

## **Position Paper**

### **Policy implications arising from the development impact of local and regional procurement of food aid**

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#### **Summary**

EC policy endorses local and regional procurement of food aid, a practice that is believed to assist in the development of local agriculture and livelihoods in supplying countries. The research hypothesis for this study was that such procurement of food aid can make a much larger contribution to the economies of developing countries, and poor people in particular, and that policies can be put in place to increase such benefits.

Available literature was reviewed, and case studies were undertaken in Ethiopia and Uganda where combined local procurement of grain is running at over 300,000 tonnes per annum. Preliminary results were discussed with key players the EC, in the USA and with the World Food Programme (WFP). The study confirmed earlier indications that this was an under-researched area, and while WFP has very recently commissioned some reviews of its own, much more remains to be done. Nevertheless, available information permits certain conclusions about the impact of local procurement, as follows.

- It provides much greater net benefits for rural and urban populations than equivalent expenditure on tied food aid (provided it is competently managed, and the local/regional supply base allows the activity to be developed without major adverse impacts on consumers – where this is not the case imported food aid is more appropriate).
- There is no evidence that it is currently reducing inter-annual or inter-seasonal price variability, and there is some evidence that it is increasing variability, particularly in Uganda. There is however major scope to improve impact in this area, but this calls for change in the mandate for local purchase, reforms in its management, greater co-ordination between donors, and the untying of food aid so that local purchase and imported food can be combined in a way which has a benign effect on price movements.
- The evidence for impact on market efficiency is mixed. Local procurement has led to investment and improved practices among traders supplying food aid, but appears to have had minimal impact on the conduct of the regular grain trade in source countries. Moreover food aid grain sales are, for the main part, highly concentrated among a few suppliers, giving rise to concerns of price manipulation. On the other hand, attempts to counter this by including farmer groups within tender processes have so far been unsuccessful.
- It has raised the quality of grain offered for local purchase, but has had no apparent knock-on effect on the quality of grain circulating in regular trade channels. The situation is particularly problematic in Uganda, where the bimodal rainfall pattern renders post-harvest quality management particularly difficult, affecting both consumer health and export prospects.

- It has had positive impact on the development of Ethiopia's export trade, but in Uganda, local purchase has not been organised so as to equip traders – in terms of investments, financing and quality management – to develop an export market that would cushion them in the event of a major reduction in WFP purchases.
- Local and regional procurement have led to the development of industries for the manufacture of blended food commodities, and diversification into the production of soybeans, notably in Ethiopia.

Food aid agencies can adjust tendering procedures to take account of some of the problems noted, but in countries where they are committed for the medium term, they should consider changes in procurement arrangements, with a view to developing highly efficient supply channels. Moreover, they are in a position to use their purchasing muscle to influence positively the development of local markets. This could involve working with local warehouse receipt and commodity exchange initiatives, where they exist (in countries such as Ethiopia, Uganda, and Zambia), initially on a pilot basis. Food aid agencies will however need to check carefully on the soundness of these emerging institutions and the supporting policy framework.

Other recommendations to food aid donors are as follows: to devote more resources to assessing impact of local purchase on supplying areas; for those still supplying in-kind food aid to untie a substantial proportion; to take all steps to facilitate timely and effective decisions by local food aid managers; investigate the scope for 'food aid pipelines' building on the experience of the Ethiopian Food Reserve Administration; focus on developing existing marketing systems rather than developing exclusive relationships with producer organisations; sponsor training initiatives, and; build professional capacity within food aid agencies to handle new roles related to local procurement. Steps are also recommended to improve the performance of local purchase in Ethiopia.

These findings confirm the hypothesis that local or regional procurement of food aid can make a much larger contribution to the economies of developing countries, and poor people in particular, and that policies can be put in place to increase such benefits. Recommendations are made to food aid donors and governments.

## **1. Background**

EC Council Regulation No. 1292/96 dealing with food aid policy and food aid management and special operations in support of food security endorses the growing practice of food aid procurement within the benefiting country or from a neighbouring country. This practice is widely believed to assist 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.

