NATHAN ASSOCIATES INC.
ECONOMIC AND MANAGEMENT CONSULTANTS

Experience with Auctions of Food Aid Commodities in Africa

Volume II: Case Studies and Annotated Bibliography

Final Report

submitted to
Africa Bureau, Office of Development Planning
U.S. Agency for International Development

March 12, 1990

submitted by
Nathan Associates Inc.
Economic and Management Consultants

under contract no.
PDC-5315-1-00-8100-00

LIST OF ANNEXES

TERMS AND ABBREVIATIONS USED IN THE TEXT AND GLOSSARY OF AUCTION TERMS

ADC	Agricultural Development Corporation, the Somali parastatal that is currently responsible for national food security and cereals price stablization and that formerly held a monopoly over the domestic grain trade
A.I.D.	the U.S. Agency for International Development; generally responsible for managing food aid programs within the recipient country; offices in country are usually referred to as USAIDs
ALIMAG	the Guinean parastatal responsible for rice imports; closed December 1985
appel d'offres	invitation for bids (IFB)
auction	vente aux encheres
auctioneer	commissaire priseur; individual conducting an auction (often a licensed professional)
banker's acceptance	note drawn on and guaranteed by a bank for payment at some future date (generally 30-180 days after sight) (French: traite avalisee)
BB	broken rice
bid bond	an amount paid at the time bids are submitted, or prior to that time, which might be set at a fixed amount or as a percentage of the amount bid; bid bonds are generally refunded to unsuccessful bidders and to successful bidders upon signature of a contract to purchase, being retained only from successful bidders who refuse to complete the purchase (French: caution de soumission)

bid documents	the documents provided to potential bidders specifying the terms of the offer and the procedures for the auction (French: cahier des charges)
bid opening	public opening and reading of the bids in a sealed envelope IFB process (French: depouillement)
bid-tender	a process whereby the seller issues an invitation to bid (IFB) and the prospective buyers submit written bids
buyer's commission	payment made to the auctioneer by the buyer over and above the price bid (often a percentage of the sale value)
C&F	cost and freight (import price including the exporter's purchase price and international freight)
cahier des charges	bid documents
caution de bonne exécution	performance bond
caution de soumission	bid bond
CCC	Commodity Credit Corporation, the branch of USDA responsible for the purchase and sale of U.S. agricultural commodities by the U.S. Government
CIF	cost, insurance, and freight (C&F plus insurance)
CFAF	West African franc (CFAF 315 = US$ 1 in October 1989)
commissaire priseur	auctioneer
CRS	Catholic Relief Services, a U.S. PVO
dalasi	Gambian currency (7.5 dalasis = US$ 1 in October 1989)
Dutch auction	auction in which the auctioneer indicates successively lower prices (sometimes regulated by a clock-like instrument showing declining price levels) until one of the bidders accepts the price (by signalling or calling out); also called descending bid auction; a sealed bid tender in which multiple lots are awarded is in effect a Dutch auction
EEC	European Economic Community

ENC	National Trade Agency, the parastatal handling imported foodstuffs (primarily food aid) in Somalia
English auction	open outcry auction (French: vente aux enchères)
f.a.s.	free along side (export price at the dock); the basis for determining the dollar-equivalent of the minimum amount required to be deposited as counterpart for food aid sales
first-price auction	an auction in which the goods are awarded to the highest bidder at the price bid
f.o.b.	free on board (export price including loading and port charges)
GCU	Gambia Cooperative Union
GDRM	Government of the Democratic Republic of Madagascar
GF	Guinean franc
GOG	Government of Guinea
GOTG	Government of The Gambia
GPMB	Gambia Produce Marketing Board; parastatal responsible for grain marketing
GRM	Government of the Republic of Mali
GSDR	Government of the Somali Democratic Republic
HIID	Harvard Institute for International Development
IFB	Invitation for Bids, tender announcement (French: appel d'offres)
lot	an item or group of items sold together as a single unit; e.g., 50 metric tons of rice
MEF	Ministry of Economics and Finance in Guinea
MICA	Ministry of Industry, Commerce, and Artisans in Guinea
MOFT	Ministry of Finance and Trade in The Gambia and Somalia; agency responsible for managing food aid sales

MOH	Ministry of Health in The Gambia; agency responsible for certifying grain quality
MPCI	Ministry of Planning and International Cooperation in Guinea
MT	metric tons
MYOP	multi-year operational plan
negotiated sale	a sale in which a small number of potential buyers are contacted directly and offered the good, with the price and quantity of the sale or sales determined through informal negotiation
noncompetitive bidding	system permitting bidders for small quantities to submit bids without specifying a price; they pay a price determined by the competitive bidders (e.g., in the case of pay-as-bid, the average of all winning prices)
ODR	Opération de Développement Rural, a type of regional development parastatal in Mali
OGL	Open general license
ON	Office du Niger; a regional development parastatal
OPAM	Office des Produits Agricoles du Mali; parastatal responsible for managing food aid cereals in Mali
open outcry auction	auction in which potential buyers gather in a public place and compete by offering successively higher prices at the bidding of the auctioneer, with the goods going to the highest bidder at the final price offered (or being retained by the house if the reserve price is not reached); also called English auction, public auction
oral auction	auction in which potential buyers gather in a public place and compete by offering successively higher prices at the bidding of the auctioneer, with the good going to the highest bidder at the final price offered (or being retained by the house if the reserve price is not reached); also called English auction, public auction, open auction, open cry or outcry auction, and ascending bid auction (French: vente aux enchères)
ORS	Operation Riz Segou; a regional development parastatal
PAAD	Program Assistance Approval Document

pay-as-bid	auction system in which each winning bidder pays the amount that he or she bid; also called discriminatory pricing (contrast uniform pricing)
pay at the margin	auction system in which multiple lots are offered in a single auction, with lots awarded successively beginning with the highest bidder and proceeding downward until the quantity available is exhausted, but where all bidders pay the price at which the final lot (or partial lot) was sold, rather than the higher prices that each had bid
performance bond	bond paid by winning bidders upon signature of a contract; bonds are returned to the purchaser following satisfactory completion of the transaction covered by the contract (French: caution de bonne execution)
P.L. 480	Public Law 480 of 1954, the basic legislation governing U.S. food aid
prequalification	a process whereby eligibility to bid is determined by a formal process, which might impose standards on bidders (e.g., possession of a warehouse) or require a show of good faith (e.g., payment of a bid bond), or might simply require registration prior to bidding
PRMC	Projet de Restructuration du Marche Cerealier; multi-donor program in Mali using food aid to support policy reform in the areas of grain marketing and pricing
PVO	private voluntary organization
reserve price	a minimum acceptable price determined in advance by the seller; the reserve price might or might not be announced prior to accepting bids (French: prix minimum or, in cases where both a minimum and a maximum are set, fourchette)
RM 40	a grade of rice used in Mali with 40 percent broken grains
SAP	Structural Adjustment Program
sealed bid tender	an auction mechanism whereby bidders submit prices for the commodity on offer (in single or multiple lots) in sealed envelopes that are opened on a predetermined date, often in public

second-price auction	an auction in which the goods are awarded to the highest bidder, but at the price bid by the next highest bidder; also called a Vickrey auction; rarely used in practice
seller's commission	amount paid to the auctioneer by the seller out of the auction proceeds
SNS	Stock Nationale de Securite; program in Mali managed by OPAM and responsible for maintaining an emergency reserve of local cereals
stop-out price	in an auction where multiple lots of an essentially similar goods are offered (as in the U.S. Treasury Bill auction), the price at which the winning bids exhaust the supply
TA	Transfer Authorization
Tender Boards	in The Gambia, standing or special committees formed under the jurisdiction of the MOFT, including the permanent Major and Minor Tender Boards, which supervise regular government procurement, and ministerial tender boards established to supervise procurement under specific projects (generally donor-financed), such as P.L. 480
uniform pricing	auction system in which multiple lots are offered in a single auction, with lots awarded successively, beginning with the highest bidder and proceeding downward until the quantity available is exhausted, but where all bidders pay the price at which the final lot (or partial lot) is sold (the stop-out price), rather than the higher prices that each had bid; also called marginal pricing (contrast pay-as-bid)
USDA	the U.S. Department of Agriculture, responsible for commodity management under U.S. food aid programs
vente aux enchères	auction (generally an open outcry auction)
WFP	World Food Program
Whitten program	A one-time sale of CCC commodities by auction, limited to certain drought-affected countries in Africa

APPENDIX A

EXPERIENCE WITH FOOD AID AUCTIONS IN THE GAMBIA

TABLE OF CONTENTS

APPENDIX A

EXPERIENCE WITH FOOD AID AUCTIONS IN THE GAMBIA

Country Background: The Context for Auctions

The Gambia lies along the Gambia river in West Africa. It has a population of approximately 788,000 and a land area of some 11,295 square kilometers. The climate is subtropical, with two distinct seasons. Agriculture accounts for 33 percent of the GDP, with groundnuts accounting for 60 percent of the country's exports. Industry, responsible for approximately 9 percent of GDP, consists mainly of agro-processing, manufacturing and assembly. Services constitute the remaining 57 percent of GDP, with trade and government being the largest components. Per capita GDP is estimated to be $356 per year.

