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PL 480 TITLE II MONETIZATION PROGRAM IN BOLIVIA

CURRENT SITUATION AND FUTURE OPPORTUNITIES

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The responsibility for the conclusions and recommendations is mine alone They do not represent the policies, judgements, or agreements of any of the private or public sector institutions or individuals which were interviewed pursuant to preparing this report

EXECUTIVE SUMMARY

This report analyzed the Title II monetization in Bolivia from four perspectives the openness, transparency, and competitiveness of the monetization process used by the PM in reference to its ability to capture the market price of the PL 480 wheat flour at the time of each sale, the potential for incorporating a broader range of commodities to be monetized, the potential for cost reduction involved in operating the monetization program, including the cost of the commodity, transportation, and administration, and the potential role for third-country monetization to both increase net sales receipts and cost recovery percentages, and to enable future expansion of the development programs through a larger monetization program

Major changes in the monetization procedures as currently being implemented by the Agencies in Bolivia would not result in either significantly greater competition, increased sales, higher sales prices, or greater cost recovery The sales process fully captures the highest price in the regional and local market context Flour from Argentina sets the wholesale and retail price in Bolivia The wheat flour market makes it impossible to "time" sales to the highest prices, therefore, the most judicious approach is to continue to be a known and consistently reliable entity in the wheat flour market and incorporate the maximum competition and participants in the bidding process

No alternative commodity to wheat flour which can be effectively and efficiently monetized, and which can meet the test of the Bellmon Determination is apparent However, U S commodity groups or associations have a wealth of knowledge about their products and other key factors which are critical in identifying potentially new options for the Title II program – and they should be encouraged work with the Agencies in analyzing potential markets

Matarani has been preferred by the Agencies in Bolivia to bring in Title II commodities for both the direct distribution and monetization programs The weight placed on losses as an indicator of commodity management, and USAID policy not to replace losses, has focused the emphasis by the Agencies on saving product rather than saving money However, there appears to be sufficient requisites available at Arica for the Agencies to begin using it in FY 1999

The actual cost recovery CIF/La Paz for the FY 1998 monetization program was 86 5% (using U S Flag ships) The reconstructed cost using Free Flag vessels was 92 0% Factoring in the potential cost savings by using Arica, the percentage cost recovery rises to 94 5%

The problem of incorporating the Bolivia monetization program into the program in Peru is the unfavorable cost recovery due to the taxes Logistically, there would be no problems involving commodity handling The Chilean market for wheat could absorb the volume anticipated for the Bolivia program, but at the expense of regular U S commercial imports

The overall conclusion of this analysis is that the best option for the Title II monetization program in Bolivia is to focus on those aspects within Bolivia which can reduce cost and allow for future growth of the program There is an opportunity for cost savings related to inland transportation which can be realized by switching the arrival port from Matarani, Peru, to Arica, Chile, and the opportunity for expansion by having commodities available for sale throughout the entire year

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ACRONYMS

ADRA	Adventist Development and Relief Agency
ADIM	Bolivian Millers Association
AER	Annual Estimate of Requirements
BHR	USAID Bureau for Humanitarian Response
CARE	CARE International
CARITAS	Catholic Archdiocese Relief Agency (Bolivia & Peru)
C&F	Cost & Freight
CIF	Cost, Insurance, & Freight
CRS	Catholic Relief Services
DAP	Development Activity Proposal
DIP	Detailed Implementation Plan
FFP(O)	USAID Food for Peace (Office)
FHI	Food for the Hungry International
FAS	Free Along Side
FOB	Free On Board
FY	Fiscal Year
GATT	General Agreement on Tariff and Trade
GOB	Government of Bolivia
GOC	Government of Chile
GOP	Government of Peru
HRW	Hard Red Winter (Wheat)
IBRD	International Bank for Reconstruction & Development (World Bank)
IMF	International Monetary Fund
ISA	Institutional Support Assistance (Grant)
LOA	Life of Activity
MERCOSUR	Southern Andean Free Trade Agreement
MOU	Memorandum of Understanding
MT	Metric Ton
NGO	Non-Governmental Organization
PAA	Previously-Approved Activity
PCI	Project Concern International
PL 480	Public Law 480
PM	Bolivian Monetization Program
PVO	Private Voluntary Organization
SNI	National Industrial Society (Peru)
Technoserve	Technoserve International
Title I	U S Government Commercial Food Export Sales Program
Title II	U S Government Food Aid Donation Program (Government to NGO)
Title III	U S Government Food Aid Donation Program (Government to Government)
UMR	Usual Marketing Requirement
USAID	United States Agency for International Development
USG	United States Government
WFP	World Food Programme

1 BACKGROUND

Bolivia has a considerable history of monetizing Title II commodities Initially, little concern was paid to the efficiency of the monetization process, i e , converting the Title II food aid commodities into local currency Also, each Agency individually imported and sold the commodities approved for their respective program There was also a system of assigning prices based upon volume, i e , the cost per bag would be lower if 1,000 bags were purchased rather than if 100 were purchased by an individual buyer The focus was on generating whatever revenue was necessary by whatever means as rapidly as possible

In 1989, an inter-agency unit, called Monetization Program (PM), was established to provide overall management and oversight of the monetization of Title II commodities This entity grew, at one point, to comprise a staff of 24 persons, including full-time managers, accountants, marketing specialists, commodity specialists, auditors, etc However, in the mid-1990's, the Agencies were becoming increasingly concerned that rather than facilitating the monetization process, the PM was acting as more of a constraint on the effective generation and distribution of monetization resources in support of development programs By 1998, the PM had been streamlined to include only those staff necessary to efficiently manage the monetization process The cost-effectiveness of the monetization program has been enhanced accordingly

Once efficiencies had been achieved through reducing the local costs for implementing the monetization program, the next step was to do an in-depth analysis of the other key factors which defined the amount of revenues which could be generated, and the ability to recover, to the greatest extent practicable, the cost of purchasing and shipping the monetized commodities

This report was commissioned to analyze the Title II monetization in Bolivia from four perspectives First, was to evaluate the openness, transparency, and competitiveness of the monetization process used by the PM in reference to its ability to capture the market price of the PL 480 wheat flour as determined by the market clearing price at the time of each sale Achieving the market clearing price is essential to maximize income and cost recovery

The second issue was to assess the potential for incorporating a broader range of commodities to be monetized Historically, the Agencies in Bolivia have utilized wheat flour as the commodity of choice in the monetization program

The third issue examined deals with the potential for cost reduction involved in operating the monetization program, including the cost of the commodity, transportation, and administration The role of cost reduction is an important one in generating higher net revenues, but an even more important factor in cost recovery Especially if the market environment precludes significantly higher gross sales prices

The final subject of this analysis is the potential role for third-country monetization to both increase net sales receipts and cost recovery percentages, and to enable future expansion of the development programs through a larger monetization program

2 MONETIZATION PROGRAM

2 1 Organizational Structure

The Monetization Program is headed by a Directorate which is comprised of the Country Directors of the Agencies involved in Monetizing PL 480 commodities The Chair of this rotates annually among the Directorate members USAID/Bolivia participates as a non-voting member This committee is responsible for setting policy on issues of joint interest, and ratifying recommended actions proposed by the other committees which comprise the PM

Responsibility for opening, reviewing, and making subsequent recommendation for adjudication to the Directorate is vested in the Commercialization Committee This group is comprised of a representative of each participating Agency, plus a member of the permanent PM staff Again, USAID/Bolivia participates in observer status

The permanent PM staff is comprised of the Administrator, Marketing Specialist, Accountant, Assistant Accountant, Commodity Specialist, Auxiliary Accountant/Document Processor, Secretary, and a Messenger A permanent legal advisor was also part of the staff until September 30, when his contract expired The Directorate is currently considering a replacement The total budget of the PM staff and operations in FY 1998 was about US$180,000 (Bs 995,955 30), or about 1 86% of sales proceeds (Bs 995,955 30/Bs 53,426,934 Bs) This would equal about US$2 20 per metric ton of wheat flour sold (US$0 11 for each 50 kilogram bag) Although each Agency includes a line item in their annual budget for the PM operations, its actual cost is more than covered by the interest earned from the deposits of the sales receipts Each agency also bears an additional indirect cost in relation to its membership and participation in the PM committees

There is an additional, and intangible, strategic benefit which accrues to the Agencies through their participation in the monetization process as currently structured -- they have the opportunity to understand and appreciate the role of the marketing process in agricultural production Most Agencies in Bolivia have an agricultural component, usually emphasizing production or productivity gains, among their development activities The role of marketing is less strongly emphasized And when it is addressed, there is always the danger that the Agency may want to "do" marketing, rather than the more effective role as a facilitator in the marketing system Providing information about markets is an example of a key facilitating role

By their involvement in the monetization of PL 480 commodities, the Agencies gain first-hand experience in the marketing aspects of agriculture They have a "real-life" school which teaches the interrelated roles of supply, demand, competition, and prices This knowledge is not exclusively applicable to monetized commodities, but extends to the impact of food provided for direct distribution in the market as well The principle that the objective of economic activity is consumption, and not production, is made abundantly clear

2 2 Sales Procedure

The PM operates two procedures for selling the Title II wheat flour For sales in quantities of less than 20 bags, a potential buyer can go directly to one of the Agency's warehouses and purchase wheat flour at the price established by PM through an actual bi-monthly market survey This survey is conducted in conjunction with the bid solicitation process described below

For sales of 20 or more bags, which comprise the overwhelming proportion of sales, PM uses a bidding process They program to make available 100,000 bags of wheat flour every 15 days The procedure begins with an advertisement being placed in the newspaper Potential buyers are instructed to provide sealed bids prior to a specific closing date After the closing date, the bids are opened by a committee which is comprised of a representative of each participating agency, USAID/Bolivia, plus a member of the PM staff This committee determines what is the minimum acceptable price, and recommends adjudication accordingly They can also recommend that all bids be declared non-responsive if they believe that the offering price is too low This is what occurred at the opening of bids in the first solicitation in FY 1998

In the event that the sales price is below the reference price as presented in the AER, the next step is for the President of the PM Directorate (a position which rotates annually among the Country Directors of the participating agencies) to send a letter to the USAID/Bolivia official in charge of the Food Security Unit, requesting his or her approval to sell the flour in the quantities and at the prices recommended by the committee This letter also includes the price for direct sales as established by a market survey Based on the response from USAID/Bolivia, the actual sales proceed

2 3 Market Supply/Demand

Analyzing the PM data shows that the constraint on monthly sales volume is related to the market demand, and not the supply being offered for sale by PM, at least in those months in which PM is present in the market Only three times in the past fiscal year has the demand for flour exceeded the amount being offered by PM However, in these cases, actual sales were less than the volume advertised due the minimum acceptable bid price Never having sales volume exceed the amount advertised is an important aspect, as buyers can be expected to tender bids based at least partially upon information of anticipated supply in the marketplace Advertising a fixed volume assists buyers in making responsive bids Any variation in this would be extremely detrimental to PM's image as a reliable and reputable supplier in the market Potential buyers would perceive increased risk associated with their purchases because supply would become an unknown factor, and they would, in turn, compensate for increased risk by offering lower prices in their bids

On the other side of the balance sheet, increasing sales to match the amount being offered would result in lower overall sales receipts, and correspondingly, a lower cost recovery percentage PM was able to sell almost all of its allotment of wheat flour during FY 1998 Only about 2,250 metric tons (45,000) bags of flour remained unsold at the end of FY 1998 This was sold in the first solicitation of FY 1999, which occurred during the first week of October Since the Agencies were able to sell their entire FY 1998 allotment in less than a year, there are no supply pressures to sell a greater volume via reduced prices There appears to be, however, an opportunity to increase revenues by maintaining a presence throughout the entire year This could allow capturing sales at the periods which may have relatively higher prices To make this a reality, either the volume offered per month would need to be reduced, the minimum acceptable bid price at each sale would have to be raised, or additional commodities would need to be monetized

The question of adequately dealing with the period between September and February, when no additional commodities are arriving, is a critical one from two aspects which impact directly upon sales prices Reviewing the sales data for the period FY 1993-1998 shows that the October through January period is historically a time when the least amount of wheat flour is monetized This also, and unfortunately, coincides with the period of strong consumption of wheat-based products by Bolivian consumers, and anticipated strong market prices

The first detrimental impact is felt in the management of each agency's development program These are on-going activities which have a continuous need for financing throughout the year They cannot simply stop when funds are in short supply, and restart the moment financing is available This makes them acutely sensitive to changes in liquidity and being able to establish a sufficient cash reserve to cover periods of little or no additional sales receipts By the end of the period when no commodity has been available for sale, signaled by the first arrival of commodities in February, most of the Agencies' reserve of available local currency has been expended This places an inordinate pressure on the program to accept bids which are lower than they otherwise would just to replenish their cash reserves Data from FY 1998 sales illustrates this, as the lowest bid accepted was usually only 80-90 percent of the highest offer in the early solicitations However, from the 10th solicitation onward, the lowest bid accepted was more than 95% of the highest bid offered The ability to generate sales in each of the months of the year would mitigate this to a significant degree At the same time, it should increase the cost recovery factor

The second has long term consequences as PM tries to establish itself as a reliable participant in the market To be absent from the market for an extended period of time -- historically this has been up to four months -- must have a negative effect The nature of the wheat flour market is such that if one purchaser cannot count on a reliable supply from a particular source, it is very easy to shift to another And once that buyer is "lost", it may be difficult to regain their confidence and participation in the monetization program The end result of any reduction in the potential pool of buyers will be negative both in terms of current revenues and expansion potential All of the buyers interviewed stated that being present in the market for the entire year was the most important step PM could take to improve its operations They believed that the program had a stabilizing effect on prices And that by remaining in the market for the entire 12 months, speculation would be reduced and more buyers would have access to U S wheat flour

