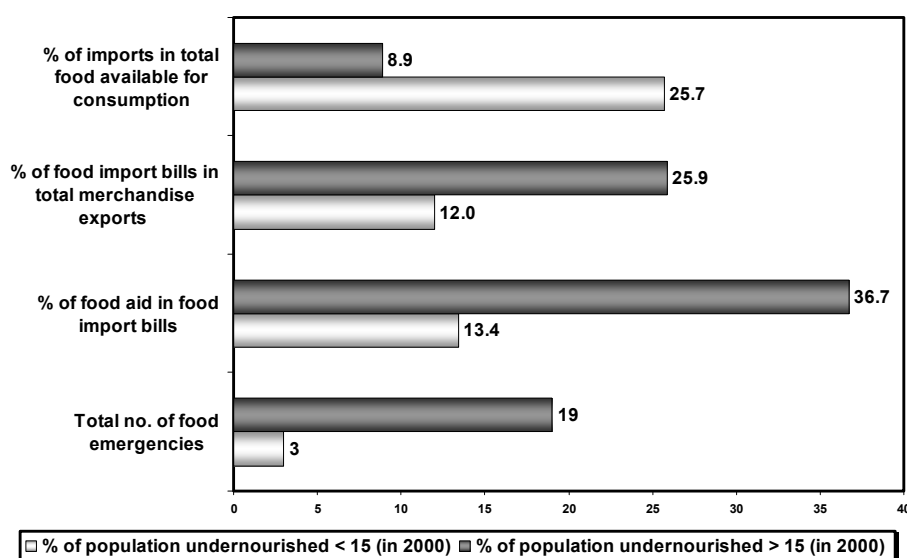


Figure 3: Share of food aid in official development assistance and in food import bills of developing countries



**Figure 4: Profiles of food secure and insecure developing countries on selected variables**

#### 4 Is there a “consensus” on food aid impacts on domestic markets?

Views on food aid's impact on domestic markets of the recipient countries diverge considerably among the experts, mainly because of the considerable lack of market data and other relevant information at the micro/household level in those countries. Analyses using aggregate level data yield contradictory results depending upon the nature of the model and statistical techniques used in estimating the impacts (Abdulai, Barrett and Hoddinott, 2004). Data on food aid and trade flows tend to be more reliable as compared to, for example, estimates of human consumption, as are the conclusions that can be drawn from similar types of analyses assessing impacts of food aid on displacement of commercial imports.<sup>7</sup> In general, such studies do indicate the existence of a displacement effect, vindicating to some extent the concerns that lie at the heart of the attempts to discipline such transactions since the early 1950s. The findings in these studies indicate that an important part of food aid received does not go to additional consumption. But the discovery that commercial imports are displaced also indicates that food aid deliveries are likely to have smaller disincentive effects at the domestic level, depending on the extent of import displacement.

The issues of changing traditional consumption patterns and creation of dependency on food aid, and measuring its beneficial effects remain largely unresolved. Nevertheless, there is some evidence

to suggest that a significant part of food aid has been delivered to those countries that are the most vulnerable and, therefore, the neediest (USDA, 2004; Gupta, Clements & Tiongson, 2004). Addressing fully the concerns of those who worry about the distortions that food aid may cause to the international and domestic markets if it continues to be provided, and about the loss of welfare of the most vulnerable population groups that receive food aid if it is no longer to be provided, requires a closer focus on household and local market levels, rather than on the country as the main unit of analysis.

Whereas views often diverge on food aid impacts on the domestic and international markets, there is widespread agreement on the importance of proper targeting and appropriate timing in ensuring that food aid delivered leads to additional consumption and thus minimizes market distortions and maximizes welfare impacts of the vulnerable groups. While emergency food aid, by its very nature, reflects the most targeted of the three major food aid modalities, experts consider improved targeting practices under project aid as the primary reason for it to have lesser distortive impacts compared to programme food aid. Good timing is also viewed as an essential component of making targeting more effective, especially in responding to sudden food shortages.

<sup>7</sup> Even here care needs to be exercised because of the possibility of informal trade in some of the recipient countries.

## 5 How to manage food aid issues in multilateral trade negotiations

The principle reason for the continuing debate on food aid in multilateral trade negotiations is the argument that some exporters/donors could use some form of food aid transactions (under grants and/or concessional sales) to circumvent restrictions on export subsidies. It is for this reason that the food aid text has remained under the “export competition” pillar of the Agreement on Agriculture (AoA) in the Doha Round and, most recently, in the August Framework, which established full “parallelism” between food aid and other forms of export subsidization.