The Gambia has traditionally been a very active trading and transshipment point, with tariff levels and barriers much lower than its neighbors in the subregion (Senegal, Mauritania, Guinea-Bissau). Until 1985, the Government of The Gambia (GOTG) controlled the country's primary product, groundnuts, through the operations of the parastatal Gambia Produce Marketing Board (GPMB). In addition to marketing groundnuts, the GPMB also had the legal monopoly on rice imports until 1985, when World Bank-financed structural adjustment measures mandated the restructuring of GPMB operations and the further liberalization of cereal markets, including rice.

The United States, under the auspices of its Economic Policy Reform Project, reinforced the structural changes with complementary policy reform measures leveraged by cash resource transfers from 1985-89. Within this larger context of overall market liberalization, the P.L. 480 Title II Section 206 rice program was designed in 1985 and implemented in 1986 as support for the government's liberalization of markets and restructuring of the GPMB. In keeping with the reduced role of the parastatals in marketing, the Ministry of Finance and Trade (MOFT) was designated as the GOTG implementing organization for the P.L. 480 activities.

Rice Marketing Structure

Although the GPMB had nominal monopoly control over the marketing of both imported and domestically produce rice until the early 1980s, the extremely active nature of The Gambia's informal trading activities has ensured that there have always been private sector traders involved in rice marketing. The officially recognized (and small) portion of that private sector involvement was controlled by an import licensing system administered by the MOFT until 1985, when import licenses for almost all products were abolished under the new liberalization measures.

Because a very large proportion of economic activity in the country has always involved imports and re-exports (both recorded and unrecorded) to neighboring countries, almost all traders, irrespective of size or capital structure, trades in a wide range of products. There are very few specialized traders, and none who trades exclusively in rice. Since the liberalization of rice trade in 1985, commercial imports have increased dramatically, and participation in the import, trading, and distribution of rice has expanded even more dramatically. To provide an idea of the magnitude of this market expansion, note that in 1985 rice imports totaled a little less than 55,000 metric tons, while in 1987 they reached 92,800 metric tons.

The rice market in The Gambia is generally perceived as being very segmented, although the empirical degree of segmentation is a question of considerable debate. Using 1987 as a sample year, we can sketch the general outline of this three-tiered market. Total demand for cereals was estimated at 150,000 metric tons, of which demand for milled rice is 50 percent, or 75,000 metric tons.

The taste preferences of Gambian consumers, albeit exercised by only the middle- and upper-income urban and semi-urban consumers, are markedly different from the tastes of their Senegalese and Bissau neighbors. While the Senegalese prefer broken rice (generally 40 to 95 percent broken), Gambians very much prefer the long- and medium-grain premium imported rice. Local rice production in 1987 was limited to approximately 17,000 metric tons of paddy, which converted to roughly 10,200 metric tons of milled rice. This rice is classified by consumers as the lowest quality available in the country, and it is largely consumed and traded in the rural regions up-country; very little of it arrives in the Banjul area semi-urban markets.

Of the more than 90,000 metric tons of rice imported in 1987, 70,000 metric tons was medium-grade Thai, Burmese, and U.S. rice, averaging 70 to 100 percent broken. This rice is classed by consumers as the middle quality, and the robust domestic demand for this grade must compete with demand from Senegal for re-export of this rice. Traders often face substantially higher prices in the neighboring country, due to the higher Senegalese duty on imported rice and the overvalued CFAF. Senegalese prices in the Dakar area since 1986 have seldom been less than <u>double</u> those prevailing in Banjul, and there has been no perceptible narrowing of the gap between the two price levels in the past three years.

Analysts estimate that over 40,000 metric tons of the 70,000 metric tons of medium-grade rice imported in 1987 was re-exported, leaving 28,000 for domestic consumption. This substantial outflow of imported rice is very much a phenomenon of artificial price differentials and not insufficient domestic demand. Estimates of the rice deficit in 1987 suggest that Gambian consumers would have purchased 14,000 additional metric tons in medium-quality rice had it been available at the Gambian market price.

Finally, there is a very distinct market niche for the premium long- and medium-grain rice, imported from the United States both commercially and as food aid. In 1987, 22,800 metric tons of premium-quality rice was imported, of which almost 10,000 metric tons was under the P.L. 480, Title II, Section 206 program. Only the upper- and upper-middle income consumers in the urban areas can afford to pay the high price for this preferred rice, but in spite of the generally low level of per capita income, the demand for this more expensive premium rice is robust. Although definitive data on the quantity and composition of re-exports are elusive, preliminary analyses indicate that although 40 to 60 percent of total rice imports are re-exported, <u>none</u> of that is the high-quality premium U.S. long-grain rice, which is instead retained for local urban consumption.

Traders who handle rice are usually sophisticated import-export agents with storage facilities and distribution networks (which up until mid-1989 included extensive contacts with roving Mauritanian traders who handled small shipments throughout the subregion). These traders manage diversified portfolios, which include imports and re-exports of consumer products and manufactured goods of European and British origin, and they all have strong relationships with one of the two commercial banks operating in the country. Many traders also have extensive networks of friends or family in England or continental Europe, and they hold bank accounts in dollars or pounds sterling in Europe as well.

In contrast to the extensive use of formal financial instruments in their dealings with overseas contacts and suppliers, the Gambian traders often rely on extending suppliers' credit to their distribution agents to facilitate the marketing of the rice. In general, Gambian traders tend to store rice for a longer time than their Malian counterparts, and they are more likely to invest in storage management and fumigation. There is an informal but commonly held perception of the quality differentials implicit in the different grades and origins of imported rice, but there is no official Gambian grade or standard used other than those presented by the exporting sources.

94
12

Experience With Food Aid Auctions

Chronology of Auctions, 1986-89

In the following pages, the three years of expereince in The Gambia with auctions and tender sales are described, providing details on the auction management strategies and subsequent results. For a summary of these three years, see Table A-1 on page A-20.

Designing the P.L. 480 Program

The designers of USAID's Title II-206 program for The Gambia did not specify the use of public outcry auctions or tender bid sales as a mechanism for the distribution and sale of the rice. The March 1986 Program Assistance Approval Document (PAAD), stressing market liberalization, provides the context for P.L. 480 rice imports to The Gambia:

> The contribution of this program toward the goal of food self-reliance for The Gambia will be to work with the GOTG to create the policy and institutional conditions which will promote an economic balance between food crop production and imported food, as well as between cash crop production and the import of essential materials. This will involve efforts to . . . (iv) make full use of the most economically efficient marketing mechanisms and channels. Our strategy to meet these objectives has two components. First, policy measures including . . . liberalizing trade so that merchants can participate in all aspects of the marketing system.

As part of the Section 206 design process, the Office of the A.I.D. Representative (OAR/Banjul) urged the GOTG to "end the de facto monopoly that the GPMB had on commercial rice imports . . . and to allow private merchants to trade those commodities . . . . Allowing the private sector to handle the commercial rice trade will conserve official foreign exchange reserves."

The program's designers recognized that the development of an active, competitive, robust private sector trade in rice would take some time to develop.

> Based on experience up to December 1985, it is apparent that the private sector is moving cautiously into the commercial rice trade. To that date only three merchants are known to have imported rice. Therefore, OAR/Banjul expects that The Gambia will continue to experience a structural food gap until the private sector acquires confidence in the GOTG commitment to free trade, builds up sufficient foreign exchange to engage in the

13

> trade, and acquires experienced agents to facilitate the distribution of imported rice. Hence, our Section 206 program will provide the food to bridge this gap during the time it takes the private sector to sustain commercial rice imports adequate to meet The Gambia's needs.

One aspect of the P.L. 480 program that the designers did not mention was the potential "learning effect" of these imports on the Gambian traders — the use of P.L. 480 imported rice as a "training" experience for the traders and a means of encouraging new entrants.

Thus, although the PAAD discussed the context of market liberalization and increasing private sector participation in cereals marketing, it nonetheless specified administered prices and sales to designated experienced traders cleared by the government.

> As subsequent food aid arrives during the second and third years of our Section 206 program, the GOTG will be required to turn over its rice stocks to the private sector for distribution and sale . . . . Private merchants will handle the distribution and sale of the USAID rice also in keeping with the liberalization of the commercial rice trade . . . . GOTG will receive the rice and hold it for sale to the private sector. Two months before each biannual rice import (imports will be on a biannual basis to lighten demands on the limited storage capacity of most private traders), the GOTG will designate those traders who will be eligible to purchase rice from the GOTG for distribution and sale. Only those merchants who have been importing rice for sales will be eligible to receive equal shares of the rice provided to the GOTG by USAID. The FAS value will be the established price for the GOTG to purchase the rice from OAR/Banjul. The rice will be sold in minimum lots of 500 metric tons by the GOTG at a price which includes its documented handling/storage costs.