It is widely known among the buyers that there will not be more U S wheat flour available in the monetization program until February, at the earliest The knowledge has led to a Bs 10 00 rise in the price of this flour in the market in the two weeks following the last solicitation

PM, and the Agencies, can compensate for their absence in the market by three actions First, they can make no modifications to the Call Forwards and receipt of commodities, but reduce the total offered bimonthly by a sufficient amount to permit stocks to cover this period The positive aspect of this would be to maintain a presence in the market throughout the year A potential danger with this is that if the actual generations throughout the year are less than anticipated, then additional commodity imports would be necessary to achieve the program budget The falling prices which have characterized the world market for wheat this year amply demonstrate this circumstance The effect would be to place a larger that anticipated volume on the market toward the latter part of the fiscal year, which could further depress the ability to achieve greater cost recovery as lower prices would have to be accepted in order to generate the necessary revenue This need for meeting financial obligations could result in a "fire sale" situation -- further exacerbating the financial crisis The Agencies would also be limiting their ability to take advantage of unforeseen upward movements in the market price by having insufficient supply available

One could argue that it would make the best financial sense to increase the volume offered at times when the price is highest, and reduce the volume offered for sale in those months when the prices are lowest However, a review of the actual data of PM sales does not present a clear enough picture of sales to make reliable forecasting possible Holding the supply constant at 100,000 bags being offered every 15 days, the data show that the months of greatest demand (sales) do not correspond to those with the highest sales prices For example, in Fiscal Year 1997, the highest price was paid by buyers for sales during the month of October However, the month ranked tenth in terms of total sales (Again, remember that the supply being offered was held at a constant 200,000 bags/month)

The second alternative is to adjust the Call Forwards to cover the September-February commodity arrival "gap" It is unclear that the Agencies are able to do this Adjusting the programming Call Forwards immediately runs up against the USG fiscal year budgeting limitations such as on making forward financial commitments, or the end of fiscal year USG budget uncertainties, e g , rescissions, or the system for accounting for carryover stocks Trying to accommodate the two principal, and independent, factors which govern monetization, i e , market forces in Bolivia and the USG budgeting cycle, imposes a very real constraint on the monetization program

The most often cited explanation for the gap in commodity arrivals between December and February is that most food programs are not approved soon enough to meet the first two invitation deadlines for placing a call forward These deadlines according to the procurement schedule given by USAID are as follows

1st invitation September 4 (overseas arrival 12/25-1/20)
2nd invitation October 2 (overseas arrival 1/25-2/20)

Actual experience has shown that rarely will any program be ready for the September 4 Call Forward And only a few will be ready by the October 2 deadline Most begin calling forward commodities by the next deadline, November 4, which means overseas arrival can be expected between 2/25-3/20

The explanation for the absence of commodities from September through November appears to be a result from the fact that most programs don't use the last two or three invitation periods in the fiscal year This is because the Agencies have a strong perception that sales must be completed in the same fiscal year as the Call Forward is issued Otherwise, they are concerned that any carryover of commodities to be monetized after October 1 will result in a reduction in the subsequent fiscal year's approval level Processing a Call Forward in late third quarter or in the fourth quarter of a fiscal would result in product being available to fill this gap

A third option would be to implement a program of borrowing wheat flour between the direct distribution and monetization programs If the Agencies determined that the supply of wheat flour for either program was in excess of the anticipated demand during the period until the next commodity arrival, that surplus could be temporarily loaned to the program experiencing the shortfall It should be stressed that this would be a two-way process, and not restricted to commodity loans from the direct distribution to the monetization program Reduced losses due to product deterioration in storage would be one of several benefits possible through better management of stocks The ability to capture unforeseen favorable market conditions which would otherwise not be possible due to absence from the market would also benefit the monetization program And again, the image of presence, as an indicator of reliable supply, would be enhanced The principle involved is, in actuality, not substantially different than that now used between the Agencies to cover shortfalls in product or financing Having the PM staff as a central clearing house among the Agencies for such a program is a distinct benefit in assuring adequate oversight

This option is not without its negative aspects, including additional cost of rebagging in bags which are used for the monetization program The wheat flour destined for direct distribution is clearly marked "Not for Sale", and if not rebagged before sale, it would be difficult to detect any unauthorized diversion of the commodity from the direct distribution program to the market Also, the market would interpret the presence of flour in these "Not for Sale" bags as an indication of mismanagement in the Title II program This would give those who most oppose the monetization of wheat flour in Bolivia a very opportune argument for discontinuing the program

A second drawback associated with this option is that most of the commodities which could have the potential for being used in the "loan" procedure are already stored in warehouses outside of La Paz Transporting them to La Paz would represent an additional cost

2 4 Market Expansion

2 4 1 Geographical Coverage

The question of broadening the market to beyond the greater La Paz area is one which would have the potential to expand the volume of sales, and thus, permit financing a larger development program Unfortunately, this does not appear to be a viable option in the foreseeable future The sales procedure used by PM is sensitive to this contingency, because it places no geographical restrictions on the origin of bids The availability of wheat flour from the program is well recognized throughout Bolivia, as evidenced by the fact that PM has, and continues to, receive bids from outside the La Paz area principally from Oruro, Cochabamba, and Santa Cruz However, these bids are always significantly below the offers from buyers in La Paz This is a clear indication that, given current market conditions, Title II wheat flour is most competitive, and returns the highest cost recovery rate, in the La Paz market where sales prices are the highest and the inland freight charges are the lowest

The lowest relative price obtainable for Title II wheat flour would be anticipated in the Santa Cruz market, as it is the center of national wheat production Therefore, flour is available in the market without the additional transportation costs associated with shipping flour from La Paz to Santa Cruz Even in the event of a significant reduction in national production due to weather, pests, etc , wheat flour of Argentine origin would enjoy a price advantage due to transportation costs Transportation costs are also a factor limiting the sales potential in the Cochabamba market, as does the price of flour arriving from non-formal commercial channels The third major commercial center, Oruro, is one in which prices are highly sensitive to informal imports The market prices are lower than in La Paz, again due in part to the lower relative transport costs from origin to Oruro

In summary, it is most important to reiterate that although there are economic reasons defining the scope of the monetization program's current market, the system being implemented by PM would capture any potential market expansion which becomes available as a result of a favorable change in the economic environment

2 4 2 Potential Buyers

Analyzing the PM data from another perspective, i e , the total number of potential buyers who present bids throughout the year, should provide insight on the susceptibility of the marketing process to collusion by groups of buyers to fix purchase prices at an artificially low level

PM has analyzed the individual bidders, and has determined that there are several bidders whose bids appear independent, but in fact are persons having mutual family relationships, or are employees of a single company or buyer They have identified sixteen such groups, and estimate that in 1997, about 60% of total sales went to such "groups" And the remainder of the wheat flour sold, about 40%, was to bidders who did not have similar relationships with other bidders

An analysis of the 1998 data (22 solicitations) indicates that 63% of the wheat flour sold was purchased by the former groups

The inference which can be drawn from this review of the data is that, although there are a number of bidders who, in theory, could act in concert to attempt to artificially depress the sale price by submitting low bids, there is no evidence that they exert a sufficient presence to actually reduce the price of the wheat flour sold in the bidding process There are, in fact, competitors, and the sales data show cases where none of the wheat actually sold pursuant to a particular offer went to any of these groups This, plus the responses of the buyers interviewed, reinforces the overall conclusion that the sales procedure used by the Agencies is open, fair, and captures a representation of the actual market clearing price at the time each sale

From another aspect, the continued presence of the same buyers throughout the year is an indication of the image of satisfaction and reliability as a supplier of wheat flour to the market which has accrued to PM The reliability of monetization to generate the necessary and opportune cash flow for the Agencies' development programs is due, as with any other economic activity, to a significant degree of repeat business And to the extent that development programs require an extended time frame to achieve success, the role of repeat buyers is an important factor in maintaining the capability of monetization to generate the necessary local currency for the development activities in a regular and timely manner

A closely related issue is whether or not the bidders have a preconceived idea of the cutoff price which will be acceptable to PM, and thus, tend to present bids which are below the actual market clearing price Over time it would be possible for these buyers, who purchase from several suppliers throughout the year, to track the difference in price paid for Title II wheat flour versus what they must pay to buy from other sources It would make logical business sense to do this If a price trend difference could be observed, the result would be a tendency to make offers below the actual market price, knowing that the probability of procuring at least some of their needs at a reduced price is better than average Again, a relative large pool of bidders, including new or occasional participants, would mitigate against this possibility Reviewing the data from the 22 bid adjudications in FY 1998, the average lowest bid accepted was 94 5% of the highest bid offered Table 2 4 2 below presents a more detailed picture of this

Close inspection of the bid data shows that selected bidders often submit multiple bids, one high and one low This would indicate that they are testing the sensitivity of the lowest acceptable price The Agencies could put some upward pressure on the pricing by raising the lowest acceptable bid to 95 percent of the highest offer, for example If the FY 1998 data is representative, then it would have the effect of selling less wheat flour at a lower price, and having additional commodity available toward the end of the calendar year when prices are anticipated to be relatively higher Implementing this would require that adequate cash reserves are on hand at the time of the earliest solicitations to minimize the need for a large influx of receipts at that time

TABLE 2 4 2 ACTUAL SALES PRICES FOR WHEAT FLOUR IN THE FY 1998 MONETIZATION PROGRAM (Bolivianos/50kg bag)

Solicitation	Number of Bidders	Highest Bid	Lowest Bid	Cutoff Price	Percentage of Highest Bid
1	11	100 00	83 00	N/A	N/A
2	9	102 00	94 00	94 00	92 2
3	7	100 00	85 00	94 00	94 0
4	6	98 00	68 00	90 00	91 8
5	12	95 00	69 00	83 00	87 4
6	17	97 00	75 00	82 00	84 5
7	7	97 00	78 00	83 00	85 6
8	14	95 00	75 00	88 00	92 6
9	19	97 00	84 00	88 00	90 7
10	19	94 00	82 00	90 00	95 7
11	14	92 00	85 00	90 00	97 8
12	23	94 00	85 00	90 00	95 7
13	5	90 00	89 00	90 00	100 0
14	17	92 00	87 00	88 00	95 6
15	15	91 00	82 00	88 00	96 7
16	9	90 00	84 00	90 00	100 0
17	12	91 00	85 00	88 00	96 7
18	15	90 00	73 00	87 00	96 7
19	23	91 00	84 00	87 00	95 6
20	26	90 00	83 00	87 00	96 7
21	23	88 00	79 00	87 00	98 9
22	18	90 00	85 00	89 00	98 9

Source PM data

Another alternative could be to use the price obtained in the retail price survey as a guide to set the minimum acceptable bid at a certain percentage of that price This would, in effect, establish an "acceptable" profit margin for purchasers It is certainly far beyond the scope of this analysis of the monetization program to even speculate on what an acceptable percentage might be It is also unclear that this would have any impact on the actual price being offered, given the relative importance of Title II wheat flour in the market versus imports and national production The amount of commodity provided through the Title II monetization cannot orchestrate market prices And the market itself should set the prices, not the Agencies

It is also interesting to note that increasing the number of bidders did not necessarily result in an increase in the highest price offered, or in the highest cutoff sales price Again, based upon the assumption that collusion would be unlikely among a relatively strong number of buyers (15 or more), this would indicate that the process used to monetize the wheat flour is capturing the truly representative market clearing price representing the perceived value of the commodity

PM undertook several pro-active initiatives to expand the market and the number of potential customers for Title II wheat flour, and to secure higher prices One such activity was to have a short video which advertised the "benefits" of U S flour, e g , higher protein, compared with flour of other origin This was aired over a time on local television stations The result was no measurable change in demand or price

This response is not surprising, because price, and price alone, regulates demand in the wheat flour market in Bolivia There is no price discrimination based upon quality factors

A second initiative was to visit the bakeries in the La Paz area and discuss with them the benefits of participating directly in the biweekly bidding instead of obtaining their flour by buying from the wholesalers who do participate in the solicitations

Again, the result was not manifested in either greater demand or higher prices And again, this is not unexpected when one looks more deeply at the functioning of the market As with markets elsewhere in the world, the marketing system in Bolivia provides a major portion of the commercial credit available Therefore, the wholesalers provide financing along with their products, be that product wheat flour, or other foodstuff The reaction of the bakers visited was that they would like to buy from PM, but only if they could get the same financing terms that were being provided by the wholesalers For this to happen, PM, and the Agencies, would have to venture even farther afield from their real purpose, i e , development assistance programs, and also become, in effect, financial institutions The policy implications of this aside, there is no evidence that PM would have any competitive advantage in this activity, or that the benefit cost to the Title II program would be positive

A second consideration by the bakeries and noodle produces is the absolute need for a secure source of flour They make money by selling baked or processed goods, and must have a regular supply of inputs, e g , flour, in order to operate successfully Since the wholesalers purchase from several sources within the formal and informal commercial channels, they can assure their clients of a constant quantity, while PM cannot for many of the reasons described in the preceding section

The third option tried was to visit the relatively smaller consumers of wheat flour to assess the viability of selling to them And again, the benefit cost was entirely unfavorable, as the administrative costs involved in numerous small sales could not compensate for the anticipated increases in the sales price Stated simply, PM and the Agencies are not, and should not be expected to be, viable competitors of established enterprises in marketing agricultural commodities in small quantities Their comparative advantage is the ability to implement development activities, not to be deeply involved in the wheat flour market as wholesalers or retailers Assuming a higher profile at the retail level carries with it the potential to provoke a negative reaction against the monetization program on the part of those who would feel threatened by this action