Moreover, local or regional procurement are commonly believed to result in multiple efficiencies in the provision of food aid vis à vis trans-continental procurement, due to:

- lower purchase costs
- reduced transport and handling costs
- reduced delivery time
- provision of types of food more preferred by the recipients, and
- allowing local food aid staff to procure more flexibly.

There is a strong preference for such local and regional purchases in the policies of many donors, particularly the EU and member states.

Significant research has been undertaken on how best to govern food aid to minimise distortions of commercial markets and the disincentive effects on production, on the virtues or otherwise of untying it from developed country supplies, financial versus food aid, transfer efficiency, targeting and impact on recipients. However, there is a lack of systematic and critical review of the contribution that locally procured food aid is making, directly and indirectly, as a development tool in the source countries.

The hypothesis of this study was that local or regional procurement of food aid can make a much larger contribution to the economies of developing countries, and poor people in particular, and that policies can be put in place to increase such benefits.

The study, financed by the DFID EC-PREP programme<sup>i</sup>, set out to identify, collect, evaluate and collate existing information on the development impact of sourcing local and regional food aid procurement on agricultural marketing and agribusiness systems in developing countries. The expectation was that the outputs of this research would inform and guide the EC and member states in maximising development impact through their implementation of this type of food aid procurement.

## **2. Activities**

Review of the literature showed a general lack of information, few published papers, and little grey literature. It indicated that the focus of this study should be on grain, and that case studies in Ethiopia and Uganda would reflect contrasting situations. The country case studies comprised two week visits by a post-harvest technologist and an economist to Uganda (October 2004) and Ethiopia (January 2005). They identified and interviewed the main participants in local and regional procurement, and food aid in general, and prepared country study reports.

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<sup>i</sup> EC-PREP is a UK-funded policy orientated research programme to enhance DFID/European Commission collaboration.

During the second half of 2005, preliminary findings of this study were presented and discussed at a USAID ‘roundtable’ in Washington<sup>ii</sup> DC, at the First Regional Grain Summit<sup>iii</sup> in Nairobi, Kenya, at the head office of the World Food Programme, Rome, and at EC DG-Development, Brussels.

### **3. Food aid procurement in Uganda**

Food aid is required to support refugees from conflicts in surrounding countries and internally displaced people sheltering from the armed insurgency movement in the north of the country. Uganda is also the source of some of the food aid procured for surrounding countries. WFP is the main agency responsible. It started procuring in 1991 in support of feeding programmes in Burundi, Democratic Republic of Congo, Rwanda, Tanzania and Uganda. Since 2000, annual procurement has increased from 28,000 to 121,000 tonnes. Maize grain and meal, beans and Unimix (a maize meal-based blended fortified food) have been the focus of local procurement; 80% of purchases by weight are maize or maize based products.

WFP local procurement quality standards for grain and grain products are high in comparison with the quality marketed domestically, but have been out of line with those in the region, most importantly concerning maximum moisture content. In practice, WFP appears to apply these standards in a somewhat flexible manner, with a view to guaranteeing quantity of supply and avoiding suppliers incurring financial losses.

Most food aid procured locally is purchased from medium and large agricultural trading and processing companies, which win 95% of the business. Since 2000, WFP has purchased from 28 different companies, of which about 15 are regular suppliers. It is considered that sales remain heavily concentrated in a small number of companies, reflecting the incipient nature of the formal agricultural trading sector in Uganda. Companies winning tenders can use their contract to secure bank financing to accumulate the necessary stocks to supply WFP. In a country where banks are rarely involved in financing the regular grain trade, this places WFP’s suppliers in a privileged position.

From 2000 onwards, WFP has also procured maize and beans directly from farmers’ associations. Standard procurement guidelines were significantly relaxed to encourage farmer participation. Targeted groups received training from partner organisations and benefited from free transport to WFP warehouses. WFP’s objective is to purchase up to 10% of locally procured maize and beans from farmers’ groups, but up to the time of this study it had achieved no more than 4.7%. The maximum number of groups able to supply WFP in a year was 11, and only 5 groups have been involved more than once. Supplies are heavily concentrated in a very small number of groups. This situation reflects the early stage of development of farmer-controlled enterprises in Uganda.

