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A NOTE ON LOCAL AND REGIONAL PROCUREMENT OF FOOD AID AND ITS POTENTIAL FOR TRANSFORMING AFRICAN GRAIN MARKETS

General observations

Researchers and development practitioners are growing increasingly interested in the potential role of local and regional procurement (LRP) of food aid in improving the marketing of staple foods, especially in countries which have liberalised but lack strong institutions that allow the markets to work properly. The two major players in LRP for grains are the World Food Programme and the European Commission (EC). Until recently, the EC worked through EuronAid and national government organisations. The Natural Resources Institute (NRI) has worked extensively in the field with both the EC and WFP, especially the latter with whom we have worked very closely since the 1970s and whose activities we continue to support. Our observations on WFP's involvement in LRP are set out below:

- It is well-documented that LRP is usually faster, cheaper, and delivers a more preferred and acceptable commodity to beneficiaries. These reasons, which are often cited by the WFP as the basis for requesting untied funding from some donors, have been confirmed in studies by the Natural Resources Institute (NRI) and others. NRI was the first to initiate these studies, carrying out a scoping exercise on the development impact of LRP in 2002. Outputs of the scoping study led to EuronAid commissioning a study on the 'Contributions to Rural development by Local and Regional Procurement of Food Aid'¹ by NRI in 2003. The report generated interest at WFP and the findings were discussed by WFP policy makers. It also led to the more in-depth study undertaken by NRI during 2004 and 2005 for DFID's EC-Prep programme². WFP's thinking on this subject has since been moved forward substantially by a series of studies financed by Belgium and Sweden in 2005 on LRP³.
- In recent years WFP has also acknowledged that LRP can help to develop local commodity markets. This is consistent with the long-held view of the EC that LRP has a wider development role (as enshrined in the EC Council Regulation No. 1292/96 – dealing with food aid policy, food aid management and special operations in support of food security and which endorses the growing practice of

¹ <http://www.euronaid.net/documents/EuronAid-NRI%20Final%20Report%20LocPur-October-20042.pdf>

² <http://www.nri.org/news/foodaid/foodaid.htm>

³ <http://www.wfp.org/eb/docs/2006/wfp083640~2.pdf>

food aid procurement within the benefiting country or from a neighbouring country). Furthermore the EC believes that this practice assists in the development of local agriculture and livelihoods in the source countries. It can also be expected to contribute to the development of more transparent and efficient domestic and regional grain marketing systems in the countries concerned, with positive impacts on producer incomes.

- WFP's position on the contribution of LRP to local market development is less clear than that of the EC. Though it expresses commitment to help strengthen developing country markets, WFP stresses the need to protect its primary objective of ensuring timely and cost-efficient procurement of appropriate food for its beneficiaries while doing what is possible for its programmatic objectives of promoting developing country food markets and food security of food aid recipient countries.
- As confirmed in the NRI studies in Ethiopia, Kenya, Sudan and Uganda, LRP entails high administrative costs and risks when WFP procures in markets that are not well-developed. There are also practical problems with LRP, especially when WFP applies its procedures to small-scale producers, co-operatives and traders, which are likely to benefit most (either directly or indirectly) from market development initiatives. Its procurement systems are modelled on generic UN-style international procurement procedures involving restricted tendering procedures with an established list of reliable suppliers. The tenders specify quality, quantity, price, packaging, markings, fumigation, delivery terms, delivery period, performance bonds, quality/weight/package control and payments. Each country has its own restrictions and phytosanitary requirements.

Direct support to the small-scale sector

WFP has sometimes been involved in preferential procurement from farmers and farmers' groups as well as small traders. However, the results have been mixed and have absorbed effort, in terms of staff time, which is disproportionate to the volumes procured. The initiative has also been questioned in NRI's own studies and in the Policy Issues paper produced by WFP staff at the beginning of 2006⁴ on the grounds of the high administrative cost and risks of such procurement, while the benefits go to surplus producing farmers rather than to food-insecure households. There are also a range of practical difficulties in procuring from small-scale farmers. They typically lack understanding of certain aspects of WFP's procurement systems and are unable to arrange bid bonds, performance bonds and bank references.

WFP requires untied aid – unrestricted and predictable funding – so that it can plan and undertake LRP more effectively. It also requires reliable information on crop output and local market supplies. However, because procurement is in response to emergencies, annual procurement planning in a country presents a great challenge. Fluctuations in needs and cash funding can lead to substantial divergence from initial plans. Once WFP stops procuring, farmer group suppliers are unable to compete,

⁴ WFP (2006) "Food procurement in developing countries", Policy Issues, Produced for Executive Board First Regular Session, Agenda item 5, Rome, 20-23 February 2006.

unless they have used the income gained to invest in storage and quality control capacity – they risk over-dependence on WFP.

NRI does not question the wisdom of helping surplus-producing farmers, but suggests that the best way to do it is by helping establish market chains, involving efficient traders, that will help farmers link up with local and regional markets once LRP has subsided or disappeared.

WFP’s engagement in the development of local markets

As indicated in the Minutes for its meeting of Feb 2006, the Executive Board of WFP signalled a willingness to collaborate in the development of local markets⁵. However, the above-mentioned Policy Issues paper drafted for the same meeting plays down market development activities, and this seems in practice to be having more impact on the organisation’s approach.