2 4 3 Direct Retail Sales

The rationale for maintaining the second "window", i e , direct sales of quantities of less than 20 bags of flour is a valid one First, it maintains the presence of PM in a market which they otherwise would not have access Although the amount they sell to this market is too small to have any effect on retail prices, it does act as a form of advertising by making both small-scale and wholesale buyers aware of the availability of flour from PM

And second, it can act either as a safety valve to reduce excess inventories, or to empty warehouse stocks whose quantities would otherwise be too small to justify the use of the bidding process For example, after the adjudication of bids from the first solicitation process in FY 1999, somewhat less than 2,000 bags remained in the PM inventory The exact number is unknown as most of this flour is a transfer from the stocks remaining with CARITAS when their participation in the Title II program ended earlier this year This quantity needs to be inspected for quality, rebagged if necessary, or discarded through other means if found to be unfit for human consumption The retail outlet will serve to commercialize this odd-lot quantity

The Agencies should maintain the price of small-quantity direct sales at the price determined by the market survey There is no evidence that providing subsidized wheat flour to the market will result in any positive gains to the monetization program On the contrary, the wholesalers would match any subsidy by lowering their prices This would have ramifications on the bidding process, as wholesalers would see PM as undercutting their margins, and react by lowering their offers Also, there is ample experience from analyses of commodity markets in other countries that a subsidy is not passed on to the ultimate consumer Rather, it is captured as rents by the first receiver of the subsidy, who then sells his or her product at the market clearing price in the next link in the marketing chain Clearly, any variance from achieving the market-determined prices for the wheat flour would be genuine bad policy

2 4 4 Role of Quality

The discussion of price should also mention the vital role of product quality Wheat flour arrives from the U S with a consistent quality This fact is known in the market, and it reduces the degree of risk which must be evaluated by potential buyers And again, reduced risk facilitates higher prices Quality issues have arisen with other imported products (e g , wheat grain) in the past, that were very difficult to resolve In each case, the potential purchasers insisted on renegotiating the price to be paid for the commodities prior to taking delivery

A corollary issue was raised by several of the buyers interviewed Because the high quality standard of wheat flour of U S origin is widely recognized in the market, there have been incidents where wheat of other origin or quality has been "rebagged" into bags which previously contained Title II flour, and sold as "legitimate" commodity from the Title II program This adulteration by unscrupulous traders, while not widespread, does occur with sufficient frequency to pose a potential problem to the image of Title II wheat flour A method of detecting when a bag is reused would be desirable, but perhaps not practical or cost effective

2 4 5 Sales versus Budgetary Process

Finally, it is important the sales process be separated from the budgetary process to the maximum extent practicable This will insure that there is no pressure to accept a lower than desirable price to compensate for temporary local currency shortfalls in the budget, i e, "fire sales" It will also avoid the tendency to try to time the wheat flour sales to market prices The actual data show that the market contains too much volatility and these changes are not predictable enough over time to make this a viable way to increase sales receipts Again it is important to reiterate that stability, both in terms of presence and product quality, will be the most sound method of assuring the best sales price, and highest cost recovery

2 5 Summary

In summary, there is little to indicate that major changes in the monetization procedures as currently being implemented by the Agencies in Bolivia would result in either significantly greater competition or increased sales, which in turn, would achieve higher sales prices and greater cost recovery Wheat flour prices are established in a global marketplace, and the sales prices in Bolivia fully capture those prices in the regional and local market context The volume imported under the monetization program, about 25-30,000 metric tons per year, is only about six-to-eight percent of total imports, and this is not sufficient to influence the market price for wheat flour At this level, the Agencies are price takers Flour from Argentina is the real factor setting the wholesale and retail price in Bolivia This will remain the de facto standard as the import duties, now at 10%, are gradually eliminated as Bolivia becomes a full partner in the MERCOSUR regional trade agreement The current date envisioned for the total phase-out of import duties on wheat flour is 2011 Consequently, it can be anticipated that the relative volume of wheat flour arriving via informal imports will likewise diminish and be replaced by official imports as the financial incentive for informal imports is removed

It is also very important to reiterate that the nature and volatility of the wheat flour market is such that it is not possible to "time" sales to the highest prices In this environment, the most judicious approach is to continue to be a known and consistently reliable entity in the wheat flour market And continue to be sensitive to ways that can incorporate the maximum competition and participants in the bidding process

ALTERNATIVE COMMODITIES

3 1 Bellmon Determination

The analysis of importing alternative commodities for the monetization program begins with the Bellmon Determination, a legislatively-mandated analysis which must establish that adequate storage facilities are available in the recipient country, and that "the distribution of the commodities in the recipient country will not result in a substantial disincentive to or interference with domestic production or marketing in that country "

3 2 Wheat Flour

USAID/Bolivia has completed their FY 1999 Bellmon Analysis Update, and among the relevant findings are the following which pertain to the current monetization program which is based upon importing wheat flour

First, international wheat prices have declined throughout FY 1998 in response to large supplies entering the market from all the major world producers Argentina, Australia, Canada, and the U S And based upon the Chicago futures prices, wheat prices are expected to remain low due to both large production forecasts, as well as low prices for maize, the dominant alternative used principally in the animal feed industry The record Argentine wheat harvest, along with its close physical proximity to Bolivian markets and associated transport costs, provides the framework within which market prices for wheat flour are defined in Bolivia at the wholesale and retail levels

It should be noted that the market price for wheat flour (US$206 62/MT FOB Gulf) purchased for the FY 1998 Title II program was significantly below its average from January 1994 to July 1995 During this period, the FOB price ranged between US$250/MT and US$300/MT Beginning in mid-1995, the price rose to US$429/MT in May 1996 It then dropped rapidly to about US$300/MT until mid-1997 when it again entered into the US$250/MT to US$300/MT range, before falling to its FY 1998 price level Because of the cyclical nature of commodity prices, one could expect the price to rise in the future as supply decreases and demand increases However, one needs to be cautious in assuming that it will again reach the US$400+/MT level in the near future

Local production of wheat flour is estimated at 108,000 metric tons, or about 30% of the 360,000 metric ton national demand for wheat The deficit is met, for the most part, through imports via either formal (about 44%) or informal (about 17%) commercial channels The Title II program is the major source of donated commodity (about 6%), with the remainder (less than 4%) arriving through WFP and French government donations Currently, the three Agencies, ADRA, FHI, and PCI, plan to import 22,220 metric tons of wheat flour to be monetized in FY 1999 The evidence indicates that these imports replace an equivalent volume from Argentina which arrives through informal commercial channels Even the potential addition of an additional agency to replace Caritas would not substantially change the situation

Finding an acceptable alternative agricultural product to wheat flour, either unprocessed or processed, is not an easy task First, because Bolivia appears to be largely self-sufficient in other products which would be available under the Title II program, e g , maize, peas, soya beans, vegetable oil, etc

3 3 Lentils

One possible exception could be lentils, which although do not appear on the list of registered imports, are found widely available in the major commercial retail markets, supermarkets, and in many small local family-operated retail outlets It has been manifestly difficult to determine either the potential demand for or the current source of supply for lentils The most common response to the question of origin provided by sellers is either Argentina, Peru, Canada, or the U S Since no registered imports of lentils are to be found in official GOB records, it is reasonable that the supply, from whatever origin, is via the informal commercial sector This would also help explain the reluctance of the sellers to supply relevant information

The possible sources of this include the food aid programs in Bolivia (either Title II or WFP), or given the proximity and other contributing factors, a second possible explanation is from the food aid program in Peru The terms of trade would be favorable for wheat flour to enter Peru in exchange for lentils Analyzing this possibility further was not possible due to the secretive nature which characterizes much of the trade occurring along the Bolivia/Peru border

Whatever the source, there is no evidence to suggest that illegal diversion is occurring It is probably the recipients of the lentils themselves who sell the lentils for cash which is needed for other household priorities, including food, medicine, clothing, or school fees and supplies All households, rich or poor, allocate available resources against household urgencies And the marketing system for foodstuffs in Bolivia does include intermediaries who specialize in buying small quantities of selected commodities from food aid recipients, assembling them into larger lots, and then reselling to either wholesalers or retailers

At any rate, there is a commercial demand for lentils which is not being met by local production The general consensus among the Bolivians interviewed was that Bolivian production was practically nil, but that lentils were an extremely important source of protein in the diet, especially for those with fewest economic resources And there is a commercial demand for lentils, as was shown by an advertisement in a La Paz newspaper expressing an interest in buying lentils Because of the wariness of the current sellers in the market to provide information, it is impossible to judge at this moment the number of potential buyers Also, historically, negotiating a price with a single or restricted number of purchasers has not resulted in the most advantageous outcome in terms of fair prices or cost recovery

During the interviews with several of the regular participants in Title II monetization program, the question of the potential for including lentils in the monetization program was raised The unanimous conclusion of the buyers was that there does not presently exist a sufficiently large market to warrant a program of soliciting bids That if PM wanted to sell lentils, they would have to operate as they do for small volumes of wheat flour, i e , via the system of direct sales

A final consideration regarding lentils is related to their marketing Because Bolivia neither produces lentils, nor registers them on the list of official imports, it must be concluded that their commerce is predominately confined to informal imports, possibly including food-aid programs This makes it controversial for either the Agencies or the Unites States Government to be closely associated with sales of this commodity until such time as it also enters the official marketing channels Any appearance of "irregularities" will have a direct impact on the image of the program and the institutions, including USAID, involved

3 4 Wheat Grain

Another potential alternative commodity, bulk wheat grain, has an extensive history in Bolivia as a food aid commodity It, perhaps, best exemplifies the challenges in selling to a restricted market Wheat imports, either through the Title III or Title I programs, have been destined for the La Paz market This is due to the potential disincentive to increasing domestic wheat production in Santa Cruz In fact, proceeds from the import of Title III wheat financed the expansion of the local production in the Santa Cruz area from about 3% of national demand to its present level of about 30% Both the presence of national production and the cost of transportation from La Paz to Cochabamba, another major commercial center, have made the entrance of US wheat into this market commercially uncompetitive The overall result has been that wheat of US origin competes with wheat from Argentina, and wheat flour from the same origin

Negotiating acceptable terms with the Miller's Association, ADIM, has sometimes been fraught with difficulties Their understandable desire to minimize risk and maximize profits has forever made the program challenging It has always been in the interest of ADIM to cover the risk associated with the dynamic nature of the Argentine wheat and wheat flour export trade As a result, the price for Title III wheat negotiated between the GOB and ADIM at the initiation of the year, could be made commercially uncompetitive by subsequent changes in the Argentine market which were unforeseen at the time the GOB/ADIM agreement was signed establishing the sales price to ADIM, and other payment provisions This often resulted in long delays in evacuating the wheat from the ports of Arica and Antofogasta in Chile and transporting it to the millers' silos in the La Paz area This, in turn, led to further delays in milling, flour sales, and subsequent payment conditions, which often had to be renegotiated in light of the new market conditions

Currently, 45,000 metric tons of wheat provided under the PL-480 Title I program in FY-1998 remain in the port of Arica Additionally, there is about 5,080MT of donated wheat belonging to the WFP In light of the continuing low world prices for wheat, ADIM is reluctant move its Title I wheat to their mills until more favorable conditions can be expected They are able to store the wheat for up to 365 days without paying port storage fees The amount programmed by USDA for a FY 1999 program has been reduced from the US$10 0 million in FY 1998, to US$6 5 million This reduction is in recognition of the difficulties associated with the market for wheat of U S origin in Bolivia

ADIM has been approached regarding their interest in buying Title II bulk wheat, but the conditions under which they want to operate are considered by USAID/Bolivia and the Agencies as difficult to meet A major obstacle is the insistence by ADIM that the USG negotiate with the GOB the exoneration of the 10% import duties (GAC) which are levied on all imports at the CIF value of the product at the point of entry into Bolivia This is probably unrealistic from either a financial or policy standpoint, as one of the major IMF and IBRD objectives in restructuring loans is improved revenue collection, including those derived from taxes and duties ADIM has expressed, however, a strong desire to continue a dialogue with the Agencies and USAID/Bolivia to see if an agreement can be reached to import wheat grain under the Title I program which could be beneficial to all parties involved

There was a concern, expressed by the U S Wheat Associates in Santiago, Chile, that including wheat, in lieu of wheat flour, in the Title II program would be important in sustaining the Bolivian milling industry in the Altiplano Their uneasiness is that once PL 480 wheat from the U S (Title I or II) is no longer available, the most viable economic alternative for Bolivia will be wheat flour from Argentina This would eventually mean the end of the milling industry in Bolivia, and consequently, the end of a potential market for U S wheat

3 5 Quality Factors

Also, while the quality of wheat flour is a known factor in the Bolivian market, the same can not be said for other products, including lentils The history of trying to monetize Title II commodities, especially unprocessed commodities, is replete with problems associated with quality As long as the grading system for Title II food aid is at variance with the standards for normal commercial U S exports, problems will prevail It is in the vested interest of both the Agencies and USAID to pay strict attention to grades and standards when procuring unprocessed commodities And not to rely on simply specifying a standard Title II grade 1, 2, etc This same level of concern should be shown by exporters who are interested in expanding their markets, because there is always “carryover” in the image of one product to another For example, one shipment of wheat from the U S which does not meet buyer expectations impacts the perceived image of quality of maize, beans, rice, etc

The chronicle of the Title III program includes a significant chapter involving the disparity between buyer expectations and the quality of the wheat delivered ADIM often insisted on a separate and independent inspection of quality before accepting delivery Their fears have not always been unfounded, and again, increased risk was manifested in lower prices being offered for the product or in protracted renegotiations over price and other financial terms