USA gives very limited support to local procurement. Uganda Grain Traders Ltd estimates Food for Peace grain shipped from the USA costs the US taxpayer 2.6 times more than local purchase.

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<sup>ii</sup> This was organised by USAID Africa Bureau and Food for Peace.

<sup>iii</sup> This was organised by COMESA, the East African Community, the RATES Project, USAID, and the Nairobi Stock Exchange on 12-13 October 2005.

#### **4. Food aid procurement in Ethiopia**

Ethiopia is the largest regular recipient of food aid in the world. The quantity is tending to increase, and the annual average for 2000 to 2004 exceeded 900,000 tonnes, mainly cereals. Local procurement started with the Relief Society of Tigray (REST) in 1983, but became a major activity in many other areas of Ethiopia in 1996, when the EC began active support and funding. Since then, around a quarter of Ethiopia's food aid has been procured locally in the form of maize, wheat and sorghum, and on average this is equivalent to about 12% of Ethiopia's marketed surplus for these crops.

The main procurement agencies are the Ethiopian Government's Disaster Preparedness and Prevention Commission, World Food Programme and EuronAid<sup>iv</sup>, all of which use tendering procedures, and purchase in lots of not normally less than 500 tonnes. Despite attempts to target farmer associations, most purchases are made from large traders specialising in food aid supply.

Annual cereal availability studies, following the model developed by REST, are designed to protect the market from adverse effects. However the quality of statistics for local and regional procurement of food aid is poor, there is disagreement between the different information sources and there is only limited co-ordination between the food aid agencies involved in local purchase. Additionally, there are various procedural sources of delay: donors' slow and centralised procurement procedures (WFP requires tenders over a certain size to be approved in Rome, EuronAid in Brussels, and the timing of cereal availability estimates (the survey is carried out after the harvest and estimates are not published until March). These delays are frequently countered by the availability of food aid reserve stocks held and managed by the Ethiopian Food Reserve Administration. This is a unique 'food aid pipeline', which allows donors to draw down stocks for distribution and then procure locally or regionally to replenish the stocks. Thus, whilst the timing of distribution is normally appropriate, the timing of procurement tends to be later in the season than would be expected from the perspective of commodity availability and price.

However, local procurement is still demonstrably cheaper than aid tied to donor country sources, and food aid agencies estimate a saving of 25 to 30% of the landed cost of imports. Nevertheless, various donors, including the leading donor, USA, continue to tie their aid to home supplies.

Donors and Government are currently working on the implementation of a 'Productive Safety Net Programme', which involves a shift from food to cash distribution. However, various factors are likely to limit implementation, notably difficulties in ensuring security. Hence, food aid, including local procurement, will remain very important to Ethiopia in the foreseeable future.

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<sup>iv</sup> EuronAid is a European NGO Association and Network whose members are active in Food Aid and Food Security programmes

## 5. Impact of local procurement

Given the general lack of prior impact studies, key informants were interviewed. However, in Ethiopia, there had been a review of the EC's 1996 local purchase experience (Amha *et al.*, 1997), while Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) and REST had carried out significant studies of impact in some supplying areas. However, the latter provided limited guidance re overall impact, given the small scale and atypical nature of their respective programmes. Since completion of the fieldwork (and probably stimulated by it), WFP has started to make good the lack of study in this area, by commissioning reviews of local procurement in Bolivia, Burkina Faso, Ethiopia, Nepal and Uganda.

Based on the information obtained, it is possible to make the following statements concerning impact.

### *Impact of local purchase vis à vis tied aid*

It is logical that local purchase has beneficial development effects vis-à-vis a similar quantity of tied aid, since it makes a much larger net contribution to rural and urban livelihoods in the source countries concerned. However, this assertion only holds in circumstances where local purchase is well managed and appropriate, i.e. there is an adequate local/regional supply base, so that it does not cause a price rise of such a proportion as to cause severe adverse impact on the food security of vulnerable populations.