Beginning the Implementation Process

The first official document formalizing the agreement between USAID and the GOTG was the Transfer Authorization (TA) for the first shipment of rice, dated July 18, 1986. Item nine of the TA shows that by late summer 1986, the orientation of the Title II program sales was still towards government sales to designated merchants at an administered price:

> Sale of rice: The GOTG will deposit in a special account the dalasi equivalent of the f.o.b. cost; the GOTG will sell equitable portions of the rice to designated private licensed merchants operating in The Gambia . . . . Two months before each biannual

26
14

> rice import, the GOTG will designate those traders to be eligible to purchase rice from the GOTG for distribution and sale. Only licensed merchants who have been active in the commercial rice trade will be eligible to receive approximately equal shares of the rice provided to the GOTG . . . . The rice will be sold in minimum lots of 500 metric tons by the GOTG at a price which includes its documented handling and storage costs.

Setting Procedures for the First Rice Sales: Discussion of Auctions and Tenders

Within the GOTG, the organization charged with the implementation of the P.L. 480 sales process was the Ministry of Finance and Trade (MOFT). The Ministry of Agriculture has not been involved to any extent, and the previously dominant agricultural parastatal, the GPMB, has participated only as a storage agent for some of the rice before sales (with very poor results).

The minutes of a meeting between the GOTG, represented by the MOFT, and USAID, in October 1986, provide insight into the early implementation of the sales procedures. A group of the concerned parties, including representatives from USAID, the MOFT, the Attorney General's office, the Central Bank, and other government agencies, formed the P.L. 480 Program Coordinating Committee. The MOFT, the Attorney General's office, and USAID formed the nucleus of the group, which also constituted the ministerial-level Tender Board during later sales, once auctions and tenders had been established.

A shipment of approximately 6,470 metric tons of rice was expected in early November, 1986. The MOFT, noting that the P.L. 480 program design specified 5,000 metric tons to be initially used as a stabilization "working reserve stock," also pointed out that at the moment the government only had the capacity to manage storage for 4,000 metric tons. So it requested that the balance of the first shipment be sold to the private sector.

The MOFT indicated that it would announce immediately that 2,470 metric tons of rice was available and that all interested merchants should submit bids; then the GOTG Tender Board would accept and evaluate all bids and make recommendations to the Minister as to who should get certain quantities and at what price. The MOFT technical advisor noted that although the TA stipulates that only licensed buyers active in the rice trade are eligible to bid, since July 3, 1985, there has been no license requirement for Gambian rice importers.

Given that the trade was now open to anyone, the MOFT questioned the need for a minimum bid of 500 metric tons (as specified in the TA). It expressed a preference to lower that minimum to 100 metric tons to give small businessmen the opportunity to buy and sell some rice, and not thus

27
15

confine the sales only to larger entrepreneurs. USAID agreed that it would be appropriate to lower the amount in order to involve more small businesses in the trade, and it indicated that this modification would be included in a memo of understanding between the MOFT and USAID.

The First Tender Sales: November/December 1986

The original announcement (designed by the MOFT without USAID input) requesting bids was read over Radio Gambia several times daily from October 29 to November 5, in English, Wolof, Mandinka, and other local languages. The announcement specified minimum lots of 100 metric tons of no. 5 20-percent broken U.S. rice, due to arrive in The Gambia on or about November 8, with successful tenderers to be prepared to take delivery of the rice from the ship. The deadline was set at close of business (4 p.m.) on November 5. No mention was made of the payment terms or of the restriction that the rice was for sale and consumption only in The Gambia, with re-export prohibited.

The bids were opened by the USAID/GOTG Tender Board committee on November 6 — four sealed bids submitted on time and one submitted late but accepted anyway. Three bidders bid for the total shipment amount — 2,470 metric tons — at prices ranging from 1,314 dalasis/metric ton to 1,800 dalasis/metric ton. One bidder bid for 1,000 metric tons at 1,400 dalasis/metric ton, and one for 150 metric tons at 1,600 dalasis/metric ton.

Discussion then commenced on the allocation of rice to the bidders, given that all bids were above the f.o.b. price equivalent in dalasis — 1,286 dalasis/metric ton — which is the effective reserve or floor price. (This was the amount the GOTG was contractually bound to pay for the rice.) USAID pointed out that different objectives would require different management strategies — i.e. maximizing revenue by selling as much as possible to the highest bidder(s) versus ensuring some equity in distribution by allocating portions of rice to all bidders. The MOFT representative and the HIID adviser argued that selling shares to different traders at different prices would "undercut" the traders who bid high because they would have to keep their resale price high in order to recover costs. They felt that the rice should be sold at only one price. Furthermore, they felt that since the GOTG objective was to maximize government revenues, it should accept the highest bid and sell all 2,470 metric tons to that high bidder.

On November 12, USAID informed the MOFT that the ETA for the rice was delayed to December 3; the MOFT felt that this might necessitate another auction to replace the November 6 one, because market conditions (prices and quantities available) would probably have changed by December 3. Also, the MOFT pointed out that the winning bidder of the November 6

28

16

tender did not have the money to pay for all the rice he bid for, and the next highest bidder had bid for only 150 metric tons.

The GOTG and USAID agreed on the importance of stressing in future auction announcements and resultant contracts that the USAID rice was for sales and consumption in the Gambia only. This issue was not stressed in the first announcement, and the GOTG had resisted it because they did not want to raise the politically explosive "re-export" question.

On November 18, the MOFT and USAID decided to re-auction the 2,470 metric tons of rice, since the original winning bidder could not pay for the rice and also because the market conditions had indeed changed. Announcements for the new auction began on Radio Gambia November 18, with a deadline for bids of November 28. This time the announcement included a caution about sale and consumption only in The Gambia, and it specified that there would be no credit arrangements for sales.

On December 3, the Tender Board met to open and consider bids. Five bids had been submitted, of which one was disqualified because it was for a quantity under the minimum 100 metric tons. Three bidders were awarded rice — the top bidder got 500 metric tons at 1600 dalasis/metric ton; and the next two, having bid identical prices of 1,500 dalasis/metric ton, were allocated equal shares of the remaining rice — 985 metric tons each — for a total of 2,470 metric tons. In the end, bidder number three ended up buying 432.5 metric tons of bidder number one's allotment of 500 metric tons, because bidder number one could only pay for 67.5 metric tons of his allotment.

Sale of Sweepings and Broken Bags: January 1987

This was the Tender Board's first experience with disposal of broken bags and rice sweepings. Information was not announced publicly regarding the availability of the sweepings; rather, one of the successful bidders from the December tender sale knew that there was rice remaining, and he and another merchant both submitted requests to the MOFT, proposing a price of 800 dalasis/metric ton. Both were allocated 40 metric tons of rice. (Note: One of the successful bidders later served as auctioneer for the 1989 open cry public auction of degraded rice for animal feed.)

Documenting the Sales Procedures: Memorandum of Understanding, February 2, 1987

In February, the GOTG and OAR/Banjul signed a Memorandum of Understanding specifying in greater detail certain issues in the TA of 1986. It is interesting that although the GOTG had already conducted three sales using auction/tender procedures by this date, the Memorandum of Understanding still uses the original TA language regarding specified eligible traders, and then it refers to sealed bid procedures "contained in the TA" — but there is no discussion of sealed bids in the TA. (Note that the evaluation of the P.L. 480 program conducted in April 1988 points out that this Memorandum of Understanding was never cleared through A.I.D./Washington or REDSO/WCA, and thus it is not an officially binding policy/program agreement.)

Pertinent sections of this memorandum help to illustrate the evolution of the program procedures:

"1. Distribution plan (for first shipment due in Nov-Dec 1986).

MOFT announces designation of eligible traders — that is, those private traders, plus the NTC, previously active in the commercial rice trade.

Within two weeks of confirmation of arrival date, the MOFT announces the date for the opening of rice sales period, as well as the sales arrangements.

On date announced, MOFT commences sales according to sealed bid procedure in line with provisions contained in the Transfer Authorization."

"4. Covenants.

The GOTG and USAID/Banjul further agree that:

b) The GOTG and USAID will jointly establish the mechanism for managing rice sales to private merchants, to include:

1) a list of eligible traders, and
2) bidding process for eligible traders."

Taking into account the fact that this document never became formally binding, it is still interesting to note that the language in Covenant 4 about eligible traders remained in the Memorandum <u>even though</u> the issue of developing a list of eligible traders had been abandoned during the discussions preceding the December 1986 auction.