Finally, all food imports must be approved by the Bolivian Ministry of Agriculture They have a very strong policy of minimizing disincentive effects on local production And they are especially sensitive to the role of food aid donations in this process Each year authorization must be obtained import all Title II commodities, regardless if they are destined for direct distribution or monetization That authorization is always contingent upon demonstrating that each of the commodities proposed does not represent a potential threat to Bolivian domestic production

3 6 Summary

In summary, finding an alternative agricultural commodity to wheat flour which can be effectively and efficiently monetized, and which can meet the test of the Bellmon Determination would not be an easy task No obvious choices are apparent

However, the example of the US Lentil and Dry Pea Association bringing their expertise to focus on defining potential markets for their products in Bolivia is a model which clearly bears repeating They sent two representatives to Bolivia with the expressed objective of making a preliminary analysis of the market potential for their products in Bolivia If the first analysis is positive, they will follow up with a more in-depth analysis Groups or associations such as these have a wealth of knowledge about their products, transportation considerations, markets, prices, and other key factors which are critical in identifying potentially new options for the Title II program – whatever the country Other U S producer and processor organizations who have a potential interest in selling their respective product in the Bolivian market are strongly urged to follow suit And to work with Agencies monetizing in the Title II program to identify potential markets for their products and assist in defining sales procedures which can be mutually beneficial They have the necessary expertise, and the definite interest in the outcome

4 TRANSPORTATION

One of the ways whereby the Agencies could increase cost recovery is to reduce the CIF/La Paz cost of the commodity or commodities being imported for the monetization program To achieve this it is necessary to find savings in the transport and administrative costs involved between the commodity's arrival in the port to final delivery in the Agencies' warehouses Although the savings would not go directly into the cash reserves of the Agencies, it would strengthen the argument to maintain support for the existing program, or expand it in the future because monetization would be viewed as an efficient way of generating the cash needed to complement the direct distribution of food

As a result of USAID/W/BHR/FFP reviewing information on transportation costs which they had received from the World Food Programme, they expressed concern that these costs were significantly below those associated with transportation of Title II commodities The costs of inland transportation from Arica to La Paz shown varied between US$42 14 and US$53 54 per metric ton This was compared with the US$105 average cost per metric ton to transport Title II commodities from Matarani to several points within Bolivia

Closer analysis of these data clearly shows that the costs are not comparable First, and foremost, because the WFP data are for the shipment of wheat grain, and not wheat flour Handling and transportation requirements for bagged wheat flour are significantly more rigid than the corresponding treatment for bulk grain Usually, bulk grain is offloaded from a ship's hold using either augers, aspirators or clamshells, and deposited in a mound on a site within the port, often near the ship's dock It is stored uncovered until loaded into railway boxcars for shipment to La Paz This process usually includes moving the grain from the initial storage point to near the rail line via front end loaders or into a hopper using clamshells If the latter system is used, the grain then enters dump trucks and is trucked to an area near the rail site From this point it may either once again be moved via clamshells into a hopper where it is then discharged into boxcars or other cars designed especially for the transport of bulk commodities, or it may go from where it is deposited by the trucks directly into the railway rolling stock for shipment to Bolivia Since the flour mills in the highlands have facilities for direct reception of bulk grain arriving by rail, an appropriate number of cars can be shunted directly to each mill's reception area

Bagged wheat flour, on the other hand, is much more fragile, and its handling from cargo hold to final destination demands greater care The current system is to place 30 bags on a pallet in the ship's hold, and then use a crane to move the pallet from the ship to the dock It is then moved to a warehouse via a forklift Once inside the warehouse, it is removed from the pallet and stacked by hand The process for shipping the wheat flour begins by restacking the bags back on pallets by hand, moving these via a forklift to beside the transportation trailer, and then stacking the bags on the trailer, again by hand labor Once loaded, the cargo is covered with a tarp These additional requirements have direct consequences on the storage and handling costs involved

A more appropriate comparison would be the cost to the WFP for commodities which are shipped in "bags, cartons, or loose" The table below shows the costs involved, including the port charges (Rhode = US$14 00/MT, Schenker = US$23 30/MT, Cotrans = US$33 00/MT), for each destination in Bolivia

TABLE 4a WORLD FOOD PROGRAM COSTS FOR COMMODITY SHIPMENTS FROM ARICA, CHILE TO SELECTED POINTS WITHIN BOLIVIA (US$/Metric Ton)

	Transportation Company		
Destination	Rhode	Schenker	Cotrans
El Alto	81 50	113 60	124 00
Oruro	81 50	113 60	118 00
Cochabamba	101 00	128 60	133 00
Potosi	113 00	148 60	140 00
Sucre	126 00	148 60	148 00

Source World Food Programme

The costs, averaged across companies and destinations is US$121 27 per metric ton This is considerably above the US$105 06 per metric ton average for Title II commodities However one company, Rhode, showed lower comparable prices for commodities from Arica to El Alto (La Paz), Oruro, and Cochabamba than those for shipments of Title II commodities from Matarani to identical locations in Bolivia (La Paz = US$81 50 vs US$82 69, Oruro = US$81 50 vs US$95 68, Cochabamba = US$101 00 vs US$105 60) (See Table 4 1 below)

The higher prices shown for Cotrans are because these are for shipment in containers WFP has experienced important losses due to damage in handling several of its commodities, including milk powder, fish, oil, etc For this reason they generally ship these products in containers And although containerized transport is significantly more expensive than other methods, they consider it effectively reduces losses for their most fragile products Although no data was available to do a traditional benefit/cost analysis, the extra cost involved is, in effect, an insurance policy

The quotations obtained by USAID/Bolivia for shipments from Arica were considerably below the actual costs cited by WFP for each destination in Bolivia Also, the average cost across the four destinations was US$92 63 (See Table 4 3a below)

The contracts for transportation of Title II commodities are negotiated individually between each Agency and a transportation company This is usually proceeded by a solicitation for bids published in the local newspaper Bids are received, classified, and a contract awarded to the company which has provided the most responsive proposal

One important consideration in awarding a contract is the specific company's "track record" of service and reliability This sometimes means that the lowest bidder does not receive the contract This variance from the "lowest-bidder-takes-all" approach is necessitated by the need for secure transport which assures timely deliveries and minimal losses The Agencies in Bolivia have a much lower than average loss of commodities as a result of this procedure In fact, the transportation contract usually requires the transporter to replace all bags lost or damaged during loading, in transit, or while unloading into the Agency's warehouse

A negative aspect of this is that it restricts the pool of potential transport companies competing for the contracts, by favoring those who are already participating in the program A new company, regardless of their potential to provide better service at a lower price, would find it extremely difficult to actually sign a transportation contract due to the "track record" factor

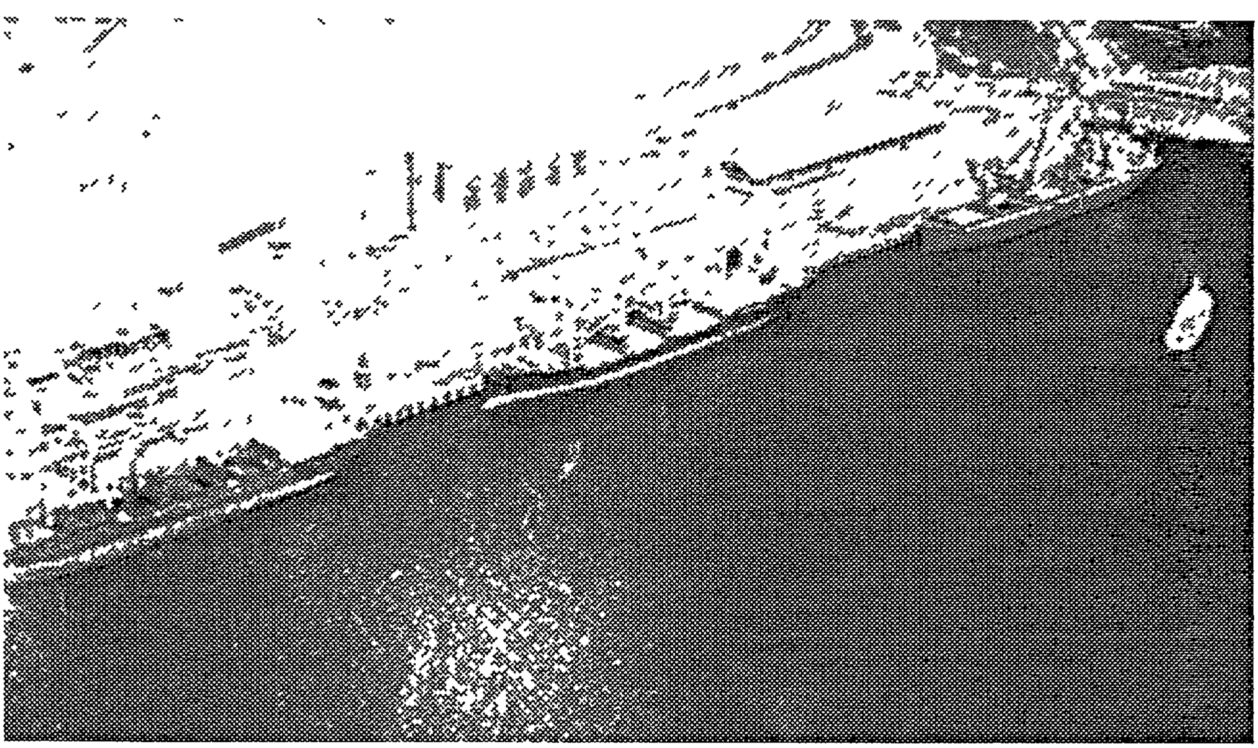
Clearly, new companies represent a risk factor which is difficult to assess in strictly monetary terms It can be expected, however, that the smaller the pool of potential transportation companies, the easier it is to reduce competition and inflate prices The Agencies are probably paying an indirect insurance premium for this low level of commodity loss But it is not possible to accurately determine what that premium is, or its cost-effectiveness

One solution to expand competition, prequalifying transportation companies of Peruvian and Chilean origin and then allowing them to compete in the solicitation process, is excluded by the provisions of the 1904 Treaty between Bolivia and Chile This allows only Bolivian companies to carry commodities in transit from the Chilean ports of Arica or Antofagasta to Bolivia It is interesting to note that one of the Bolivian companies which consistently is awarded contracts has no truck fleet of its own It subcontracts with individual Bolivian or Peruvian truckers to provide the actual transportation

Also, all cargo in transit to Bolivia must be received, managed and dispatched by the Bolivian Port Services Agency (ASP-B) This autonomous agency, which has private sector participation on its Board of Directors, is anticipated to be a significant improvement over the previous government agency, AADAA Its Board of Directors is accessible, but it still maintains most of the heavily bureaucratic procedures of its predecessor agency In a letter to USAID/Bolivia dated August 31, 1998, ASP-B stated that its port charges were US$7 16/MT for direct dispatch, and US$9 25/MT for indirect dispatch of commodities from Arica to Bolivia

4 1 Matarani-La Paz

Historically, most Title II food aid commodities, whether destined for direct distribution or monetization, have arrived in the Peruvian port of Matarani From there they are discharged, warehoused, and eventually transported via truck to the Agencies' warehouses in Bolivia All commodities to be monetized are shipped to warehouses within La Paz The distance between Matarani and La Paz is 738 kilometers There are two stretches of the road which are not paved, and this factor enters into the cost of transportation as it increases the time needed to transport the commodities, as well as increases the rate of depreciation of the transport vehicles The time necessary for commodities to transit this distance is about 24-36 hours, including the time necessary to complete the necessary customs formalities at the border



The expense of this inland transportation and handling is significant In FY 1998, the actual cost, averaged across the three Agencies and the five destinations, was US$105 06 A more detailed breakout of the costs involved is shown below

TABLE 4 1 COSTS FOR TITLE II WHEAT FLOUR SHIPMENTS FROM MATARANI, PERU TO SELECTED POINTS WITHIN BOLIVIA (US$/Metric Ton)

Bolivian Port of Entry	ADRA	F H I	P C I	AVERAGE
La Paz	84 90	82 69	87 20	84 93
Oruro	0 00	95 68	0 00	95 68
Cochabamba	0 00	0 00	105 60	105 60
Potosi	118 55	113 22	0 00	115 88
Sucre	0 00	123 21	0 00	123 21

Source USAID/Bolivia

Although the cost of inland transportation has been relatively high, the losses during transport have been exceptionally low, usually less than 1% The Agencies believe that the use of Matarani has provided them with a high degree of reliability of service

As with most of the ports in southern Peru and northern Chile, Matarani is an important point of export for minerals such as copper, lead, silver, tin, and sodium borate This makes it imperative that storage of Title II commodities is handled in such a way so as to preclude contamination by these materials History indicates that acceptable precautions have been taken to avoid contamination problems

The main problem incurred has been the losses within the port itself Adequate security is a continuing problem And losses have occurred when commodities have been stored outside and exposed to climatic conditions, such as rain The port authority, which is a Government of Peru institution, refuses to accept any responsibility for these losses Although the port authority is currently in the process of being privatized, estimates range from two-to-five years before the transition will be completed