Imported food aid is more expensive. OECD (2005) found that the cost of food aid transfers was on average approximately 50% more than local food procurement and 33% more costly than procurement in third countries. Local purchase is cheaper and normally much faster. In practice however, the bureaucracy of the agencies supporting local purchases often nullifies some of the latter advantage<sup>v</sup>. Such observations provide a case for improving the management of local purchase, rather than a justification for maintaining tied aid.

Defenders of tied aid argue that untying diminishes the willingness of donors to provide food assistance. There may be some truth in this but it also begs the question as to whether tied aid is acting as a palliative, favoured by northern lobbies, and easing pressure for more effective international action to address world hunger. Notwithstanding the benefits of local purchase, 75% of overall food aid to Ethiopia remains tied, as does 20-40% to Uganda. This situation constrains food aid managers in their ability to vary the proportions of local

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<sup>v</sup> Barrett and Maxwell (2005) state that while in principle, local procurement allows donors to drastically reduce time between call and delivery, vis-à-vis the alternative of transoceanic shipment, the limited available evidence on delivery delays is somewhat mixed. They recommend that several major donors, "perhaps most especially the EC", should expedite their approval and disbursement procedures. The EC has earned a reputation for often being slower to deliver resources than the USA, despite the EC's more flexible and frequent use of local purchases, triangular transactions and complementary cash resources.

purchase and imported food aid in relation to the state of local harvests and markets. The problem was particularly evident in 2001 and 2002, when Ethiopia experienced an unusually large price fall for all its major cereals while simultaneously receiving large quantities of US imported grain. The tying of American aid subsequently constrained the US in dealing cost-effectively with the famine which occurred in 2003<sup>vi</sup>.

### ***Inter-annual price stability***

There was no evidence that local procurement is having a positive impact on inter-annual price stability in the supplying countries. Greater price stability could be achieved by varying quantities procured locally according to the size of the local crop. However, in Ethiopia the figures indicate that this is not being done; indeed local purchase was highest in 2003, the year when the estimated market surplus was lowest. Food aid donors may have reacted in a delayed and somewhat untimely fashion to very low and unremunerative cereal prices in 2001 and 2002. In Uganda, there was a major maize price crash in 2001, resulting from the combined effect of a bumper crop in Kenya and minimal WFP purchases for much of the year. By contrast, heavy WFP intervention in 2003 caused a major rise in Kampala prices in the April-August period.

Given that domestic price stabilisation has not been an explicit objective of local procurement, these findings are not altogether surprising. Notwithstanding, there exists considerable scope to use local procurement to stabilise inter-annual prices. However, to do this in a fully effective manner would require a high level of co-ordination between the leading donors (notably EC and member states, and USA), considerable delegation to their local offices, and the untying of a large proportion of USA food aid. It is also possible to stockpile local grain to cover deficits in future years, though food aid agencies are unlikely to do this at present.

### ***Intra-annual (inter-seasonal) price stability***

The World Bank (in press) finds a considerable degree of short-term (intra-annual) price volatility in Ethiopia, and it is likely that the pattern of local purchasing is contributing to this. Local procurement peaks in the lean season (July), whereas it should logically peak earlier in the year, after the main harvest. Agridev Consult (2005) found that this problem benefits traders at the expense of farmers, who must sell their produce at poor prices to meet cash needs, and that it may have impacted adversely on food insecure consumers in the lean season. As noted above, the delayed procurement results from the food aid agencies' centralised procurement procedures and the timing of the publication of the annual cereal availability estimates. In Uganda, WFP intervention (or the absence of it) is having a major impact on seasonal price patterns, and this appears to be contributing to price variability both between years and within years. However, maize is not a leading staple food in Uganda, so this is unlikely to affect the food security of nutritionally vulnerable populations.