Tender Bid Sales: April 1987

There is no memo in USAID files that discusses this auction, but the MOFT minutes from the Tender Board meeting are available. The discussion (which preceded the opening of the 59 sealed bids for the 2,000 metric tons of rice available) included suggestions as to the criteria to be used for

18

choosing the winners. The criteria mentioned included "ability to pay," "offer price should help bring the current price down in the market," and "bidder should be one currently involved in rice trade."

After the bids were opened, six were disqualified because they had bid for less than the minimum 100 metric tons, and the other bids were categorized based on the above-mentioned criteria. There then ensued a lengthy discussion on whether the Board should "sell exclusively to those in a particular category." Eventually it was resolved that they would sell the rice to the highest bidder with a maximum of 200 metric tons. The top 13 bidders were thus allocated between 100 and 200 metric tons of rice, at their bid price, and a list of the next 9 highest bidders was drawn up as an alternate list.

In the end, however, there were 10 successful bidders who actually bought rice — each got only 100 metric tons, and they paid the prices that they had originally bid, which ranged from 90 dalasis/bag (1,800 dalasis/metric ton) to 105 dalasis/bag (2,100 dalasis/metric ton).

Note that one of the successful bidders was once again the trader who later served as auctioneer for the 1989 open cry public auction of degraded rice for animal feed. (The Auctions Act, as passed and amended by Parliament, specifies that no auctioneer nor his/her agents may legally participate in an auction conducted by that auctioneer, but no restriction is made on their participation in other tenders or auctions sponsored by the same governmental organization.)

Tender Bid Sales: August 1987

As usual, the government released an announcement soliciting bids, but The MOFT inserted two additional prerequisites for successful bidders. (1) bids must be accompanied by a document of business registration, and (2) bids must be accompanied by a tax certificate. This is the first time, after the initial 1986 discussions over licenses and eligibility, that the Tender Board (or, in this case, the GOTG) initiated restrictive parameters designed to screen bidders.

Forty bidders submitted bids, with prices ranging from 73 dalasis/50-kilogram bag to 100 dalasis/50-kilogram bag, but of the seven high bidders (who all bid 100 dalasis/bag), the MOFT ruled upon opening the bids that only four had submitted the required documentation with their bids. Upon opening the bids on August 20, the committee decided that, rather than split the 2,000 bags (100 metric tons), they would allocate all four bidders 2,000 bags <u>each</u> (given the need to move some of the other USAID rice in storage), thus quadrupling the total quantity sold.

On August 21 an emergency follow-up meeting was held because the MOFT found a misinterpretation of the two conditions specified in the announcement. In fact, the exact documents requested had been an "Income Tax Clearance Certificate" and a "Business Certificate" — and none of the initial four winners had submitted those documents. Re-examining all 40 submissions, the committee found only 5 with the appropriate documents, and the highest bidder of those 5 was awarded all 100 metric tons (2,000 bags) at his price of 96 dalasis/bag (1,920 dalasis/metric ton).

These confusions resulted in a lively committee discussion about the necessity for, on the desirability of, adding more conditions to the submission of a tender bid. The MOFT had added the requirement for additional documents to emphasize to the merchants that if they wanted to do business with the government, they had to pay their taxes. But USAID pointed out that the objective of the program was to increase involvement of the private sector in the rice trade, not to police income tax payments. It was agreed that these requirements should not be included in any future rice auctions: instead, any merchant doing business in The Gambia should be allowed to bid.

Tender Bid Sales: September 1987

Bids were opened on September 14. Before opening the bids, the committee discussed how the rice should be awarded, agreeing to award it to the highest bidder in order to maximize government earnings. The suggestion was made that in order also to maximize competition among the merchants, the committee could consider dividing up the 2,800 metric tons among the top bidders, and the committee agreed that, depending on how the bids were clustered, every effort would be made to ensure that several merchants received rice.

A total of 78 bids were submitted, and 1 was disqualified because it was actually for another GOTG project. Each member of the Tender Board was given 11 envelopes to open and to record the pertinent information — price, quantity, name of bidder, and address. Prices ranged from 70 dalasis/bag to 107 dalasis/bag: the minimum amount requested was 25 metric tons and the maximum was the full 2,800 metric tons. Thirteen merchants had bids clustering at the top of the range, 105-107 dalasis/bag. Some of those bidders had requested only 100 metric tons, and so they were allocated that amount, while those who had requested more received either 150 metric tons (for those who had bid 105 dalasis/bag) or 500 metric tons (for those who had bid 106 dalasis/bag). (Note: There were three women among this winning group of 13.)

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Tender Bid Sales: March 1988

The Tender Board met on March 8 to open bids for 3,870 metric tons of rice. Before opening bids, the committee discussed problems encountered to date with the bidding process, i.e., bounced personal checks. Agreement was reached that buyers who were known to the Tender Board because of successful bids or executed sales in the past would be allowed to use personal checks, but new buyers would be required to use a certified bank check or cash for payment.

The 259 bids were opened. They were divided among the members of the committee, who were instructed to number them; to record the price, number, and quantity; and to rank them. (Note: This was the first instance of the Tender Board instituting the numbering process, which they would continue to use. They felt it would prevent favoritism in the final allocation of quantities since the Board would be looking at a list of bidder numbers, not names.) The top 5 bids from each pile were then used to assemble the list of top bidders, resulting in 13 bidders who had offered prices ranging from 120 dalasis/bag to 135 dalasis/bag.

The total quantity demanded just by these 13 top bidders was 10,800 metric tons. To "ensure that no one merchant corners the rice market," to ensure wide distribution, the committee decided to limit the maximum amount per trader to 1,000 metric tons even though the fourth highest bidder had bid for 2,000 metric tons. To ensure wide distribution, the committee also agreed that all bidders over 120 dalasis/bag (thus, the above-mentioned 13) should receive at least some rice. Bidders who offered 120 dalasis/bag were allocated 100 metric tons each, regardless of amount demanded. Bidders above 120 dalasis/bag received their amount requested, up to the ceiling of 1,000 metric tons. The 20 metric tons left after this allocation process was done was added to the allotment of the Gambia Cooperatives Union (GCU), because the committee felt that since GCU has an extensive distribution network up-country, "more rice would end up in the remote areas."

The committee also prepared plans in case any of the successful bidders was unable to pay for his/her rice — their allotment would then be offered to those merchants who had bid for larger quantities than they received, in descending order of price offered. This strategy for alternate winner selection differs from that used in earlier and later auctions, where the rice was offered in succession to those whose bids were just below the cut-off point.

Tender Bid Sales: September 1988

Bids were opened at the Tender Board meeting of September 12. A total of 408 bids were submitted. They were opened and ranked by price and quantity demanded. Then the list of top bidders was developed.

The committee agreed that 500 metric tons would be the maximum for any one bidder, and that all bidders must pay by cash or certified bank check, with a deadline of three days to pay and take delivery of the rice. Any rice not taken by a bidder within the allotted three days would be offered to those on the alternate list. (Note the difference in alternate selection strategy from the March 1988 auction described above.)

There were 13 successful bidders on the top list, and each received his/her request, up to 500 metric tons, at the price they offered. The price range of these 13 successful bids was 145-165 dalasis/bag. A very interesting by-product of the dramatically increased participation rate is demonstrated when we examine the list of bidders for this auction. The bidders' list reveals that there were at least five merchants who bid multiple times at different prices in their own names, in addition to an undetermined number who by this stage had begun using agents to front for them in order to hedge their bids with other lower and higher offers.

On September 16 the USAID Representative and the Minister of Finance had a telephone conversation in which the Minister expressed grave reservations about selling rice for up to 165 dalasis/bag when the retail price was around 135 dalasis/bag. He did not make the distinction between the higher quality USAID long-grain rice and the Thai/Burmese 100-percent broken rice at retail. In spite of USAID insistence that selling at administered prices would violate the TA, the MOFT implemented a sales process whereby the 160 bidders who had bid above 130 dalasis/bag were each to receive 20 metric tons (thus also violating the TA provision for minimum lots of 100 metric tons).

In the end, the MOFT was required by USAID to make up the difference in revenues that were forgone because of the Ministry's decision to change the sales procedures. (The difference in revenue was 1,430,000 dalasis, almost $204,000 at the prevalent exchange rate.)

Tender Bid Sales: March 1989 (bids opened) —
May 1989 (sales completed)

A radio announcement was made between February 25 and March 2 (complicated a bit by the fact that the MOFT named the wrong month in the announcement, citing May instead of March!) The MOFT reported to USAID that "interested parties" were informed that payment terms would be in cash or certified check, one week after notification of winning, and that the rice was only for sale and consumption in The Gambia. However, the press release did not specify the one-week timeframe, only the payment terms.

In fact, to date not one of the announcements of tenders has given advance notice regarding the deadline that would be imposed for payment and delivery. Although the Tender Board's case-by-case decisions on auction parameters have resulted in an evolution of general auction policy, these refined principles have not been documented in written form, formalized by the two governments, or broadcast to the bidding public.