4 2 Ilo-La Paz

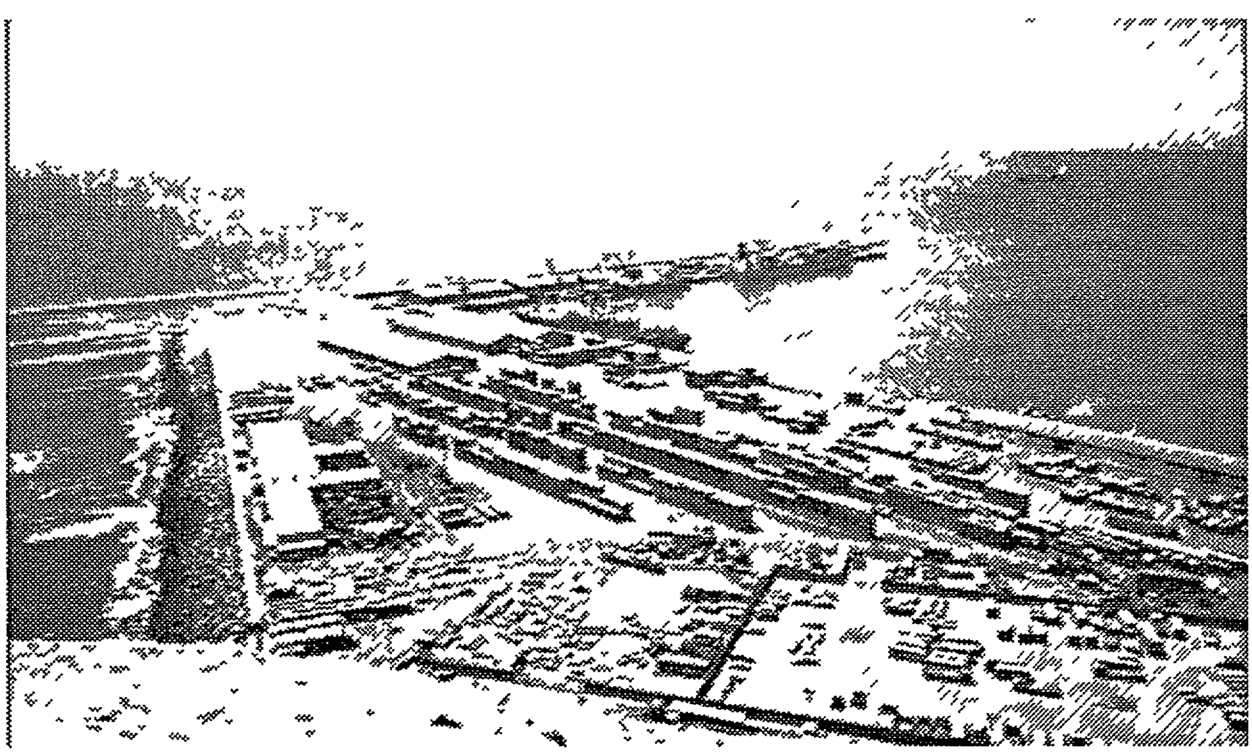
There is no history of food aid shipments from the Peruvian port of Ilo to Bolivia among any of the U S and international Agencies, or the World Food Programme Therefore, there are no cost or loss data to make comparisons with any of the other ports which are commonly used

Since Ilo is somewhat closer to the Bolivian points of entry than Matarani, but more distant than the port of Arica, the presumption would be that the cost of transport would be somewhere between the two However, in discussing this option with Bolivian transport companies, they stated that Ilo does not have sufficient infrastructure at this time to adequately handle the volume of commodities of the Title II program, and therefore the losses could be expected to be much higher than in other ports A formal Bellmon determination would need to be done to assess the capability of the port to adequately manage any commodity arrivals, but in general, preliminary information indicates that it is inadequate

The main interest in Ilo is due to its special status accorded in a recent treaty between Bolivia and Peru It is considered to be Bolivian territory for imports destined for Bolivia This special standing could potentially provide an opportunity for third-country monetization in Peru which avoids the import duties and taxes which would otherwise be assessed on the import, sale, and eventual transfer of funds to Bolivia from commodity sales in Peru The Peruvian government's interest in seeing the economic activity at Ilo increase is for it to become a stronger competitor with the port of Arica, in Chile At the present time there is insufficient economic activity to provide a market for the direct sale of Title II commodities in the port area, facilities and handling capacity are referred to by transport companies as being unsatisfactory for extended storage, and the transportation from the port is currently problematical as well

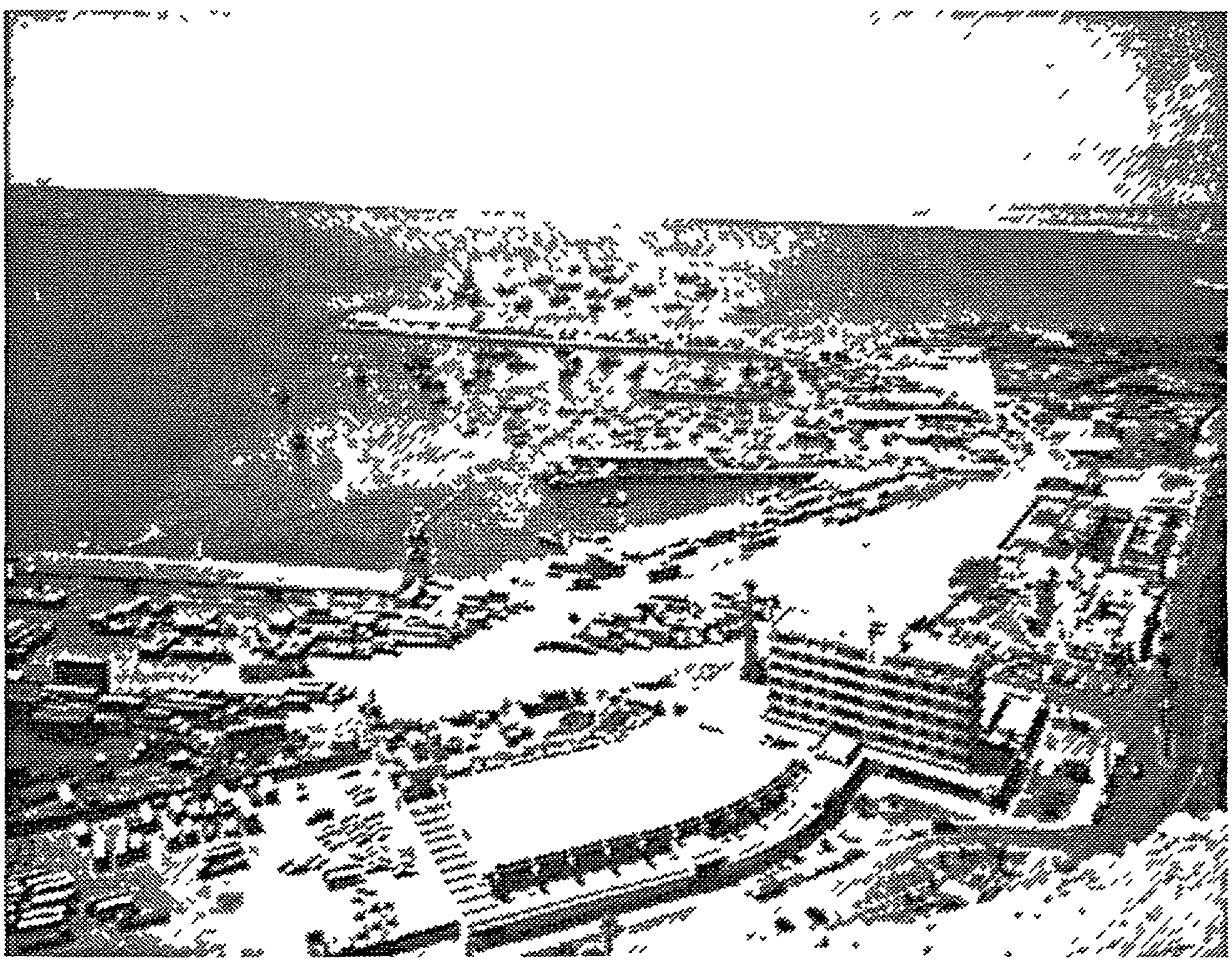
4 3 Arica-La Paz

Arica, Chile, has been a very important commercial center for both products destined for Bolivia, as well as Bolivian exports Because of the exceptional dry climate of the Atacamas Desert, the port is particularly suited to storage of food commodities, either as bulk grain or as processed and bagged commodities such as wheat flour It has seen extensive use in Title I and III programs which imported wheat grain, as well as WFP shipments



Like Matarani, Arica has a history in the export of ores and minerals, and precautions must be observed to avoid contamination of products destined for human consumption Antofagasta, further to the south, is the main port for exporting minerals from Chile FHI did report one experience of contamination seven years ago, and a significant volume of Title II commodities were incinerated by Chilean port authorities to avoid them entering the food chain In recent discussions with authorities in Arica, they have assured that operating procedures now in place would preclude a reoccurrence of that event

Mineral exports are stored at considerable distance from the main warehouses and "downwind" from the warehouses where food commodities are stored All imports designated as hazardous materials are also stored in a separate area to avoid any potential contamination WFP, which uses Arica for most of its food aid shipments, did not report problems related to contamination



The table below illustrates the prices obtained by USAID/Bolivia in response to a recent solicitation of bids for transporting Title II wheat flour from Arica

TABLE 4 3a <u>COSTS FOR TITLE II WHEAT FLOUR FROM ARICA, CHILE TO SELECTED POINTS WITHIN BOLIVIA (US$/Metric Ton)</u>

Bolivian Port of Entry	Rail	Truck	Difference
La Paz	64 60	71 35	6 75
Oruro	76 30	76 55	0 25
Cochabamba	86 90	85 22	(1 68)
Potosi	93 20	96 25	3 05
Sucre	N/A	104 95	N/A

Source USAID/Bolivia

In addition, the FY 1998 transportation contract between FHI and a Bolivian transport company showed the following cost figures

TABLE 4 3b <u>FHI COSTS FOR TITLE II WHEAT FLOUR FROM ARICA, CHILE AND MATARANI, PERU TO SELECTED POINTS WITHIN BOLIVIA (US$/Metric Ton)</u>

Bolivian Port of Entry	Arica	Matarani	Difference
La Paz	72 34	82 69	10 35
Oruro	79 40	95 68	16 28
Potosi	104 29	113 22	8 93
Sucre	114 50	123 21	8 71

Source FHI/Bolivia

Although the cost of inland transport from Arica to all destination points within Bolivia was significantly less than from Matarani, FHI/Bolivia used the port of Matarani exclusively in FY 1998 Their explanation was that having had this extremely negative experience in the past using the port of Arica, they were very disinclined to risk a repeat incident Experience is always a compelling taskmaster, but based upon the more current information available, they are extremely willing to once again begin using Arica

Arica is 517 kilometers from La Paz and the road linking the two is asphalt-paved and in excellent condition The time required for commodities to transit this route is about 24-36 hours The explanation by the Bolivian transport company interviewed for this lengthy time required to make the journey is due to the extensive bureaucratic procedures involved in Arica prior to departure for La Paz The delays mean that the truckers must spend the night at the Bolivian-Chilean border, because they arrive after the customs officials have ended their work day at 8 30 p m

4 4 Iquique-La Paz

Iquique, like Ilo, has not been a port which has seen use as an entry point for Title II food aid The focus of imports destined for Bolivia are manufactured or finished goods, especially electronic goods for household use Like Ilo, the Bolivian transport company interviewed said that Iquique is not a viable option due to infrastructure, etc Should further interest in using this port be manifested, a formal Bellmon determination would need to be done At this time, however, there is nothing to recommend this port over Arica

4 5 Antofagasta-La Paz

Antofagasta has been used quite extensively in the past for arrivals of PL 480 Title III bulk wheat grain Although it is somewhat more distant from La Paz than the port of Arica, its advantages included its relatively closer location to the wheat mills in the Potosi, Oruro, and Sucre areas, and the private-sector railroad from the port to the Bolivian border which was more reliable than the government-owned railroad from Arica to Bolivia At times is was necessary to divide the Title III shipments among two ports, Arica and Antofagasta, in order to have space for the arriving commodities, and to increase the rate of evacuation from the Chilean ports to the mills in Bolivia The availability of sufficient grain or box cars was often a constraint at the port Privatization and additional capitalization of the railroad, especially within Bolivia, has markedly improved service for transporting bulk commodities

In light of the greater distance from Antofagasta, and the lack of adequate road connections for truck transport, it is extremely doubtful that Antofagasta would be a viable entry point for Title II commodities destined for Bolivia, especially processed commodities en route to La Paz for monetization However, it could be a point for monetizing commodities in the Antofagasta area, if third-country monetization proved feasible in Chile Also, its relative importance in exporting minerals compared with the other ports described above, means an increased potential for contamination of the food aid commodities

4 6 Summary

The Peruvian port of Matarani has been the port preferred by the Agencies in Bolivia to bring in Title II commodities for both the direct distribution and monetization programs There is an established record using this port which shows that transportation has been reliable and transport losses minimal Given the emphasis placed on losses as an indicator of commodity management, and the importance that the Agencies feel at keeping losses at an absolute minimum, their reluctance to venture into the unknown and switch to another port is understandable It is also somewhat difficult for them to see a benefit in taking this additional risk, since savings in inland transportation costs do not end up on their balance sheet Also, USAID does not, as a rule, “make up” for losses of commodities This policy makes the emphasis by the Agencies shift to saving product rather than saving money For insufficient product, whether for direct distribution or monetization, does have a direct and immediate impact on the Agencies' development activities

The concern over losses has another aspect Because hard data on losses is often readily available, it is tempting to evaluate the management of a particular program based on these numbers, rather than on the more complicated and extensive data which is needed to objectively evaluate the impact of same program

The major liability in continued use of this port is that the Peruvian authorities refuse to accept responsibility for losses in the port area Instances have been reported of Peruvian port officials removing commodities from warehouses and placing them in uncovered areas without notifying either the Agencies or the transport companies This has resulted in losses for which the port authority denies accountability Also, because the distance to La Paz is greater than from Arica to La Paz, the transport costs can be expected to always be greater – even whenever the road is paved the entire distance