Against this background, at least three fundamental actions have been identified for policy makers to consider. The *first* is about determining/defining the type or kind of food aid that can result in commercial displacement; the *second* is about agreeing on some institutional arrangements at the international level for evaluating/assessing “legitimate” food aid needs; and the *third* is to establish a mechanism for effective monitoring and reporting of aid flows to ensure adherence to the agreed disciplines under the current round of multilateral trade negotiations.

### • “Decoupling” food aid?

Identifying specific types of food aid transactions that require regulation in order to safeguard commercial transactions is, as already noted, not a trivial task. It may therefore prove useful to consider a simplified classification scheme in which all food aid transactions are differentiated based on the different degrees of additionality in consumption that they are perceived as generating.

Given the trend towards increasing the share of emergency food aid, one broad dimension of any categorization scheme is the emergency/non-emergency axis. It is generally accepted that a large part of emergency food aid often leads to “additional consumption” by the ultimate beneficiaries. However, any negative effects of displacement of imports and/or disincentives for domestic production arising from leakages into the local markets in the recipient countries are likely to be outweighed by the benefits emanating from the immediate humanitarian relief that such aid would provide. A second dimension along which a categorization scheme can be developed is the tied/untied axis of food aid. Although, this dimension does not directly involve the concept of additionality, it can address some of the trade issues of concern. Moreover, since food aid is generally viewed as a needs-driven resource and that maximizing additionality in consumption minimizes domestic and international market distortions, then any categorization scheme must necessarily be based on targeting food insecure

and vulnerable population groups as the ultimate beneficiaries of food aid.<sup>8</sup>

With this broad picture in mind, the scheme presented in Figure 5 is a framework that identifies, in a very broad manner, those food aid transactions aimed at food insecure and vulnerable populations that may require different degrees of monitoring and reporting because of the differences in the degree to which their effects distort international food markets when compared to the benefits that they confer. The rows and columns of the table represent the emergency/non-emergency and the tied/untied food aid axes, respectively. Different shadings represent the degree of perceived trade displacement.

Before explaining the underlying reasons for the manner in which the food aid transactions have been categorized, it is necessary to dispense with some definitional and operational issues related to the concepts of “emergency” food aid and “tying” of food aid.

As far as “emergencies” are concerned, what constitutes an “emergency”, who has the authority to declare such an emergency and how food aid needs are determined in each emergency require an agreement at the outset. In this particular context, “tying”, as already noted, means the requirement that the complementary services used for delivering food aid (i.e. bagging, processing, transport, etc.) be provided by the donors’ own national companies.<sup>9</sup>

Programme food aid provided to governments for open (non-targeted) monetization or non-targeted distributions would not be considered as “legitimate” food aid in the scheme presented in Figure 5. This is because of the initial premise of the scheme that the principal genuine beneficiaries of food aid are the food insecure and vulnerable population groups in countries, which is not the case with such food aid transactions.

<sup>8</sup> The use of the concept of targeting is necessary, even if there may be practical difficulties in accurately identifying the target groups and ensuring that only they receive such aid. Identifying certain categories of households based on *a priori* considerations as the most food insecure and vulnerable could serve as a way forward, until more reliable information can be collected to allow accurate “mapping of the hungry”.

<sup>9</sup> Tying in the sense of requiring food aid donations to be conditional on additional/other commercial transactions is already disciplined under the current AoA Article 10.4.a and is not relevant here.

**Figure 5: A scheme for classifying food aid transactions in terms of their possible impact on trade flows of food commodities**

	TIED		UNTIED
NON-EMERGENCY	closed monetized food aid		
EMERGENCY			
	Minimally distorting- not a WTO concern		
	Monitoring needed to ensure that such food aid is destined for slow developing and complex emergencies - if not, possibly distorting, thus, a potential WTO concern		
	Monitoring needed to ensure that such food aid is targeted to well defined vulnerable population groups - if not, distorting, thus, a potential WTO concern		
	Close monitoring needed to ensure that cash proceeds reach well defined vulnerable population groups - if not, distorting, thus, a potential WTO concern		

When food aid is approached from a needs-based perspective, the long standing issues related to grant vs. concessional and commodity vs. cash become redundant: the former because the donors are not likely to “lend” the food to the ultimate recipients who would not have had the means to procure it in the first place or to pay the “loan” back,<sup>10</sup> and the latter because the aid, in most cases, will reach the ultimate recipients in the form of food,<sup>11</sup> regardless of the form in which the original donation was made.

<sup>10</sup> It may well be that governments in the recipient countries would prefer to underwrite the “food loans”, but as long as the food received is not monetized on the open market but is targeted to vulnerable groups, the transaction could be considered as “legitimate” but requiring monitoring to ensure that the market effects are minimized. This issue is addressed below.

<sup>11</sup> The scheme presented does allow for closed (targeted) monetization, provided the recipients of the cash proceeds are well defined vulnerable groups.