WFP procurement staff are concerned that new systems will fail to assure contract performance by suppliers. However, the examples they quote in this regard all concern direct procurement from farmers and reflect the problems we mentioned in above. The Policy paper does not really address one of NRI’s main recommendations, i.e. that WFP should try to work with local warehouse receipt system (WRS) and commodity exchange initiatives, subject to a check on the soundness of these institutions and the supportive policy framework. The Policy paper mentions the need to explore further the use of futures markets – for instance, using the South Africa Futures Exchange (SAFEX)⁶ – but rejects any proactive involvement in the development of WRS, on grounds that its establishment is an exclusively private sector preserve⁷. This position may need revising for the following reasons:

- a) WRS is to a large extent a public good, i.e. it involves some public investment and has strong ‘externalities’, benefits which go beyond the immediate private sector participants in the system. It was in recognition of this that the Government of the USA passed a Warehouse Receipts Act in 1916. Governments of Colombia in 1921, Tanzania in 2005 and Uganda in 2006 passed similar legislation to support efforts of private participants.
- b) WRS are often used for public procurement, e.g. through the Commodity Credit Corporation (CCC) price support operations in the USA.
- c) In some countries (e.g. Uganda) WFP is the dominant buyer of food grains, and it has a direct ‘stakeholder’ interest in establishing the WRS, both as a means of procuring grain more efficiently, and providing a better exit strategy for the day it winds down its procurement.

⁵ The Board decided that WFP should “give due consideration to optimizing the potential development benefits of procurement by: working closely with national governments, FAO, IFAD and others to assess the capacity of local, sub-regional and regional markets to participate in WFP procurement and to support partner efforts to develop this capacity further; - - -”

⁶ SAFEX Division of the Johannesburg Stock Exchange (JSE)

⁷ The paper says that “the warehouse receipt system is a private sector response to manage risk and increase credit flows”, and that “WFP does not have a direct role in the creation of such systems.”

With regard to the latter point, the Policy Issues paper stresses the need (Page 26) for WFP “as an influential actor on the Ugandan maize market... to consider how best to exit from the market over time”. According to NRI’s findings, WFP could use the WRS initiative to make this transition, i.e. to help Ugandan producers establish linkages with private markets in the East African region that will outlast WFP’s presence. WFP should consider this argument.

Over the last six months the Uganda Commodity Exchange (UCE) has been making a case for WFP to collaborate with it in exploring how best the evolving WRS in Uganda and the Exchange can be promoted in a manner that enhances efficiency and reliability of LRP, while assuring that a subsequent decline causes minimum disruption. However, UCE has found it difficult to seriously engage WFP in discussing these proposals. WFP’s key objection has been that the WRS is risky. UCE questions this on grounds that the new system would be phased in, and WFP would have a ‘quick exit strategy’, i.e. if the WRS does not perform, WFP can fall back on its existing selective tender procedures, and thereby avoid major risks with regard to its supply channels.

Based on the above, it is our general conclusion that WFP needs to do more to engage with constructive proposals for enhancing LRP. We would not recommend they uncritically support all local initiatives, but they should support initiatives with a good chance of success, by putting some of their massive buying power (approaching one million tonnes per annum in Africa) behind them.

NRI’s proposal for WFP and LRP

We believe that WFP is in a position to help substantially improve food marketing in Africa, in a manner that contributes to enhanced food security. This could happen without accentuating, and indeed could help reduce, supply uncertainty as well as cost and transparency of procurements under LRP. If WFP requires suppliers to tender on the basis of certified stocks deposited with certified/licensed warehouse operators, these suppliers can more easily arrange inventory finance from banks and plan their procurement in a manner that does not lead to sudden hikes in local commodity prices.

Such involvement would moreover have a strategic spin-off, by helping overcome an impasse in the development of food markets in Africa much noted by policy analysts⁸. Governments have in principle liberalised their food marketing systems, but have often continued to intervene in a way which unsettles markets, and have done little to establish a framework of institutional support that helps private players perform more efficiently and effectively. In this environment, the enormous buying power represented by LRP can provide some initial impetus for the development of indigenous market institutions. Simply by the way it structures its procurement contracts, WFP and like organisations can favour the emergence of new institutional structures (for further information see paper by Coulter (2005)⁹). Moreover, it is

⁸ Problems of this kind were extensively discussed in an international policy workshop on Food Market Risk Management on Feb 28-March 1, 2006 (see http://www.passlivelikelihoods.org.uk/default.asp?project_id=240).

⁹ Coulter J.P. (2005) “Making the transition to a market-based grain marketing system”, Paper presented at Workshop on Price Risk Management, Washington, 28 February-1 March 2005.

likely that WFP's support for market development will encourage national policymakers to work with other stakeholders to create and maintain supportive agricultural trade policies.

In the light of this discussion we feel entities engaged in LRP should take a proactive stance towards the development of domestic and regional market institutions, particularly within Africa. In particular, WFP should:

- a) Participate in national and regional stakeholder fora seeking to enhance the efficiency of the grain trade;
- b) Officially confirm their willingness to become proactively involved in market development initiatives, including warehouse receipt systems, working with other stakeholders to identify and advocate for creating and maintaining the minimum conditions for successful development of such institutions;
- c) Participate in the development of commodity standards – ensuring that these do not only reflect the preferences of target beneficiaries but are also trade-friendly, making it possible to promote trade independent of WFP, and;
- d) Review tender requirements in countries where WRS and exchanges have been established or are far advanced.

This latter point might, for example, involve WFP accepting warehouse receipts in place of performance bonds, which would lower access cost for suppliers while reducing non-performance risk. WFP could moreover require delivery of commodities against procurement contracts in the form of warehouse receipts. If suppliers tender for WFP contracts on the basis of certified stocks deposited with licensed warehouse operators will also make it relatively easier for potential suppliers to arrange inventory finance from banks and plan their procurements in a manner that does not lead to sudden hikes in local commodity prices. Furthermore, groups of small-scale farmers and traders can be encouraged to participate in the WRS as it will give them access to more remunerative markets for relief food as well as to regional markets (particularly if commodity standards are harmonised regionally). WFP could also institute bidding through the local exchange as a competitive alternative to its current system of restricted tenders.

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