However, there does appear to be sufficient improvement in conditions available for handling and storage of Title II commodities at the port of Arica, Chile, to be optimistic that a repeat of the experience of FHI seven years ago is not likely Obviously, the proof will be in actually using the port, and analyzing the results Given these new circumstances, plus an attractive price differential in favor of Arica, it is strongly recommended that the Agencies begin using Arica in FY 1999, on a trial basis However, the extensive delays attributed to bureaucratic red-tape in Arica reported by the transport company needs to be addressed

Operationally, the Agencies should request prices for both Matarani and Arica in their solicitations for transportation contracts, and include both in the signed contract with the transportation company The 1998 FHI transportation contract can be used as an actual example of this process Then, they should use Arica in their first Call Forward If the results are positive, the Agencies should continue using Arica in the subsequent Call Forwards If not, they can revert to using Matarani with no additional administrative action other than specifying the port in their Call Forwards

Finally, although the price differential favors the use of rail transport over truck, the additional handling involved in rail/truck transport would be expected to result in a noticeable increase in losses The commercial sector in Bolivia uses truck transport for this reason, as well as for its timeliness and reliability

5 COST RECOVERY

PM records indicate that the average sale price for wheat flour monetized in the FY 1998 program was US$324 20 per metric ton Note that this does not include the first sale in FY 1999, although this was the remainder of the total purchased and shipped to La Paz under the FY 1998 authorized level Dividing this by the average CIF La Paz cost to the United States Government for the commodities (US$374 77/MT), the cost recovery percentage is 86 5

TABLE 5 ACTUAL CIF LA PAZ COST FOR MONETIZED WHEAT FLOUR IN BOLIVIA FOR THE FY 1998 MONETIZATION PROGRAM USING AMERICAN FLAG OCEAN TRANSPORT (US$/MT)

Bill of Lading	Metric Tons	Declared Value	Ocean Freight	C&F Matarani	Inland Transport	CIF La Paz
1	2,808 65	590,090 01	269,207 42	859,297 43	221,817 28	1,081,114 70
5	899 20	194,469 13	74,667 65	269,136 78	74,354 85	343,491 63
6	1,664 00	358,397 59	136,361 12	494,758 71	137,891 79	632,650 50
9	2,372 85	459,810 69	232,567 30	692,377 99	206,912 52	899,290 51
LC-3	2,544 40	527,276 49	264,809 76	792,086 25	186,250 08	978,336 33
LC-11	1,654 20	357,752 24	137,361 32	371,488 56	144,246 24	639,359 80
LC-12	239 95	52,952 30	19,924 93	72,877 23	20,923 64	93,800 87
LC-13	70 00	19,039 94	5,812 67	24,852 61	6,104 00	30,956 61
LC-15	1,560 65	323,413 81	162,441 03	485,854 84	136,088 68	621,943 52
LC-17	310 50	64,344 95	32,318 54	96,663 49	27,075 60	123,739 09
LC-18	1,396 80	308,246 00	115,987 35	424,233 35	102,245 76	526 479 11
LC-22	1,480 00	306,700 68	154,046 58	460,747 26	122,381 20	583,128 46
HOU 2	950 00	188,099 56	56,177 15	244,276 71	69,540 00	313,816 71
HOU 3	840 00	166,319 61	49,672 40	215,992 01	61,488 00	277,480 01
HOU 4	1,490 00	291,298 62	90,459 72	381,758 34	115,426 30	497,184 64
HOU 5	1,000 00	189,990 41	62,641 75	252,632 16	82,690 00	335,322 16
HOU 6	70 00	13,440 05	4,384 93	17,824 98	5,788 30	23,613 28
TOTAL	21,351 20	4,411,642 08	1,868,841 62	6,280,483 70	1,721,224 24	8,001,707 94
AVERAGE US$/MT		206 62	87 53	294 15	80 61	374 77

Source USAID/Bolivia

If one looks at the comparable C&F/Matarani data, then the sale price in La Paz is 110 2 percent of the C&F/Matarani cost It is, therefore, clear that Bolivia's status as a land-locked country, and the transportation costs associated with that status, weigh heavily on the ability of the monetization program to recover the full cost to the Unites States Government for the commodities monetized It is also clear that reducing the US$80 61/MT cost for inland transport can influence the cost recovery percentage

Using an estimated average cost of ocean transport on free-flag vessels of US$65 00/MT (Appendix C), the opportunity cost to potential buyers can be estimated This is the highest price they could be expected to pay for wheat flour of U S origin The commercial sector would not be anticipated to pay the difference in the cost of ocean transport between U S and free-flag vessels for normal commercial imports, but instead opt for the lowest landed cost by using free-flag ships However, by legislation, 75% of the PL 480 commodities must be shipped on U S flag carriers, and this subsidy to the U S maritime sector weighs heavily on the cost recovery equation

Substituting this value, US$65 00/MT, for the average cost of U S flag ocean transportation (US$80 61), the average cost recovery percentage increases to 92 0 Adding in the direct cost of administering the monetization program of US$2 20/MT, as shown in Section 2 1 above, the cost recovery percentage for actually carrying out development activities is 91 5

Carrying the analysis further to explore the possible change in cost recovery related to cost savings on inland transport, there are two options (Please note that for the purposes of this analysis, the value of the product, cost of ocean transportation, and the sales price remain unchanged) The first, and most conservative, is to use the actual cost of inland transportation from the port of Arica to La Paz using the data shown in the FY 1998 FHI transportation contract Substituting this value, US$72 34/MT, as shown in Table 4 3b above, the average CIF La Paz price becomes US$366 49/MT And dividing the average sales price of US$324 20/MT by this value, the cost recovery percentage increases to 88 5

The second, and more optimistic, option is to use the lowest price quote received by USAID/Bolivia for truck transport of US$71 35/MT, as shown in Table 4 3a above Using this value in our calculation, the average CIF La Paz price becomes US$365 50/MT, and the cost recovery percentage rises to 88 7%

Finally, combining the FOB U S price of $206 62, plus the C&F Arica cost using free-flag ocean transport estimate of US$65 00/MT, and the US$71 35/MT for inland transportation, the cost CIF La Paz becomes US$342 97 per metric ton of wheat flour Comparing this value with the actual average sales price in FY 1998 of US$324 20/MT, the cost recovery percentage becomes 94 5 And adding the direct administrative cost of US$2 20/MT, the percent available for development activities is 93 9

6 THIRD-COUNTRY MONETIZATION

6 1 Background

The possibility of third-country monetization has generated much anticipation among all involved in the Title II program, both at the Agencies' headquarters and USAID/Washington, as well as in the corresponding field offices, and USAID/Bolivia This enthusiasm has its basis in three important considerations First is the prospect of using markets outside of Bolivia to recover a greater percentage of the cost of procuring and transporting the Title II commodities to be monetized Second, there is a strong desire to look to the future and the possible need to expand the development programs in Bolivia, while facing a potential reduction in the amount of development assistance (202e, DA, ISA) monies available for administering programs Since both

Chile and Peru have larger overall markets, in economic terms, than Bolivia, expansion of the volume of sales in these countries would appear to be easier and cause less disruption than a similar solution in Bolivia And finally, the agencies are looking for cost reductions, and "exporting" sales could be seen as a way to reduce the cost of administrating a monetization program in Bolivia

Third-country monetization became an option with the passage of the 1996 Farm Bill Prior to that, third country monetization was only permitted in the case of emergency programs Actually implementing this new opportunity, however, involves a series of new issues and challenges, including those associated with the transfer of funds generated in one country across national borders to another country There exists little relevant history from the emergency programs to inform the process currently under consideration for the Bolivia Title II monetization program

Third country monetization faces one appreciable liability at the outset There is one level of difficulty involved in convincing a country to exonerate imported commodities destined for monetization from certain taxes, or to return the money collected to the Agencies in the form of host-country counterpart contributions or fiscal credits, when the benefits of that action will accrue to the country making the concessions It is quite another to convincing argue that it is in their best interest to do so to benefit a neighboring country This is especially true if there has been a history of commercial rivalry or military conflict between the two countries involved

Bolivia has a long-standing dispute with Chile and Peru over its loss of territory and access to the Pacific Ocean Elements of territorial conquest and loss also can be found in the history of relations between Chile and Peru

However, in present day reality, a thriving commercial trade exists between Bolivia and each of its neighbors The Chilean ports of Arica, Iquiqe, and Antofagasta are centers of Bolivian exports and imports Arica and Antofagasta have been important for Bolivia's Title I and III programs, while Iquiqe has been a favorite for Bolivian importers of manufactured and household goods

Correspondingly, the ports of Matarani and Ilo in Peru are important for Bolivian commerce and Peruvian economic activity in the region The latter port was of special interest in this analysis, as a recent treaty signed between Bolivia and Peru accords this port the status of "Bolivian territory" for the purpose of imports Matarani has long been the preferred port for Title II commodities destined for Bolivia

Also of significant importance for regional trade is the community of Desaguadero, on the Bolivia/Peru border, near the southern end of Lake Titicaca A thriving economic activity can be observed, and its center appears to switch between Bolivia and Peru, contingent upon the relative terms of trade between the two countries Much of the trade has the characteristics of "informal" commerce, and those involved are disinclined to provide much information regarding the operations of the market or specificity of the origin of the products being traded This is also the entry point into Bolivia for the food aid commodities in transit from Matarani

6 2 Monetization Program in Peru

The monetization program in Peru has operational features which are not found in the Bolivia program (For a more complete description of the monetization procedure, please see Appendix F) One major variation from the Bolivia monetization program is the degree of participation by each of the Agencies The monetization program in Peru is characterized by a relatively more acquiescent role by each of the Agencies, with the notable exception of CARE CARE, in effect, has a contractual relationship with each of the other Agencies to manage the monetization process from the arrival of the commodities in the port to providing the sales receipts to each Agency, and includes contracting for the auditing of the program

A second major difference is in the manner in which the commodities are sold The Peru program sells directly to the SNI, according to the customer's demand at an agreed-upon price and in jointly-programmed shipments each year The Bolivia program, in contrast, offers a fixed volume for sale through a system of sealed bids twice-monthly The actual volume sold each time varies according to demand as reflected in the minimum accepted price

The Title II monetization program in Peru includes four Cooperating Sponsors ADRA, CARE, CARITAS, and TECHNOSERVE In FY 1999, a fifth agency, CRS, is anticipated to be added Each of these Agencies establishes their respective volume of commodities to be monetized each year in their AERs CARE, in coordination with the other Agencies and USAID/Peru, selects the commodity and volume to be monetized CARE also prepares the call forwards of the commodities to be monetized, in accordance with a programmed arrival developed in advance with the SNI Bulk degummed soya oil is the commodity of choice for monetization in recent years

The oil is normally transferred directly from the ships' tanks into the buyers' trucks in the port However, if an arrival is delayed and buyers are compelled to make purchases from other sources, e g , commercial Argentine imports, to meet immediate needs, then an alternate procedure is used This involves putting the oil in the buyers' tanks and these are sealed until the buyer can use the product At this time the sale is made effective The obvious result of this option is that there is a corresponding delay in providing the funds from the monetization of the oil to the Agencies

The purchase price is established by the market When CARE advises the SNI that a shipment is scheduled to arrive, SNI requests price quotes from their main commercial suppliers in Argentina The objective is to assure the lowest landed cost to the buyers, including import duties and taxes The most often cited reason for the lowest price being for oil of Argentine origin is that it receives a preferential import duty into Peru as part of the MERCOSUR free-trade agreement The import duty is 3%, as compared with 12% for imports from the U S CARE verifies the Argentine quotes by comparing them to those of other international traders USAID/Peru reviews this data, and makes the final approval of the selling price

The sales price is denominated in U S dollars, and paid in Peruvian local currency Financing for a period of up to 120 days is available for both the cost of the commodity and its shipping and insurance Although these have separate interest rates, both are established based on prevailing market benchmarks, such as the LIBOR Deposits are made into CARE's account in the Banco de Credito del Peru CARE then immediately transfers these local currencies into their U S dollar account USAID/Peru/OFA/FFD then authorizes transfers from CARE's account into each of the Cooperating Sponsor's accounts

Finally, CARE has a contract with a firm to carry out an independent financial review of all generations, distributions, and uses of monetization proceeds They also have a second contract with an international accounting firm to conduct periodic financial audits of the monetization program

For managing the monetization, CARE collects a fee of US$1 20 per metric ton of commodity sold They also divide the cost of the financial review and the audit among the Cooperating Sponsors The FY 1999 PAA budget indicates that the former is estimated to be US$107,446 The cost for the audit contract is estimated to be about US$137,352 The actual amount will be contingent upon the contract negotiations with the firms involved Finally, CARE collects an Indirect Cost Recovery rate of 9 02% on the overall Title II program, including the monetization program costs FY 1999 PAA budget data are used because discussions with CARE/Peru personnel indicated that an error had occurred in calculating the corresponding charges in FY 1998, and the FY 1999 budget estimate was a more accurate reflection of the true costs involved

The tonnage for the FY 1999 monetization program shown in the Bellmon Determination is 60,000 metric tons of crude soya oil Using the FY 1998 average sales price (Cash) of US$763 85/MT, this has an anticipated sales price of US$45,831,000 The actual volume of oil sold will be contingent on the real sale price, and may be either in excess or below the initial estimate in the Bellmon For example, the actual amount called forward in FY 1998 was less than initially anticipated due to a significant rise in the price in the international market

TABLE 6 2a ESTIMATED COSTS FOR MONETIZING CRUDE SOYA OIL IN PERU FOR THE FY 1999 MONETIZATION PROGRAM (US$/Metric Ton)