The Tender Board met on March 2 to open bids for an estimated of 3,000 metric tons of rice. (Note: The day before the opening of the bids, it had been noted that a GOTG/USAID inspection of the rice stocks stored at the GPMB warehouses found that some undetermined amount of the stocks had degraded to the point that they were probably unfit for human consumption. USAID requested the Ministry of Health (MOH) to inspect and determine which bags were fit only for animal feed. The rest would be auctioned.)

A total of 309 bids were received, with prices ranging from 125 dalasis/bag to 165 dalasis/bag. Quantities requested ranged from 50 metric tons (disqualified because the minimum lot was 100 metric tons) to 4,000 metric tons. Once all the bids were tabulated, discussion began on whether the Board should set a maximum price to try to keep retail prices down. Some members argued strongly that it was essential to try to keep prices down, while others argued that the program purpose was to generate as much revenue as possible for the government. These members also pointed out that the revenues that would be lost from not accepting the highest bid prices would not be balanced by any gains from lower retail prices, since there are no price control implemented at the retail level anymore, and thus traders would sell at whatever price the market would bear.

The USAID representative reminded the MOFT that the last time they sold auction stock at administered prices, the GOTG had to reimburse the rice sales proceeds account for over 1 million dalasis in lost revenues. Other board members pointed out that artificially low prices for the tendered rice would increase the margin available for traders who might try to re-export that rice to Senegal and that those re-exports were to be avoided.

In the end, the committee decided "to try to maximize revenues by selling to the highest bidders, and try to sell to as many bidders as possible to avoid market monopoly by a few of the bidders, and that bidders on the reserve list would pay the prices they originally offered." The top 25 bids ranged from 165 to 145 dalasis/bag, and the 10 alternates' bids ranged from 145 dalasis/bag to 140 dalasis/bag. Each of the 25 winning bidders was allocated 100 metric tons and given a deadline of one week to pay by cash or certified bank check and pick up their rice.

Because of the forfeiture of numerous winning bidders (much of which was due to the uncertain quality of the rice), the MOFT had to go through four iterations of replacing winners with alternates — listing them in the press and on the radio and giving them one week to pay, a process that lasted until May 12, 1989. Only 1,000 metric tons was ultimately taken by these bidders, as this rice had continued to degrade during the intervening two and one half months since USAID first noted to the MOH that it was in bad shape.

Public Outcry Auction: May 1989

On May 9, 1989, a joint GOTG-USAID inspection decided that the remaining rice was unfit for human consumption and should be auctioned as animal feed as soon as possible. A radio announcement set Monday May 15 as the day for a series of public open outcry auctions at five storage locations.

Note that during the three months that this stock had been in question, the MOFT and USAID had been trying to get the MOH to formally inspect and rule on these stocks, but the MOH did not intervene until the actual moment of the auction, and then there was a disagreement on the ruling.

The highest among five bidders won a total of 19,000 50-kilogram bags. Total bids were for 21,000 bags (1,050 metric tons, only one third of the total weight of degraded rice) for a total sum of 1,245,000 dalasis. The auctioneer was paid a commission of 3 percent of total sales proceeds, which would amount to between 36,900 and 37,350 dalasis.

Amending the Official Program Documentation:
Transfer Authorization Amendment No. 1

The evaluation of the P.L. 480 program conducted in April 1988 recommended changes in the TA, which were formalized in May 1989 with Amendment No. 1. These changes had the effect of formalizing the procedure that had been used in 1987 and 1988.

> Rice Sales and Distribution: The GOTG will agree with A.I.D. on the time and amount of rice for each sale. All rice will be sold by sealed tender bidding procedures normally used by the GOTG. Only private merchants operating in The Gambia will be eligible to bid for the rice offered for sale. Sales will be in minimum lots of 100 metric tons, and to be paid for in Dalasis. The GOTG-A.I.D. Intergovernmental Steering Committee for the P.L. 480 program will open all sealed tender bids and award the bids to the highest bidders, while also ensuring that there is equitable distribution of the rice for sale among the highest bidders so as to avoid any monopoly over the rice being supplied under this

program. Merchants awarded rice must make total payment in cash or with a bank check before they can take possession of the rice. A list of alternates will be drawn up at the time each sale is made, and if any merchant who has been awarded rice cannot pay for it, the rice will be offered to the bidders on the list of alternates at their bid prices.

Tender Bid Sales: June 1989

The Board discussed the problem of bidders not always coming forward to make payment. Informally they agreed that one way to address the matter was to require bidders to make an advance deposit, perhaps 1,000 dalasis ($140), which would be nonrefundable if a bid was accepted and the bidder did not make payment. For non-accepted bids, the deposit would be refunded and for accepted bids it would count against the total amount due.

One Board member also suggested requiring bidders to use the official tender forms for which there would be a small fee (the GOTG currently requires this when government contracts are put up for tender). Although the minutes indicate that the Board agreed on some of these issues, no written rules formalized these decisions regarding prequalification measures.

The USAID program economist noted that, under current practices, bidders have an incentive to work in partnership with others, make multiple bids, and only make payment on the lowest one. Charging a fee for each bid would help cut down on multiple or spurious bids, and instituting a deposit that would be forfeited if payment is not made would cut down on the problem of individuals reneging on bids. At this point in the evolution of the auctions, it seemed that sufficient participation and competition had been developed among the private sector rice traders and that there were efficiency gains that could be made by tightening the parameters.

A total of 281 bids were opened. The bids accepted ranged in price from a high of 145 dalasis/bag to a low of 137 dalasis/bag, submitted for quantities ranging from 300 metric tons to 100 metric tons. The bidders with the lowest prices, 137 dalasis/bag, were allocated only 100 metric tons regardless of quantity demanded. All other bidders who had offered higher prices were allocated the amount they asked for.

A reserve list was made up of those bidders who had offered 136 and 135 dalasis/bag, to serve as alternates in case of defaults among the winners. The Board agreed that cash and certified checks would be the only acceptable forms of payment and that the deadline would be one week. Once again, a pattern had developed demonstrating Board consensus on the parameter of payment terms and deadlines, and yet this consensus was not formalized or published.

Public Outcry Auction: July 1989

A public outcry auction was held on July 13 to clear Customs Shed No. 3 of the remaining loose bags and sweepings of rice. The Auctioneer received a commission of 2 percent of total proceeds on the estimated quantity of 550 metric tons. The auction was announced on Radio Gambia on July 11 and 12. The terms specified included payment in cash or by certified check and immediate delivery to be taken upon payment.

The initial winner had bid a total offer of 1,397,000 dalasis, but he did not pay in time, so it went to the next-highest bidder for 1,395,000, who also defaulted. Then it went to the third-highest bidder who had bid 1,390,000, who ultimately also defaulted.

Finally, another public outcry auction was held July 31, with the winning bidder offering 665,600 dalasis for the 550 metric tons. He was required to place an immediate deposit for the rice, and he was given two days to pay by cash or certified check and take the rice. This is the first example of a mandatory deposit, and the decision was made not at the Tender Board Level, but by agreement between the MOFT P.L. 480 Desk Officer and the USAID Program Analyst, due to the very difficult circumstances surrounding the disposal of this rice.

Improving the Process: Discussion on Lessons Learned

Discussions between the USAID Program Analyst and the MOFT P.L. 480 Desk Officer after the May and July 1989 auctions centered on the recent manipulations of the tender bid process, and it was agreed that the lack of a requirement for a deposit from the merchants making bids was part of the problem. To combat this problem, they agreed (as reported in meeting minutes) that, in the future, all merchants submitting a tender bid for the food aid rice must submit a deposit of about 5,000 dalasis in the form of a certified bank check. The checks would be kept by the MOFT and applied towards the winning bidders' final payment due. For all bidders who did not win any rice, their checks would be returned once the process was complete (i.e., all rice was sold). However, any merchant who made a winning bid and then defaulted would forfeit that deposit. The MOFT representative noted that under Gambian law, the GOTG could take these bidders to court for violation of contract.

The minutes from this meeting did not indicate whether these suggestions and decisions would be formalized and documented. The MOFT staff member reported that this was an agreement in principle, but he stressed that all action decisions must be made at the Board level and that, indeed, the MOFT position is that specific requirements/conditions should be formalized by another amendment to the TA.

Legal and Contractual Aspects of the Auctions

In contract law, the essential elements that result in a contract (whether written or verbal) include an offer, an acceptance, specified consideration (payment terms), and "a meeting of the minds" (agreement between both parties on the terms and conditions implicit or explicit in the offer and the acceptance). In cases like the tenders described earlier, the lack of specificity in the invitation to bid leaves the government open to disagreement with the successful bidders as to the terms of the contract, thus endangering the contract's solidity.