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<sup>vi</sup> Thurlow and Kilman (2005) regarding the US Government's proposal (opposed by Congress) to use a quarter of the Food for Peace Program to buy food as close as possible to countries stricken by famine: Mr Andrew S. Natsios, USAID Administrator, suggested this plan could have saved lives in Ethiopia during the 2003 famine. A bumper wheat harvest the previous year depressed local prices so sharply that farmers were discouraged from planting. When drought hit in 2003, production fell further and a famine resulted. If the USA had bought Ethiopian wheat in 2002 to use as food relief, such a move would have stabilized prices and supported local farm economy. Instead, in 2003, the USA shipped \$500 million of US food. The US food travelled past warehouses filled with the 2002 Ethiopian harvest.

### ***Impact on the efficiency of local grain markets***

Local procurement has encouraged significant investment on the part of traders supplying food aid, and has improved practices within the food aid supply channel. It has produced a cadre of relatively large companies whose main, and sometimes exclusive business, is to supply food aid agencies to order. They are reported to have improved their business skills and understanding of the grain trade through the food aid business.

However, in both case studies, there was minimal evidence of impact on normal grain handling and trading practices, or on quality and transparency, in regular grain marketing channels. The only evidence found was that of GTZ and REST, who claim a gain in the number, size, and efficiency of grain traders in the locality of their procurement activities. These organisations now account for only a small percentage of total quantities procured, and their approach to procurement involves many field staff, and could be difficult to upscale. Notwithstanding this, aspects of their operation may be relevant to the larger food procurement agencies.

In the case of Uganda, the low impact of local procurement on general trade practices can be attributed in part to the fact that food aid suppliers do not bid from a stock position, but procure grain almost entirely after winning the tender. In the absence of a contract with WFP, they find it difficult to access bank finance, and they procure almost entirely to meet the needs of this one client. Consequently, they have little stock readily available for sale to non-food aid customers. They also have very limited storage capacity, and tend to rely on the WFP Kampala warehouse to hold stocks that they have recently dried and cleaned.

In Ethiopia by contrast, traders must have stock positions if they are to participate in tenders (as much as 75% in some cases), but it is likely that stocks are mainly procured after the tender is called and are not readily available for sale to regular trade customers. Requiring companies to bid from stock positions has the effect of smoothing the impact of local purchase and reducing performance risk, i.e. the risk that tendering companies will be unable to deliver on their contracts. However, as Agridev Consult (2005) and Sserunkuuma & Associates Consult (2005) point out, it also reduces competition between suppliers. These two authors and Amha *et al.* (1996) have raised concerns that the high concentration of suppliers can lead to price manipulation. Between 2001 and 2004, the average shares for the three largest suppliers were WFP Uganda 72%; WFP Ethiopia 62%; EuronAid Ethiopia 61%, and DPPC Ethiopia 29%. Sserunkuuma & Associates Consult (2005) quotes verbal evidence that leading suppliers in Uganda are developing monopolistic price-fixing powers.

Partly to avoid the effects of market concentration, most agencies have tried to include farmer groups within their tendering systems, but with very limited success. There is now widespread consensus among seasoned practitioners that very small tenders (e.g. 50 to 200 tonnes) aimed at producer groups are costly to organise and are an inefficient use of resources. WFP Uganda's scheme for local purchase from producer organisations is particularly instructive in this regard, as it has resulted in a highly subsidised and artificial marketing channel for a few groups that are heavily dependent on the food aid market. It is difficult for these groups to handle the formal tendering procedures, to understand contracts and quality specifications, and to put up bid and performance bonds. They also find it difficult to access sufficient quantity of grain and credit.

### ***Impact on food quality***

The enforcement of strict quality procurement standards by local and regional food aid agencies has undoubtedly raised the quality of grain offered, and has increased the awareness and competence of the traders concerned, but it appears to have had very little impact on grain traded in regular wholesale/retail channels.

Managing the quality of maize grain is particularly problematic in Uganda where, due to the bimodal rainfall pattern, it is difficult to dry the crop in the field. Maize cobs dry slowly and grain is sold to primary traders at high moisture levels (18-20%), providing a fertile substrate for the development of moulds and aflatoxin during the course of marketing. There is a lack of locally available drying and cleaning facilities – virtually all are concentrated in Kampala to service WFP tenders – and when Kampala-based traders receive grain it is typically 10 days after leaving the farm. These traders assemble lots out of smaller parcels of heterogeneous quality and not surprisingly often find it difficult to meet WFP's specifications.