Item	Cost
Monetization Fee (60,000 MT x US$1 20/MT)	72,000
Financial Management	107,446
Audit	137 352
Sub-Total	316,798
CARE/Atlanta ICR (9 02 Percent)	28,575
T O T A L	345,373

Source CARE/Peru

Usıng the estımates from the sources mentıoned above, the cost of the monetızatıon program would be about US$5 76 per metrıc ton of oıl monetızed, or 7 5 percent of the total expected gross sales receıpts Further detaıls of thıs are shown ın Table 6 2a above

6 2 1 Cost Recovery

Data from the FY 1998 CARE/Peru financıal records show the proceeds generated from the sale of crude soya oıl monetızed ın the FY 1998 program was US$30,391,246 29, or US$683 58 per metrıc ton The cost to the Unıted States Government was determıned by usıng the declared value for the commodıty and transportatıon as shown on the Bıll of Ladıng from each shıpment Dıvıdıng the sales prıce by the total C&F Lıma cost to the Unıted States Government for the commodıtıes (US$29,406,903 54), the cost recovery percentage was 103 3 percent Supportıng detaıls for costs are provıded ın the table below

One ımportant factor ın the abılıty of the monetızatıon program ın Peru to achıeve an outstandıng actual cost recovery has been the opportunıty to use free-flag vessels for ocean transport The dıfference, US$83 48/MT (U S) versus US$39 74/MT (Free Flag) ıs hıghly sıgnıficant The Bılls of Ladıng ındıcate that about 16% of the commodıty was shıpped on U S Flag tankers, 25% on U S Flag ocean goıng barges, and 59% on Free Flag tankers If the entıre 44,458 643MT of soya oıl had been shıpped on U S Flag tanker vessels, the total cost of the ocean transport would have rısen to US$3,711,407 05, and the total cost to the Unıtes States Government would have been US$30,905,473 96 Substıtutıng thıs value for the actual total cost of US$29,406,903 54 ın the cost-recovery equatıon, the cost recovery percentage ıs 98 3 percent Thıs remaıns an excellent cost recovery percentage Calculatıng the cost recovery usıng the Free Flag Tanker rate of US$39 74/MT ın the equatıon results ın a cost recovery of 104 9 percent

As ıs the case ın Bolıvıa, the Peruvıan prıvate sector would not be expected to pay the dıfference ın the cost of ocean transport between U S and free-flag vessels for normal commercıal ımports, but ınstead opt for the lowest landed cost by usıng free-flag shıps Also, lıke ın Bolıvıa, they use exports from Argentına as a reference to determıne the least-cost source for theır ımports Three maın factors enter ınto theır decısıon the FOB prıce of the crude oıl ın Argentına, the cost of transport to Peru, and finally, the applıcable ımport dutıes and taxes Thıs latter element can alter the financıal analysıs to a consıderable degree As regular members of the MERCOSUR trade agreement, Peruvıan ımports of Argentıne products receıved a preferentıal ımport duty of 3% ın 1998, ınstead of the 12% whıch ıs assessed on ımports from non-MERCOSUR countrıes, ıncludıng the Unıted States Sectıon 5 2 above provıdes greater detaıl of the procedure used to determıne the actual sale prıce of the soya oıl to buyers

The actual prıce paıd by the buyers ın FY 1998 reflects the real opportunıty cost to them If the PL 480 Tıtle II program was absent, thıs ıs what they would pay ın the ınternatıonal market It ıs the stated polıcy of the Government of Peru that donated commodıtıes whıch are monetızed must be sold for the full market-determıned prıce, ıncludıng all of the dutıes and taxes whıch are ıncluded ın a commercıal sale

TABLE 6 1 2a ACTUAL CIF LIMA COST FOR MONETIZED BULK CRUDE SOYA OIL IN PERU FOR THE FY 1998 MONETIZATION PROGRAM USING AMERICAN AND FREE FLAG OCEAN TRANSPORT (US$/MT)

Bill of Lading	Metric Tons	Declared Value	Ocean Freight	C&F Callao
170232	1,999 076	1,096,229 16	166,882 86 1/	1,263,112 02
170262	955 924	624,197 72	79,800 54 1/	703,998 26
170263	1,000 000	548,367 79	83,480 00 1/	631,847 79
170282	1,771,000	1,099,792 08	74,594 52 3/	1,174,386 60
170283A	8,499 703	5,295,203 48	358,007 49 3/	5,653,210 97
170284	2,728 684	1,694,514 04	114,932 17 3/	1,809,446 21
170285	3,243 462	1,778,610 27	270,764 21 1/	2,049,374 48
180000	2,836 000	1,752,648 36	107,654 56 3/	1,860,302 92
180001	163 874	101,508 00	6,220 66 3/	107,728 66
180002	5,999 709	3,716,378 67	227,748 95 3/	3,944,127 62
180003	4,001 493	2,478,630 52	51,896 67 3/	2,530,527 19
180061	2,474 000	1,638,678 64	147,400 92 2/	1,786,079 56
180062	2,999 922	1,987,028 34	178,735 35 2/	2,165,763 69
180063	5,785 796	3,382,279 84	344,717 73 2/	3,726,997 57
TOTAL	44,458 643	27,194,066 91	2,212,829 63	29,406,903 54
AVERAGE US$/MT		611 67	49 77	661 44

1/ U S Flag Tanker (US$83 48/MT)
2/ U S Flag Ocean Going Barge (US$59 58/MT)
3/ Free Flag Tanker (US$39 74/MT)
Source USAID/Peru

Finally, adding the average USG cost for purchasing and shipping the crude soya oil (US$661 44/MT) and the estimated cost (US$5 76/MT) of administrating the monetization program together, and dividing this into the sales receipts generated (US$683 58/MT), we can determine the percentage of USG investment which is available for financing development activities in Peru The result is 102 4 percent

6 3 Potential for Market Expansion

6 3 1 Chile

6 3 1 1 Commodities

Chile has a limited spectrum of agricultural commodities which could be potentially imported under the Title II program Wheat and wheat flour are two of these Maize, for livestock feed, is another The greatest constraints on using Chile for third country monetization are first, the difficulty in achieving an acceptable cost recovery due to the import duty structure designed to protect Chilean producers And second, any Title II imports would almost certainly compete directly with commercial imports from the U S, and thus, it would be extremely difficult to find a "gap" in the UMR requirements which could be filled with Title II commodities This conclusion is shared by U S Wheat Associates, the local representative of U S wheat exporters Finally, Chile is not a food deficit country, and Title II imports destined for non-human consumption would be challenging to justify

Monetizing wheat in one of the northern ports, e g, Antofagasta, which has a mill was an option discussed with the Chilean Millers' Association However, their conclusion was that the volume required was too small to make this a cost-effective transaction These mills often use a complicated system of identifying ships which may have a limited space available, and are willing to take on a little extra bulk cargo from Pacific Northwest ports and transport it to the northern ports at a reduced rate While the most efficient system for the Title II program would be a large shipment into the principal port of San Antonio, and there discharged to the several mills located in the area

6 3 1 2 Financial

6 3 1 2 1 Banking Regulations

There are no government regulations which would restrict the transfer of funds from Chile to Bolivia The banks have a fee structure, based upon the amount transferred, with the maximum assessed amount being US$300

The most common method used to finance agricultural commodity purchases is to make the Letter of Credit payable to an account outside of Chile Most commonly, a bank in the U S is used to receive the payment, however, a bank in Bolivia could be designated as well

6 3 1 2 2 Duties, Taxes, & Fees

Chile has a unique, and complicated, system of "price bands" to determine the total tax assessed on a particular commodity Wheat and wheat flour are among the crops which are subject to the highest tax assessment The system is designed to shelter Chilean producers from the large fluctuations in the world price for these commodities The process begins with the average monthly price for a given product on the world market each month over a 60 month period Then the highest and lowest 12 prices are removed The remaining 36 prices are averaged, and this is the base price This base price is valid during a period beginning on December 16 of each year Each month, the Ministry of Finance publishes the ad valorem tax which is levied on imports based upon their FOB price The lower the FOB price, the greater the assessment per metric ton Please refer to Appendix D for a more complete discussion of the import tax policy and its application Unfortunately, the data used to establish the current base price include the high world market prices of 1995 and 1996 In addition, there is a standard 11% import duty levied on all commodities

TABLE 6 3 1 2 2 COST SIMULATION FOR MONETIZING BULK WHEAT IN CHILE FOR THE FY 1999 BOLIVIA MONETIZATION PROGRAM (US$/Metric Ton)

Item	Local Costs	Foreign Exchange	Total Cost
HRW Wheat (FOB USA Gulf)		135 00	135 00
Ocean Freight (U S A -Chile)		15 00	15 00
Insurance (0 40% C&F)	6 00		6 00
CIF			156 00
Customs Fees (11% CIF)	17 15		17 15
Discharge Fee	3 70		3 70
Customs Agent	0 40		0 40
Price Band (US$12 86/MT@$135 FOB)	12 86		0 05
Value (Cash Payment)	40 11	150 00	190 11

Source AGMC-Chile

6 3 2 Peru

6 3 2 1 Commodities

Currently, the monetization of soya oil in Peru is operating smoothly, and there is little incentive to switch to another commodity or commodities First, because Peru has a deficit in soya oil, and must rely on imports to meet the domestic demand for oil This situation is expected to continue into the foreseeable future, which means a good market for this commodity in terms of volume and prices Second, the process worked out with the buyers operates well and meets their needs Therefore, they have an interest in continuing as long as the price remains competitive with the least-cost alternative Third, the product can be moved quickly for ship to the buyers' tanks, which reduces losses which can occur in handling and storage And finally, the system assures quick and timely payments to CARE, who, in turn, can make expedient transfers of funds to the accounts of the other Agencies

Once again, the most important point of departure in looking for other commodities which could be efficiently monetized is the Bellmon Determination and the history of past monetizations The 1999 Bellmon Update for Peru does not discuss alternative commodities which could have potential in the monetization program However, the description of the monetization program prepared by CARE/Peru (Appendix F) does mention wheat, wheat flour, rice, and maize The monetization program has had past experience in monetizing other commodities, but the outcomes reported with these products were not positive The reasons given for the generally negative outcome were that either the commodity was inappropriate, or that its arrival coincided with the local harvest of the same, or substantially similar, agricultural product

6 3 2 2 Fınancıal

6 3 2 2 1 Bankıng Regulatıons

Dıscussıons wıth Banco De Credıto Del Peru officıals ın Lıma establıshed that there are no legal ımpedıments whıch would ınterfere wıth the transfer of funds from CARE's account ın Peru to an account ın La Paz The transfer fee charged by the bank ıs a percentage of the amount transferred For transfers of less than US$500, the fee ıs 0 5% of the amount transferred, up to a maxımum fee of US$12 00 For transfers of less than US$25,000, the fee ıs 0 25% of the amount transferred, up to a maxımum fee of US$25 00 For transfers of US$25,000 or above, the fee ıs 0 125% of the amount transferred, up to a maxımum fee of US$100 00 The only other charge levıed by the bank ıs the cost of the telex effectıng the transfer of funds

6 3 2 2 2 Dutıes, Taxes, & Fees

The ımport dutıes and taxes on ımported commodıtıes are consıderable In addıtıon to the 12% ımport duty, there ıs an addıtıonal 18% I G V tax deposıt levıed on the CIF value of the ımports whıch must be paıd before the commodıtıes are allowed to be dıscharged ınto buyers trucks When the commodıtıes are sold, thıs amount ıs subtracted from the 18% I G V (general sales tax) assessed on the sales prıce, and the seller must pay the dıfference to the Government of Peru In the case of the commodıtıes for the Tıtle II program ın Peru, CARE reports thıs amount to the GOP, but does not actually have to pay thıs The GOP regısters the value as theır counterpart contrıbutıon to the program Table 6 3 2 2a below detaıls the cost ınvolved

Conversatıons wıth Government of Peru officıals ın the Mınıstry of Economy and Fınance dısclosed that any Tıtle II commodıtıes whıch were monetızed ın Peru, and the revenue generated transferred to Bolıvıa to ımplement the Tıtle II program there, would be subject to all of the ımport dutıes, taxes, and fees as any regular commercıal ımport Therefore, ın order to estımate the potentıal cost recovery for monetızıng crude soya oıl ın Peru, ıt ıs necessary to calculate the cost of the soya oıl ımports under commercıal ımport condıtıons For thıs sımulatıon FOB Gulf of Mexıco prıce of soya oıl was set at US$611/MT and the U S flag ocean transport was set at US$85/MT These values, whıch were derıved from the actual costs shown ın the Bılls of Ladıng for the FY 1998 monetızatıon program, were used as the best approxımatıon of the cost to the Unıted States Government of the a thırd-country monetızatıon ın Peru Table 6 3 2 2b below provıdes greater detaıl on the cost ınvolved

Sınce the calculated "Sales Prıce (Cash)" ıs already greater than the opportunıty cost to the buyers, there ıs no requırement to calculate a sales prıce whıch ınvolves the 120 day financıng

TABLE 6 3 2 2 2a COST STRUCTURE FOR MONETIZING CRUDE SOYA OIL IN PERU FOR THE FY 1999 MONETIZATION PROGRAM (US$/Metric Ton)