In The Gambia, the solicitation of bids is considered not an offer to sell, but rather a request for offers to buy. Thus, the GOTG is in a position to issue acceptances, which it has traditionally done by letter. If the offering bid and the accepting letter were both clear and explicitly detailed regarding terms, then, under Gambian law, a contract is joined. Should the buyer renege at this point, in violation of the terms of the contract, he or she might be taken to civil court in Banjul, although some interpreters say that it might still be necessary to get a signed contract before a successful suit can be pled. In any case, the GOTG has not yet taken anyone to court for non-completion of a bid to purchase rice.

From the legal perspective, it is desirable that the announcement of invitation to bid specify as many details and parameters as possible, whether by listing them explicitly or by referring to a specific law or ministerial regulation that is also freely available to the public.

Pertinent Gambian laws and regulations include:

1. The Auction Acts, as passed and amended by Parliament, which define the parameters and requirements for public outcry auctions

2. The Tender and Auction Regulations from the MOFT, which specify the composition and responsibilities of the Major Tender Board and Minor Tender Board, and provide for the creation of various Ministerial Tender Boards for project implementation (of which the P.L. 480 Committee/Tender Board is one)

Annex A-1 provides a detailed summary and presentation of these laws.

Other Planned Uses of Auction Mechanisms

The auctions and tenders conducted by USAID and the GOTG under the Title II program have provoked interest in other donor suppliers and distributors of food commodities. The UNDP reports that Italian and World Food Program commodities are beginning to be brought in for tender sale through the MOFT, using the USAID rice auctions as a model. Moreover, the Country Director for Catholic Relief Services (CRS) has decided to use a tender process to monetize 700 metric tons of U.S. Title II rice during 1990 in order to cover the in-country costs of their maternal and child health project. The study team provided preliminary guidelines and comments on possible tender designs for CRS while in the field in September 1989.

Results of Gambian Auctions

As we have seen in the preceding chronology of experience, the program's evolution has raised awareness of the impacts of procedures and processes on the sometimes conflicting objectives of the rice sales — maximizing revenues, maximizing participation, reinforcing efficient private sector operations, and moderating retail price swings. This three-year experiment has also demonstrated how the rules, terms, and prequalification procedures for an auction or tender process will have a large and immediate impact on the results as measured against the program's objectives.

This program is a unique case within the admittedly small portfolio of Africa USAID Missions that have experimented with auctions and tenders, in that The Gambia has conducted both tender bid sales and open outcry auctions and it has succeeded in selling all but 80 metric tons of its commodity through these two auction mechanisms. Although some auctions were better organized and administered than others, the only serious anomaly was the result of last-minute government interference motivated by fear of high retail prices. Table A-1 presents a summary of the Gambian auction experience.

Impact on the Food Market

The program's designers postulated that one way for the program to benefit the neediest members of Gambian society would be by exerting a downward pressure on rice prices through the increased supply of the commodity. In fact, however, the program has been implemented during a period when world rice prices had declined sharply. This global trend overwhelmed any localized effects that the liberalization of the rice trade might have had on the Gambian economy. The PAAD suggested that the program would also "have the effect of curtailing the rice re-export trade

40

TABLE A-1: Summary of P.L. 480 Rice Auctions in The Gambia

Date	Type of Sale	# of Bidders	Quantity for Sale	# of Winners	Comments
Nov/Dec 1986	tender	5	2470 MT	3	Tender was launched while rice was en route from Gulf port. Original tender was annulled because top bidder defaulted and rice arrival was delayed. Top 3 bidders won in 2nd round.
Jan 1987	admin sale	2	80 MT	2	Sale at announced price of 800 d/MT for loose bags and sweepings (two purchasers each received 40 MT).
April 1987	tender	59	1000 MT	10	2000 MT were originally allocated for sales, and bids were received for far more than 2000 MT; the ultimate decision to sell only 1000 MT was not explained in the Board minutes.
August 1987	tender	40	100 MT	1	MOFT had imposed two prequalification requirements (tax docs etc.); eventually allocated rice to top bidder of those who had submitted the necessary docs, but then eliminated req.
Sept 1987	tender	78	2800 MT	13	Entire 2800 MT awarded to top thirteen bidders; top bidders rec'd the quantity they requested up to a ceiling of 500 MT.
March 1988	tender	259	3870 MT	13	Very active participation -- top 13 bidders requested over 10,000 MT; imposed ceiling of 1000 MT for top 3 bidders; other winners allocated 100 MT each to widen distribution.
Sept 1988	tender	408	3000 MT	160	MOFT interfered with the auction after the bids were opened and allocations made; they decreed that the top 160 bidders would each get 20 MT at 130 d/bag, for a total of 3200 MT.
March 1989	tender	309	3000 MT	25	Much stock had degraded during poor storage by GPMB, and even after four rounds of alternate winners only 1000 MT was actually sold and finally taken.
May 1989	outcry	?	3369 MT	2	Most of this grain was left over from the unsuccessful March 1988 tender; it had degraded even further and was finally sold at the outcry auction for animal feed.
June 1989	tender	281	4000 MT	25	Winning bidders at the low end of bid price range rec'd only 100 MT each; top bidders received amount requested.
July 1989	outcry	?	550 MT	1	Two outcry auctions were actually held, because the top three bidders in the first round tried to manipulate the process and ended up not buying the grain at the prices they offered. In the second round, the Board required a bid deposit before awards were made, and the rice was finally paid for and collected.

NOTE: The "Comments" section illustrates the case-by-case decisionmaking process used to allocate quantities and balance objectives.

with Senegal," because the program would support The Gambia's commitment to free market pricing even if the world price rose sharply. However, no one foresaw the sharp decline in world rice prices along with Senegal's commitment to higher rice import tariffs.

The largest quantities of P.L. 480 II-206 rice were sold in December 1986, September 1987, March 1988, September 1988, March-May 1989, and June 1989. Preliminary analysis by USAID economists indicates that the 1987 sales "may have had some ameliorating effect on prices, in that a period of stable prices may have been prolonged" in contrast to the same time period in 1986, when prices rose.

Traders who deal in imported rice stated that their decisions on the quantities and timing of commercial imports would be better informed if they knew the approximate timing of food aid auctions, because they could treat those auctions as another supply source and plan ahead.

Impact on Government Operations

Taken overall, the Gambian P.L. 480 auctions and tenders have proven to be an effective and innovative way to generate local currency revenues for GOTG/USAID uses and simultaneously to increase the participation of and competition among private sector merchants.

Participants at different levels of the system suggested changes that they felt could improve the auction and tender process, but generally all expressed satisfaction with the administrative mechanisms used. Specific problems that surfaced during the evolution of the auction/tender program, and possible solutions, are discussed in the final section of this case study.

Defining Objectives: Choosing an Auction Management Strategy

There are four objectives that have been presented at different times as the "purpose" of The Gambia's P.L. 480 program — maximizing government revenues from sales, maximizing competition and participation by private traders, reinforcing private sector mechanisms, and moderating retail price swings. Other possible objectives for a future program include maximizing the transparency and legitimacy of government sales operations and facilitating the shift from parastatal control to market conditions.

From the GOTG perspective, the critically important generation of local currency revenues was balanced with the desire to restrain retail prices and prevent monopoly control of the commercial rice trade. From the donor perspective, USAID focuses on efficient allocation of the commodity to the private sector at market-determined prices. Among all these objectives, only the goal of reinforcing private sector mechanisms is explicitly stated in the PAAD or the TA, the two binding program documents. In practice, representatives of the GOTG and OAR/Banjul, along with the other Tender Board members, have repeatedly invoked differing (and sometimes conflicting) objectives during their debates.

Measuring the Trade-offs

Because different objectives required conflicting procedures or rules, the Tender Board was forced to make decisions (whether explicitly or by default) on ways to balance the goals, compromising one objective in favor of the other. Implicit in the Tender Board debates, as well as the evolution of auction parameters and policy that resulted, was a calculation of benefits and costs associated with the different objectives and a willingness to sacrifice some portion of one goal for another.

For example, the Tender Board's decision to impose a maximum lot size of 1,000 metric tons for the March 1988 auction resulted in 42,000 dalasis in forgone revenues ($5,250), balanced by a greater dispersion of rice among more winning bidders. Another decision in the September 1987 auction also resulted in lower total revenues, although incomplete bidders' lists do not permit us to calculate the total amount of revenues sacrificed.

Similarly, the MOFT decision to annul the auction results in September 1988 and to sell all 3,200 metric tons at an administered price resulted in 1,430,000 dalasis in lost revenue (an amount that the government was ultimately required to transfer into the sales proceeds account from revenue sources). That decision represented an attempted trade-off between maximizing government revenues and moderating consumer/retail price swings, although it is very unlikely that the traders who received the rice at the low administered price turned around and sold it at a correspondingly low retail price when the market prices were already high. In each of these cases, the Tender Board decision, although rarely unanimous, expressed a trade-off with specific financial consequences.