Poor grain quality is a problem for consumers, both in Uganda and neighbouring countries. Kenya closed the borders for Ugandan maize in 2004, after 125 people died from suspected aflatoxin poisoning, which the Kenyan authorities blamed on Ugandan grain informally traded across the border. Hence poor grain quality is also a problem for developing export markets. The situation may become more difficult in light of a new East African maize grain standard, which has set aflatoxin limits at levels similar to those applied by EU countries. Uganda faces competition from other countries, notably South Africa, which can supply maize of a much higher specification than Ugandan firms.

WFP has promoted the development of maize as a cash crop to meet its local procurement objectives but, notwithstanding efforts it has made under its smallholder procurement system, has paid insufficient attention to post-harvest handling. In so doing, it has missed an opportunity to help Uganda develop a formal export market for high quality maize to Kenya, one on which Uganda can fall back when WFP reduces its procurement. However, WFP is probably in a position to turn this situation round, to Uganda's benefit.

### ***Impact on the development of export trade***

WFP purchases in Uganda have led to increased expectations that have discouraged, though not eliminated, exports to other East African countries. Due to its favourable climate, Uganda is able to produce maize and beans competitively for export to Kenya and elsewhere. Exports are mainly in the informal sector, which is vulnerable to application of the new East African Maize Standard, while formal sector players, who could potentially meet the standard and the requirements of more quality conscious clients in neighbouring countries, focus on the food aid market. While it is inevitable that large-scale local procurement will cause some diversion of trade away from the export market, WFP could take steps that would greatly mitigate this problem, and help formal sector traders develop an export market that will cushion them in the event of a major reduction in WFP purchases. Indeed, local food aid procurement could provide a future platform for successful export development.

Due to geographical and logistical factors, the impact of local procurement on regional trade is less of an issue in Ethiopia than in Uganda. However, it is undoubtedly assisting in the development of trade in blended foods and sorghum between Ethiopia and Sudan. The EU/EuronAid initiated cross border movement of over 24,000 tonnes of sorghum from Sudan to Ethiopia in 2003 had additional development impact by stimulating significant commercial trade over the same route (Smalbruch and Walker, 2004). This transaction was facilitated by use of the grain reserve stocks in each country. There is scope for increasing such operations, but this will require a determined effort to overcome administrative and trade barriers, and the compartmentalisation within food aid agencies themselves.

### ***Development of agro-industries and crop diversification***

Local and regional procurement in Ethiopia has led to the manufacturing of blended food aid commodities such as Faffa, Famix and Unimix. The four companies involved have diversified from baby food production to be largely suppliers to the food aid sector; for one of them the business is worth around US \$3 million per annum. These companies employ many hundreds of employees, albeit some casual due to the variable nature of food aid demand, and create further employment in industries supplying transport, packaging, printing and other supporting services. There is also a small blended food aid manufacturing sector in Uganda.

Local production of blended food provides a particularly large financial saving to the food aid supplier. OECD (2005) estimated that in worldwide food aid operations, it cost an average of 68% more to import highly processed and blended foods than to procure them locally. There is considerable tied aid in blended foods, which is not only cost-inefficient but also a missed opportunity to promote local agro-processing capacity.

Soya is not a common crop in Ethiopia and whilst there is a limited market for soya as a constituent of poultry feed and as an export commodity it appears that its main use is as a constituent of blended food-aid products. Ethiopian blended food manufacturers believe that their supply of the local and regional procurement markets has initiated and maintained significant increases in national soya bean cultivation.

## **6. Alternative approaches to procurement**

Food aid agencies can adjust existing tendering procedures to take account of problems noted above. For example in the case of Uganda, WFP could announce its intention to take delivery in certain provincial cities, as a means of stimulating investment of drying, cleaning and storage facilities closer to the producers. It could pay suppliers according to the quality of grain delivered, providing premiums for grain that meets the relevant standards. It could also require suppliers to bid from a stock position, but at some risk of further reducing competition between suppliers.