To return to categorization of food aid transactions, food aid provided under emergency conditions (currently constituting above 60 percent of total food aid shipments) is expected to be the least distorting as already noted above. If the emergency food aid is *untied*, moreover, there would be maximum degree of flexibility to deliver the food wherever needed with the minimum of delay and would be minimally trade distorting and not require any WTO oversight. If the food aid is *tied*, on the other hand, the ensuing delays between initiating the process, transporting to the port of delivery and, finally, distributing to the ultimate beneficiaries would make such transactions useful only for meeting the needs of slowly evolving emergencies (such as those arising out of drought) or long term emergencies (such as complex ones resulting from conflicts). Monitoring may be necessary to ensure that such food aid is indeed destined to such types of emergencies.

In either case, however, a prerequisite for the smooth implementation of this aspect of the proposed regime is the existence of a credible, dependable, independent and effective international mechanism that could assess the

nature of the emergencies and the food aid needs arising from them (discussed in more detail below).

Given the nature of the food aid transactions on the non-emergency side, concerns about trade distorting effects increase and close monitoring is required. A prerequisite to ensuring that trade distorting effects emanating out of such transactions are minimized is the identification of the beneficiaries of such food aid flows. The bulk of these transactions would be earmarked for providing support to food-based interventions, such as food-for-work, school feeding, mother-child, HIV/AIDS programmes etc., where one would expect some of the food to leak into the domestic markets. The remaining, perhaps the most sensitive of such transactions, are closed (targeted) monetized food aid transactions, where the sales are made on a concessional basis to specific vulnerable groups or in such a way as to benefit these vulnerable groups directly (e.g. capitalization of a village grain bank). Such food aid will augment supplies in the domestic market but, depending on the effectiveness of the targeting, may also augment demand (Clark, 2005). These transactions require close monitoring to ensure that the benefits accruing to the recipients are large enough to make any negative effects tolerable.

The broad categories identified here, of course, do not specifically mention all categories of transactions currently recognized as food aid under existing international legal instruments. Local purchases of food aid in the recipient countries are one important example. Such transactions, however, do not lead to displacement of imports. Neither do they discourage domestic production; on the contrary, by augmenting domestic demand in the surplus regions in the country, such purchases may encourage production in those areas.<sup>12</sup> It may well be possible to identify such food aid transactions as requiring no international monitoring.

Triangular purchases of food aid in other developing countries near to the recipients are another important example. In recent years, about ten percent of food aid deliveries have been sourced through such purchases. Although, this practice may have the potential to displace imports and discourage domestic production in recipient countries, the positive market development effects in those countries where the purchases are made may be viewed in a similar light to that for local purchases. The main point to illustrate here is that the scheme presented could be used as a framework to classify specific food

aid transactions according to whether the trade negotiators view them as liable to require a different degree of monitoring. This framework could be used to facilitate the discussions.

• *Who will monitor, analyze and report on the food aid transactions included in the regime?*

The type of monitoring, analysis and reporting required to make the above scheme operational require the specialized know-how, experience, personnel, and organizational capabilities that exist only in a limited number specialized agencies, such as FAO, WFP, and the Food Aid Convention. From the perspective of trade displacement effects of certain types of food aid, FAO's Consultative Subcommittee on Surplus Disposal (CSSD), with membership open to all FAO member countries, already has a well-established reporting procedure, which has been duly recognised in Article 10.4.b of the URAA. In the Food Aid Convention, the reporting obligations of the Signatories to the Convention extend only up to their agreed "minimum commitments". WFP maintains the most comprehensive and up-to-date databases on food aid shipments, although the donors have no reporting obligations to it. It should not be too difficult to combine and strengthen the capabilities of these bodies and perhaps of other relevant agencies, in order to provide the information and analyses needed to support the monitoring of food aid transactions from the trade perspective while reinforcing the underlying food security aims of food aid transactions.<sup>13</sup>

As far as assessing emergency food aid needs are concerned, currently FAO, through its Global Information and Early Warning System (GIEWS), and WFP are the only international agencies that perform this function in countries facing emergencies. Despite some shortcomings of the methodology that they use for this purpose, which is currently being improved, theirs are the only independent and unbiased assessments of food aid needs in emergency situations.

As already noted, the existing international instruments that deal directly with food aid matters do not present a cohesive set of rules for bringing international food aid transactions under widely agreed disciplines. In order to facilitate legitimate food aid and restrict abuses of food aid, a widely accepted international legal instrument that has a well established adjudication process is still needed.

<sup>12</sup> By doing so, however, resulting higher prices may crowd out some vulnerable food consumers from the market, jeopardizing their food security.

<sup>13</sup> Ultimately, of course, the governing bodies of these institutions will need to decide whether they would be willing to undertake such a responsibility.



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