Item	Local Costs	Foreign Exchange	Total Cost
Crude soya oil (FOB Argentina)		595 00	595 00
Ocean Freight (Argentina-Peru)		30 00	30 00
Insurance (0 238% C&F)	1 49		1 49
CIF			626 49
Customs Fees (2 4% CIF)	15 04		15 04
Discharge Fee	3 77		3 77
Customs Agent (0 253% CIF)	1 59		1 59
Phytosanitary Inspection	0 40		0 40
Scales	0 05		0 05
Value (Cash Payment)	22 23	625 00	647 33
I G V (18%)	116 52		116 52
Sales Price (Cash)	138 85	625 00	763 85
120 Day Financing (9% annual)			
Value (Cash Payment)	22 23	625 00	647 33
120 day Financing of C&F		18 21	18 21
Value (120 day Financing)			665 54
I G V (18%)	119 80		119 80
Sales Price (120 day Financing)	142 13	643 21	785 34

Source CARE/Peru

The final tax that would be collected is the federal income tax This amounts to 15 percent of profits realized from the sale of the commodities It is calculated on the difference between the CIF value plus all import duties and taxes and the final sales price Ironically, the monetization of crude soybean oil from the U S would show a net loss, and thus incur a zero income tax liability This is because the price paid by the buyers is referenced to the lowest acquisition price in the market, including all duties and taxes Historically, this has always been crude soya oil from Argentina, both because of the lower import duties, i e , 2% from Argentina versus 12% from the U S , and the actual freight charges, i e , the cost of transport of the soya oil on American-flag ships

Using the sales proceeds from the CARE/Peru FY 1998 monetization financial records of US$683 58/MT and the cost to the United States Government of US$925 47/MT shown above, the calculated cost recovery percentage is 73 9 percent This represents the most conservative estimate The most favorable estimate would be obtained by using the free-flag ocean transportation rate in calculating the cost (US$40/MT) Making this substitution and holding all other costs constant, the calculated cost recovery percentage is 83 2 percent

TABLE 6 3 2 2 2b COST SIMULATION FOR MONETIZING CRUDE SOYA OIL IN PERU FOR THE FY 1999 BOLIVIA MONETIZATION PROGRAM (US$/Metric Ton)

Item	Local Costs	Foreign Exchange	Total Cost
Crude soya oil (FOB USA Gulf)		611 00	611 00
Ocean Freight (U S A -Peru)		85 00	85 00
Insurance (1 15% C&F)	8 00		8 00
CIF			704 00
Customs Fees (12% CIF)	84 48		84 48
Discharge Fee	3 77		3 77
ENAPU Insurance Rebate	(8 00)		(8 00)
Customs Agent (1 0% CIF)	-0-		-0-
Phytosanitary Inspection	-0-		-0-
Scales	0 05		0 05
Value (Cash Payment)	88 30	696 00	784 30
I G V (18%)	141 17		141 17
Sales Price (Cash)	229 47	696 00	925 47

Source CARE/Peru & USAID/Peru

6 4 Summary

Although third-country monetization potentially has several attractive benefits, the actual situation is not particularly favorable for this type of transaction The main constraint to monetization in Chile would be in meeting the legal requirement prohibiting the Title II commodities from displacing normal commercial sales of U S products The sole window where wheat of U S origin is price-competitive in the Chilean market is about the July-August time period This provides the only opportunity for commercial U S imports At other times of the year, the sales price for Title II wheat would have to be lowered due to the competing price in the market for Argentine wheat Entering the market at this time would result in lower cost recovery to the U S government, and probably trigger protests by other suppliers that the Title II program is a USG export subsidy, and in violation of the GATT agreement Also, because of the importance of exports to its economy and its role as an exporting nation, Chile would also be sensitive to the appearance of any subsidized exports by other nations

In Peru, the problem of cost recovery due to a total duty and tax assessment of about 30% makes it economically unattractive The option of having those taxes being made available to the Agencies in Peru for their programs would require negotiations with the Peruvian government Given the favorable tax treatment the monetization program currently enjoys in Peru compared with the situation in many other countries, any discussion with Peruvian authorities regarding this possibility should be approached with great caution

7 CONCLUSIONS AND RECOMMENDATIONS

7 1 Conclusions

The two main parameters which define the boundaries of the monetization program are market demand and efficiency of converting Title II commodities into cash

A measure of the former can be obtained through a rigorous Bellmon Determination This provides the best information available as to the volume of a selected commodity that can be introduced into the marketing system without causing significant disruption to either the prevailing production and marketing capacity And it includes those factors such as storage and handling, which are an essential part of an agricultural-based economy

The second key parameter can best be determined by looking at the amount of finance which is available to implement development activities in relation to each unit of investment in the Title II commodity selected to be monetized The components of cost in this equation are the purchase price to the Unites States Government, maritime transport and insurance costs, port operations fees, duties and taxes, and the cost of operation of the monetization program Although this is a more inclusive definition than is generally used to measure cost recovery, it does represent the actual cost recovery of converting food aid commodities into development initiatives The rationale for including this last item is that because the Agencies receive commodities in lieu of cash, there is a transaction cost which is specific to monetization, and these funds are not available for development activities

Because both wheat flour imported into Bolivia, and crude soya oil imported into Peru are freely commercialized on the international market, the question of market demand extends beyond just the in-country demand for these products The market-clearing prices for these commodities is much more a function of world-wide supply and demand factors than their particular contexts in local markets Also, commodity prices have exhibited much greater volatility over time than either of the other two factors which influence price, i e , transportation and duties and taxes

All available evidence indicates that there exists the potential for expanding the volume of wheat flour sales in Bolivia Title II commodities vie directly with Argentine imports, and the market will purchase Title II wheat flour at competitive prices The process used by PM and the Agencies to sell the flour is effective at capturing the market-clearing price at the time of each sale

The current market demand for crude degummed soya oil in Peru is also strong And the program also has an excellent procedure for capturing the market-clearing price for this commodity, and the cost-recovery percentage is outstanding The problem of incorporating the Bolivia monetization program into this is the unfavorable cost recovery due to the taxes which would be assessed Logistically, there would be no problem with any aspects related to commodity handling

The principal uncertainty, as with any commodity, is the future price   Currently the world market price for soya oil is high   However, as can be seen with wheat and other commodities traded on the world market, the near-term, medium-term, and long-term price behavior is unpredictable And the danger lies in assuming that the current highs or lows accurately reflect the long-term average

Changes in world market prices should affect both the price paid by the USG to purchase the commodity and the price received by the Agency from the buyer in the same manner, i e , if the USG pays a higher price on the world market, the sales price should be higher as well   However, the relationship is not necessarily one-to-one   Due to local circumstances the change in one of the prices may be greater or lesser than the corresponding change in the other price   This would not only affect the potential cost recovery percentage, but could affect the demand for Title II commodities as well   It would be logical for any reduction in demand in the Peruvian program to be first discounted from the Bolivian program

The Chilean market for wheat could absorb the volume anticipated for the Bolivia program, however, it would do so at the expense of U S commercial imports   This displacement is prohibited by the PL 480 legislation   Also, since U S wheat is only price competitive during a very small "window" (July-August), a significant risk exists that circumstances beyond the control of the program could close this limited window unexpectedly   This might be triggered by price considerations, or as occurred recently, by to phytosanitary problems

The overall conclusion of this analysis is that the best option for the Title II monetization program in Bolivia is to focus on those aspects within Bolivia which can reduce cost and allow for future growth of the program   There is an opportunity for cost savings related to inland transportation in the Bolivia monetization program which can be realized by switching the arrival port from Matarani, Peru, to Arica, Chile   There is also the opportunity to expand the program by having commodities available for sale throughout the entire year

7 2 Recommendations

1 Immediately include transportation from both Arica and Matarani in the specifications for transportation contract bids in FY 1999   Quotations should include both direct and indirect discharge

2 Designate Arica as the destination port on the first Call Forwards of FY 1999

3 Immediately begin discussions with ASP-B to negotiate an agreement which spells out all of the conditions related to receipt, storage, and dispatch of Title II commodities   This must include clear delineation of responsibilities for losses and damage, and provide appropriate financial remedies   It should also include a tentative schedule of arrivals so that ASP-B can plan to have appropriate covered warehouse space available on a timely basis   And finally, given the reported delays due to bureaucratic red-tape, the Agencies

should include a timetable for dispatch of commodities USAID/Bolivia should assist the Agencies in discussions with ASP-B on this subject

4 Investigate the potential savings/costs involved in negotiating a single transportation contract for inland transportation for all commodities instead of a separate contract for each Agency's program

5 Negotiate an agreement (LOU or MOU) with USAID/Bolivia and USAID/BHR/FFP for the management and accounting of monetization commodity stocks so that there are commodities available throughout the entire calendar year Arrivals should be timed to the needs of the clients The best way to do this is as a yearly shipping schedule which shows arrivals and sales throughout the calendar year attached as an appendix to the PAA. This would clearly show the relationship between the two and provide a more realistic picture of any excess or carryover stocks

6 Actively encourage U S trade associations, such as the U S Dry Pea & Lentil Association, to do market analyses of their commodities in countries with Title II monetization programs It is vitally important that representatives for both processed and unprocessed commodities participate

Appendix A BOLIVIA MONETIZATION PROGRAM BUDGET - FY 1998

Appendix B FY 1999 BELLMON ANALYSIS UPDATE (BOLIVIA)

Appendix C OCEAN FREIGHT ESTIMATES

Appendix D PRICE BAND MECHANISM FOR WHEAT AND ITS APPLICATION IN CHILE , 1974/90

Appendix E TREATY OF PEACE, FRIENDSHIP, AND COMMERCE BETWEEN CHILE AND BOLIVIA (1904)

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Appendix F PERU'S FOOD MONETIZATION PROGRAM

Appendix G   CARE/PERU FY 1999 PAA BUDGET TABLES (pp 25-26)

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Appendix II GRANT AGREEMENT FOR THE MONETIZATION AND DIRECT DISTRIBUTION OF TITLE II FOOD AID (USG-GOP)

Appendix I   FY 1999 BELLMON ANALYSIS UPDATE (PERU)

Appendix J LIST OF PERSONS INTERVIEWED

BOLIVIAN PRIVATE SECTOR
Lic Slavica de Machicao, General Manager - ADIM
Sr Fernando Ayllon - Porvenir, Ltda
Ing Milton Gonzales B , General Manager - Agroindustrias Nativas, Ltda
Ing Jose Antonio Omoya A , Consumer Products Division Regional Director - Alke & Co , S A
Sr Antonio Portugal, Marketing Manager - COMPANEX, Ltda
Anonymous, major purchasers of Title II monetized wheat flour

CHILEAN PRIVATE SECTOR
Mr Sergio Ossa Errazuriz, General Manager - Associacion Gremial de Molineros del Centro
Mr Rene Donoso Sandretti, Foreign Exchange Operations - Banco de Credito Inversiones

PERUVIAN PRIVATE SECTOR
Sr Alejandro Daly Arbulu, Manager - Oils Committee, National Industrial Society
Sr Alfonso Dasso Montero, Public Relations Manager - Industrias Pacocha, S A
Sr Luis Anderson Colpaert, Raw Materials & Storage - Alicorp
Sr Oswaldo Zola Ch - Banco De Credito Del Peru

U S PRIVATE SECTOR
Mr Pablo Maluenda, Marketing Specialist - U S Wheat Associates
Mr Randy Duckworth, Marketing Manager - U S Dry Pea & Lentil Association
Mr Frank Sullivan, Consultant

NON-GOVERNMENTAL ORGANIZATIONS

ADRA/Headquarters
Ms Gwendolyn Gessel, Commodity Management
Mr Milton McHenry, Senior Grant Administrator
Mr Randy Purviance, Senior Grant Administrator
Ms Jennifer Schmidt, Office of Programming
Ms Amy Willsey, Director, Office of Programming

ADRA/Bolivia
Mr Gunther Wallamer, Country Director
Mr Plinio Vegara, Programs Director

CARE/Bolivia
Mr Francesco Boeren, Deputy Country Director

FHI/Bolivia
Mr Buck Deines, Country Director
Mr Francisco Rodriquez, Deputy Country Director

PCI/Bolivia
Mr Dudley Conneely, National Director
Sr Jose Luis Saavedra, PL 480 Title II Coordinator

Monetization Program
Lic Ricardo Peredo Omonte, General Manager
Ing Antonio Herrera Arandia, Marketing Specialist

ADRA/Chile
Mr Leonardo Westermeyer, Country Director

ADRA/Peru
Mr Ronald Kuhn, Country Director

CARE/Peru
Mr Beat Rohr, Country Director
Ing Jose Aquino Cavero, Director of Administration
Econ Jessica Mesia Rodriguez, Coordinator - Monetization Unit

INTERNATIONAL ORGANIZATIONS

World Food Programme
Sr Carlos Calderon, Logistics

BOLIVIAN GOVERNMENT
Lic Carlos Cortez Cortez, Executive Director - ASP-B/Arica
My Javier Rejas Trigo, Administrator - ASP-B/Arica

PERUVIAN GOVERNMENT

Ministry of Economics & Finance
Lic David Lascano, Economist
Sra Monica Patricia Pinglo Tripe, Manager, Tax Regulations - SUMAT
Dra Rosario Morisaki
Sr Nicasion Arriola, Customs

U S GOVERNMENT

USAID/Bolivia
Dr Larry Rubey, Coordinator, Food Security Unit
Ing Hernan Munoz, Commodity and Logistics Specialist
Econ Angel Vasquez, Title II Coordinator

USAID/Peru

Mr Stanley Stalla, ORD/FFD
Ing Alfonso Gutierrez, ORD/FFD

USAID/W/BHR/FFP
Mr Timothy Lavelle, International Organizations Coordinator
Mr David Nelson, DP Office Chief
Mr Walter Shepard, DP LAC Food Aid Programs Country Backstop Officer
Mr James Thompson, POD Development Coordinator

USDA/FAS
Mr Richard Blabey, Agricultural Attache, U S Embassy/Chile

Appendix K TERMS OF REFERENCE