However, where food aid agencies expect to be engaged in local purchase over the medium to long term, they should consider a more comprehensive change in procurement arrangements, whereby they use their massive purchasing muscle to influence positively the development of local markets, particularly in Africa. While local and regional procurement of food aid cannot, by itself, make good all the flaws in existing agricultural marketing sectors, it can provide a clear lead. Notably, it can:

- help formal sector traders develop stock positions from which they can supply both private and food aid customers;
- help them improve grain quality and make it easier for them to sell the grain to formal sector buyers both domestically and regionally, and earn quality premiums accordingly;
- encourage the trade to invest in warehouses, grain handling and drying equipment over a broad geographical area, and;
- promote greater competition within food aid marketing channels.

In order to help traders develop their stock positions, food aid agencies can work together with local warehouse receipt systems, including the one that already exists in Zambia, and those that are shortly to start in Ethiopia and Uganda. A warehouse receipt system provides an ideal vehicle for quality to form the basis for the payment of premiums because the licensed warehouse operators would grade all stocks on receipt. The system also allows food aid agencies to make use of multiple supply warehouses from which they can lift grain for delivery to the ultimate beneficiaries.

Competition can be promoted by buying grain through commodity exchanges. Most food aid agencies are currently locked into formal tendering procedures, but it is worth investigating other procurement options. The Uganda Commodity Exchange is presently inactive, apart from small-scale pilot activities with coffee, but it will shortly be developed under a three-year EC technical assistance project. In Ethiopia, the International Food Policy Research Institute is promoting the creation of a commodity exchange that will build on the vibrant informal brokerage system that already exists in the Addis Ababa market.

The development of commodity exchanges offers an alternative or complement to existing tender systems, which could be highly transparent and low cost, and would facilitate sale of grain in quantities much smaller than possible under the existing open tender procedures. For example, as an alternative to opening single tenders for 3,000 tonnes, the agency could make six bids for 500 tonnes at different trading sessions. Each 500 tonne lot could be assembled from smaller quantities offered by different suppliers; hence it could be possible to make the system directly accessible to smaller traders and could even include those farmers' groups who succeed in depositing grains in licensed warehouses. It is possible to envisage a scenario whereby food aid agencies could place bids on the exchange for given quantities of grain to be delivered in the form of warehouse receipts.

In this way, it is possible for food aid agencies to enter into an important win-win relationship with new market institutions such as warehouse receipt systems and commodity exchanges, which will contribute much to public welfare. Box 1 shows how such an arrangement could be beneficial to these parties and the public in general. However, it must be stressed that this positive scenario can only be met if the institutions are well organised and regulated, and public policy supports their development (Coulter and Onumah, 2002). Food aid agencies need to investigate carefully the soundness of these emerging institutions and the supporting policy environment.

### **BOX 1: MUTUAL GAINS THROUGH THE SUPPORT OF NEW MARKETING INSTITUTIONS**

#### **The food aid agencies will gain from:**

- improved and more consistent quality produce
- a more assured supply, as the trade will be holding stock in anticipation of food aid tenders and other buyers (mills, feed-mills, poultry farmers, brewers and export)
- reduced risk of performance failure (i.e. contract default by supplying companies)
- broader geographical spread of supply, as the system will encourage people to open licensed warehouses close to production areas
- lower trading margins between price received by farmers and price paid to the final suppliers

**The new marketing institutions** will gain since the food aid buyers will provide the financial muscle required to ensure their take-off. This is particularly significant in the light of experiences in Africa over the last 10 years. Institutions with most success include South Africa, Zimbabwe prior to 2001, and Zambia. In these countries, large-scale commercial farming provided the necessary large volumes of commodities to get these institutions off the ground. Progress has been slower in East African countries where smallholders dominate production, but there is little doubt that food aid buyers – whose aggregate purchases in the two countries studied exceeds 300,000 tonnes per annum – could provide an early boost. Food aid buyers will attract bank financing to new institutions, but once established, bank lending will acquire a momentum of its own, since the warehouse receipts system will satisfy the need for high quality collateral, and the exchange will provide the means of valuing the collateral.