Problems and Possible Solutions

The implementation of public auctions and tender bid sales of food aid rice in The Gambia ran into problems in the following areas:

- Quality of grain after long storage. While the USAID rice is generally considered to be of consistently high quality, sales of over 3,500 metric tons of rice in 1989 were undermined by the GPMB's extremely poor fumigation and storage management practices.

- Specification of auction rules and selection of winners. Only half of the parameters for the tenders/auction sales were publicized when the invitation to bid was announced. The other rules were debated and decided on a case-by-case basis, compromising the transparency of the bid process. (Table A-2 presents the parameters that must be defined by policymakers.)

- Extremely high participation. Ironically, the openness and frequency of the auctions resulted in a dramatic increase in participation and a subsequent increase in the administrative costs and delays of tender sales.

- Manipulation of tenders by bidders. As traders became comfortable with the system of tenders and as participation increased dramatically, the lack of clear, specific, public rules left the process open to collusion, multiple bidding, defaults, and other gaming behavior.

- Lack of prequalification. The failure to screen out non-serious bidders undermined the confidence of more serous traders, and it resulted in substantial administrative costs to the GOTG. The imposition of a relatively high minimum lot size (100 metric tons) meant that smaller bidders, not non-serious bidders, were eliminated.

To the credit of the GOTG and USAID, the procedure used to date in The Gambia has been flexible, and it has allowed USAID and the GOTG to learn through the implementation process. However, it has not created a consistent, stable environment for the auction sales, and a more explicit statement of rules and parameters could have eliminated some of the superfluous and disruptive bidding behavior.

Now that the Gambia's auctions have evolved and engendered active participation among the private merchants, the GOTG and USAID can "afford" to tighten the procedures used and formalize some of the processes, to support legitimate bidding behavior and discourage defaults.

Should the decision be made to design and implement another multi-year Title II Section 206 program, the following actions might improve the auction and tender process:

- Define and prioritize the program's objectives as explicitly as possible in the language of the Transfer Authorization. When two objectives are expected to conflict with each

44

Table A-2. A Checklist of Auction Parameters

This list specifies the parameters which define the potential transaction between the government and the private rice merchant. Only the entries with stars in the left margin have been specified in the announcements used to date in The Gambia.

* * Announcement of a solicitation of bids (which is a <u>request</u> for offers to buy)
* * Deadline for bids — time, date, location
* * Identity and authority of seller — agency, unit, relevant program
* * Type of commodity, origin, current location or estimated arrival time and place
* * Quantity specification — minimum and/or maximum lot size
* * Quality specifications — grade and standard
* Availability of samples and procedures for obtaining/viewing them
* Eligibility criteria — licenses or certificate required, limited to certain classes or categories defined in law
* Prequalification requirements — fee for purchase of tender documents, bid bond or deposit required upon submission (fixed amount or percentage of total value of bid)
* * Payment terms — cash, personal or company check, certified check or bank draft, credit terms, etc.; performance bond required
* Deadline for acceptance/payment/taking delivery, and specific moment from which that deadline is calculated
* Notification terms — length of time bidder is required to keep offer open, method and timing of notification of winners
* Disclaimer clauses, i.e., reserving right to allocate any quantity above the minimum lot up to the maximum
* * Restrictions on conditions of resale

other, select a flexible mechanism for balancing the two goals, and express the trade-off clearly before the auction or tender is started.

- Select the terms and rules most appropriate for achieving the desired objective(s), taking into consideration the legal and socio-contractual context of the country's economy. Make these rules as clear and explicit as possible.

- Communicate the rules and terms in detail, either through much more detailed invitations to bid, or by developing an MOFT regulation, available to the public, that specifies certain standard terms for P.L. 480 tenders. (Table A-3 presents a sample improved tender announcement that provides more of the required details than the announcements currently in use. A sample of the current announcement style is also attached.)

Table A-3. An Improved Tender Ammouncement

To: Director of Information and Broadcasting, Radio Gambia

Please assist us by announcing the following public notice in English, Wolof, and Mandinka, as often as possible (no less than twice daily), between ______ and ______ 1989.

The Government of The Gambia invites tenders from interested individuals and companies for the purchase of ______ metric tons of rice supplied by the United States Agency for International Development. The rice is sold exclusively for sale and consumption in The Gambia.

The rice is grade ____, ____ percent broken, packed in 50-kg bags, and is currently stored at __________ warehouse. Samples may be inspected at that location between ____ a.m. and ____ p.m., Monday through Thursday.

The minimum lot sold will be 50 metric tons (1000 bags); potential buyers may submit tenders for multiple lots. The Government reserves the right to award any quantity between the minimum lot and the amount requested by successful tenderers.

The Government is not bound to accept the highest or any tender.

Sealed tenders marked Tender for P.L. 480 Rice will be accepted by The Secretary, P.L. 480 Coordinating Committee, Ministry of Finance and Trade, The Quadrangle, Banjul, during normal business hours, up to ________(day/date) at ________(time) p.m. All tenders must be accompanied by a bid deposit of __________ dalasis, payable in cash or certified check.

Successful tenderers will be notified by certified letter sent by the Ministry of Finance to the address listed on the tender submission. A list of alternates will be drawn up at the moment when winners are determined, in case of default by successful tenderers.

Unsuccessful tenderers will have their bid deposits refunded no later than three days after the tender is closed (i.e., all rice has been allocated and purchased) or 30 days, whichever comes first. Bidders are required to keep their offers open for 30 days from the date of submission.

Potential buyers are hereby informed that the rice will not be sold on credit. Successful tenderers must be prepared to make full payment by cash, certified check, or bank draft, at the Treasury. The tenderer's bid deposit will be applied toward the full purchase amount. Payment must be made within seven days of the date on the notification letter, or the tenderer will forfeit the bid deposit and surrender the right to purchase rice.

Successful tenderers should be prepared to take delivery of the rice not less than 48 hours after concluding full cash payment as specified above. Purchasers must show their Treasury payment receipt to the warehouse manager before taking delivery of the rice.

By a copy of this memo, the P.L. 480 Coordinating Committee is invited to the bid opening session on __________ at _______ a.m.

ANNEX A-1: GAMBIAN LAWS AND REGULATIONS AFFECTING AUCTIONS AND TENDERS

There are certain Gambian laws and regulations that apply to sales by public auction or tender. They are:

- An auction act concerning sales by auction
- Regulations of the Ministry of Finance concerning invitation for bid or tenders and also the Auction Act (reproduced in the following pages)

Auction Act

The act and the regulations are very general in scope, and they can be summarized as follows.

Auctions

The procedure concerning sales by auction is used to sell "redundant obsolete and non serviceable stores and other assets."

An auctioneer licensed by the government must supervise and be responsible for the whole operation. The highest bidder wins the auction. The law provides that there must be some publicity during a minimum period preceding the auction.

Invitation to Bid or Tender

The law requires that the invitation to bid procedure be used for the sales of commodities of a value superior to 100,000 dalasis.

That same requirement for the sale of food exists in the U.S. P.L 480 but without any money ceiling. The reason for that requirement is the same in both countries. Its objective is to maintain the integrity of the program and to remove the possibility of selective negotiations, favoritism, and the appearance of conflict of interest.

Regulations of the Ministry of Finance on the Purchase and Sales of Commodities

Major and Minor Tender Boards

(1) There shall be established a Major Tender Board for the consideration and award of all government contracts for the procurement of disposal of goods, services and works where the estimated cost of benefit exceeds D 100,000.

(2) There shall be established a Minor Tender Board for the consideration and award of all government contracts for the procurement of disposal of goods, services and works where the estimated cost of benefit exceeds D 10,000 but is not more than D 100,000.

(3) Both Tender Boards will be chaired by the Permanent Secretary, MOFT. Other permanent members shall be the Permanent Secretary, Ministry of Economic Planning and Industrial Development, the Solicitor General, the Director of Technical Services and the Accountant General. Other Accounting Officers and specialists may be co-opted when appropriate and necessary for the matters under consideration. Where members cannot attend in person they should send their deputies or senior delegates in their places.

(4) In addition to the award of contracts the Major and Minor Tender Boards will keep under constant review all matters pertaining to the procurement and disposal of goods, services and works for Government Departments, Projects and quasi Governmental agencies, and in particular secure compliance with Financial Instructions.

(5) Both Tender Boards will meet regularly at a time and place to be appointed by the chairman to deal with urgent matters, specifically contracts and projects.

(6) The findings of the Major Tender Board will be communicated to the minister and, where required, placed before the cabinet for final decision

(7) Where the estimated cost exceeds D 100,000 the Accounting Officer must obtain the authority of Major Tender Board to procure the goods, services or works by contract after public tender. Tenders shall be opened in the presence of the Major Tender Board which shall recommend the award of the contract after considering the recommendation of the Accounting Officer and where appropriate, technical experts or specialists.

(8) Successive purchases of particular items on order to avoid any of these rules is not permitted.

(9) These procedures do not override any special conditions which may be attached to the procurement of goods, services or works financed under overseas aid or loan schemes.