#### **The public in general will gain from:**

- increased demand for grain, which will be of better quality and more marketable to domestic and, particularly in the case of Uganda, export buyers
- increased price stability resulting from readily available marketable stocks
- more efficient competitive trade with lower margins – the system will reduce existing inefficiencies, notably the reluctance to apply quality standards, systems contract enforcement and market transparency, and;
- positive production response, which contributes to self-sufficiency and food security.

## **7. Conclusions**

The above findings clearly confirm the research hypothesis that local or regional procurement of food aid can make a much larger contribution to the economies of developing countries, and poor people in particular, and that policies and practice guidelines can be put in place to increase such benefits.

The main reason that the evidence base is thin is that food aid agencies and NGOs undertaking local or regional food aid procurement do not conduct development impact assessments in the supplying areas. Whilst it is *de rigueur* to undertake impact assessment of food aid distributed to the beneficiaries, it is common that little assessment is undertaken in the supplying economy, except perhaps to ensure that the market economics have not been distorted by ill-judged procurement. This deficiency needs to be made good without delay. It would also be useful to undertake further country case studies. Findings should be documented and made available to policy makers.

## **8. General recommendations for food aid donors and governments**

1. Food aid donors should devote more resources to assessing the impact of local procurement on supplying areas, particularly to determine the benefits from market development and identify issues requiring attention. The following are a few topics that might be investigated: (a) lessons from GTZ and REST's local purchase programmes in Ethiopia; (b) the role of regional procurement in developing long-term trade relationships between neighbouring countries and; (c) the role of local procurement in kick-starting agri-business development – particularly increasing soybean production with a view to developing efficient manufacture of animal feedstuffs.
2. Governments and donors should strive to improve the information basis for food aid distribution, including local purchase. This will involve enhancing the accuracy of crop forecast, food balance sheets and estimates of marketed surpluses. Food balance sheets should take account of the substitutability across food crops (including root crops) and informal regional trade (Jayne *et al.*, 2005). In the specific case of Ethiopia, the country needs a single authoritative source of production statistics, to improve statistics for local and regional procurement, and to improve co-ordination among food aid agencies. Government should also consider the possibility of bringing forward the cereal availability survey to the time of harvest (November-December), rather than January-February as at present.
3. Donors that supply food aid in kind should consider untying a substantial proportion in order to contribute to the development of local agriculture, trade and livelihoods. Untying is endorsed by the recent US-sponsored Regional Grain Trade Summit in Nairobi, which “unanimously commended the recent decision by the Canadian Government to untie 50% of its food aid”, and “called for other donors to follow this trend”.
4. Donors should take all possible steps to facilitate timely and effective decisions by local food aid managers. Those already supporting local procurement should make multi-annual cash commitments, which will reduce uncertainties concerning the availability of funding. There is also a need for higher levels of co-ordination and information sharing between the leading donors, and considerable delegation to their local offices.
5. Donors should investigate ways of entering into arrangements with existing food reserve agencies whereby the latter provide stocks for timely distribution in return for pledges to replace through local purchase. The food reserve agency gains by finding it easier to rotate its stocks; the food aid agency gains ready and timely access to stocks.
6. Donors should attempt to improve the performance of existing marketing systems, rather than create new structures involving direct and exclusive relationships with producer organisations. Present attempts to procure from farmer groups and other small suppliers are considered ineffective and do not represent value for money.
7. Where local circumstances are favourable and food aid is expected to continue at significant levels over several years, food aid agencies should support the development of local market institutions, notably warehouse receipt systems and commodity exchanges.
8. Food aid agencies should sponsor training initiatives, targeting private sector traders, in subjects such as warehouse management, pest and quality control, procurement systems,

accounting and costing. This could contribute to broadening the supply base and promote compliance with contract specifications.

9. Food aid agencies should build their professional capacity to handle these new roles, notably in areas of agricultural marketing policy, trading and post-harvest product handling.

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