Ministry Tender Boards

(1) In the interests of the prompt, efficient and effective administration of a major product the Minister of Finance may authorize the establishment of a temporary Tender Board within the Ministry responsible for the implementation of the project.

(2) Where a Ministry Tender Board has been so authorized it will confine its attention to the supply of goods, services and works attributable and chargeable to the project for which it was established. It will cease to function when the project terminates.

(3) A Ministry Tender Board will be charged by the permanent secretary of that ministry and permanent members shall include the Permanent Secretary, Ministry of Finance and Trade and the Accountant General, or their delegates. Other members shall be appointed or co-opted by the chairman.

(4) A Ministry Tender Board shall have the same powers and limits as the Major and Minor Tender Boards and its findings will be communicated to the Minister and, where required, placed before the Cabinet for approval.

(5) The Provisions of this chapter of Financial Instructions shall apply to all matters placed before, or authorized by any Ministry Tender Board.

Tender Board Proceedings

(1) The Secretary of each Tender Board will record details of the proceedings of all meetings of the Board including particulars of tenders examined and decisions reached. A copy of Tender Board Minutes shall be sent under confidential cover to each member of the Board and to the Auditor General.

(2) The Secretary of each Tender Board will notify the Accounting Officer of each Ministry and department concerned of the decisions of the Tender Board affecting them including acceptance, rejection of tenders and other pertinent matters.

(3) The notification of successful and unsuccessful tenders and the completion of contract documents including reference to the Attorney General's Chambers is the responsibility of each Accounting Officer.

Auction Sales

Disposal of Redundant, Obsolete or Unserviceable Stores and Other Assets

(1013) Redundant, obsolete or unserviceable stores and other assets which have been written-off may be disposed of according with the following rules:

1. Items having no marketable value should either be passed on to government or non-government institutions that could make use of them or disposed of at approved dumping areas under the supervision of the Auditor General.

2. Items considered to have a marketable value must be sold by public auction.

Any departure from this procedure must receive the prior approval of the Tender Board.

Conduct of Public Auctions - (1014)

1. When redundant, obsolete or unserviceable government owned vehicles, plant or other similar assets are to be disposed of, they will be sold by Public Auction.

2. Auctions will be held at Kotu Workshop wherever possible. Items too cumbersome to be moved there may be auctioned at other government locations with the consent of the Permanent Secretary, MOFT, and subject to the same rules applying as outlined above.

3. When sufficient items have been accumulated to justify a public auction, the Chief Mechanical Engineer will notify the Permanent Secretary, MOFT and Accountant General, who will appoint representatives to join with the Chief Mechanical Engineer to form a Board of Survey to ascribe a fair value to each item and check the schedules to ensure that items have not been tampered with during storage. This value will form the "reserve price" at the auction. An official auction list will then be drawn up.

4. The Permanent Secretary, MOFT will request the Tender Board to appoint an auctioneer and fix the commission checking with the Accountant General that he holds a current auctioneer's license, fix a date and time for the auction and publicize the event to the press and over the radio.

5. Representatives of the Accountant General and Ministry of Finance and Trade will attend each public auction to ensure that government's best

financial interests are preserved. They may stop the auction or withdraw any item in the case of any apparent irregularity. A report of the conduct of the auction and the proceeds will be compiled and sent to the Permanent Secretary, MOFT, the Accountant General and the Auditor General.

Auctioneers under the auctions act must be licensed and give security by bond in the sum of one thousand pounds sterling. He is subject to penalties and must keep an account sales book. He must give notice of sales seven days in advance. His renumeration may not exceed seven pounds per centum.

APPENDIX B

EXPERIENCE WITH FOOD AID AUCTIONS IN GUINEA

53

41

TABLE OF CONTENTS

54

APPENDIX B

EXPERIENCE WITH FOOD AID AUCTIONS IN GUINEA

Country Background: The Context for Auctions

Guinea, with a land area of 245,900 square kilometers and a population of some 6.3 million, lies along the Atlantic coast in West Africa. Per capita GDP is estimated to be $285, and total economic output is dominated by the tertiary sector (at 37 percent of GDP), with the primary and secondary sectors almost evenly closing the gap (at 31 and 32 percent respectively). Agriculture is considered to be the largest subsectoral component of GDP, responsible for nearly a quarter of total output.

Between Independence and 1984, Guinea's economic and policy framework favored public sector and subsistence farming activities over private sector development. Starting in 1984-85, with a change in government, a series of economic and financial reforms was initiated to address economic deterioration and financial imbalances and to promote private sector growth. With vigorous support from the World Bank, the International Monetary Fund, and various bilateral donors, steps were taken to liberalize trade, divest parastatals, devalue the currency (with weekly auctions to determine the appropriate rate of foreign exchange), establish a new banking system, and decontrol prices.

Within the rice sector, the state trading company responsible for rice imports (ALIMAG) was closed (December 22, 1985), and private traders assumed ALIMAG's function, enlarging it considerably. Total rice imports grew from 96,842 metric tons in 1985 to 148,314 metric tons in 1986, with private traders being responsible for the non-concessional imports, some 53 percent of total imports. Private traders were encouraged to enter into the rice import business by the end of a long-standing rice rationing system favoring the civil service and the military (one fifth of the active population in 1985), and by the quadrupling of the official price of rice.

To reinforce the structural changes being instigated by the Government of Guinea (GOG), USAID tailored its P.L. 480 Title I Program — and then its

Title II program — in the country to promote the greatest participation possible from the private sector. Administered sales to private distributors were used in 1986 and 1987, and auctions in 1988 and 1989.

Rice Marketing Structure

Rice, as a staple, is the only commodity to be subject to an official price at the import, wholesale, and retail levels. Since the devaluation of the Guinean franc (GF) and the Conakry food riots of June 1988, importers and sellers of rice tend to favor the presence of an official price because it legitimizes their activities and it moves the responsibility for price fluctuations onto the government. Importers believe, however, that the margin for profit built into the official price is often too low for the risk of forecasting exchange rates, world prices, and supply and demand, as it can take up to three months to arrange for the arrival of rice shipments. Importers remain quite responsive to changes in the official price of rice, and they will import more rice when the official price is higher, as has been the case since late September 1988.

Importers do not specialize in rice, but rather hedge their risk by importing a variety of food commodities and limiting their investment in rice to 20 to 60 percent of their operating capital. Other commodities imported include sugar, vegetable oil, and flour. Most importers are interested in turning their rice inventory over as quickly as possible, but they have the storage facilities to hold rice for its expected life of two to three months.

Rice is a relatively expensive import, compared with sugar and flour. There are eight importers who operate on a large scale, commanding shipments of over 10,000 metric tons (the actual number fluctuates from year to year, but it appears to be growing over time). A few of these large importers have established stores ("boutiques detaillantes"), and they sell rice at the retail level, where the lower margin for profit is compensated by faster inventory turnover.

There is also an unspecified number of smaller traders capable of handling shipments of 2,000 to 3,000 metric tons. Some of these traders have banded together to form import associations. Most of them, however, are wholesale clients of the larger importers, and they only import intermittently, such as when shortfalls in rice supplies are expected. Independent wholesalers in Conakry are estimated to number over 100, and retailers over 300.

Rice is imported year-round from many countries, mostly Asian for rice at commercial prices and European and American for rice at concessional prices. Commercial rice imports from October 1988 to October 1989 amounted to 235,553 metric tons, and they accounted for close to 90 percent of all rice imports for the period. Most rice imports are financed with bank letters of credit. Banks will not extend letters of credit when rice supplies are high, thus indicating the degree to which importers, and traders in general, must rotate their inventories to stay in business.

The price structure for imported rice is highly evolved, with prices reflecting perceived quality and country of origin. For example, wholesale prices for imported rice in Conakry are currently:

Chinese (etuve)	GF 13,500
U.S.	GF 12,500-13,000
Chinese (regular)	GF 11,500-12,000
Vietnamese	GF 11,000-11,500
Thai	GF 10,000-10,250

The gross profit margin at the wholesale level appears to range between GF 1,000 and GF 1,500 per ton; that at the retail level, between GF 250 and GF 300 per ton.

Although it is difficult to find information on domestic rice production, the level of annual production appears to be approximately three times the amount of rice imported yearly. Domestic rice is preferred by most Guineans, and this taste preference has accorded domestic rice a price sometimes reaching as high as twice that of imported rice. While very little domestic rice moves into Conakry, imported rice is distributed to easily accessible, high-density, rice-deficit areas outside of Conakry (e.g. Fouta Djallon). Gradual improvements in Guinea's national transportation network are expected to unify the now fragmented rice market, and to increase the volume of imported rice directed in land, placing pressure on domestic rice production.

Experience With Food Aid Auctions

To date, there have been two food aid auctions in Guinea: one in October/November 1988, and the other in September/October 1989. Each auction followed the "sealed" or written bid format and lasted about three weeks from the announcement inviting the bids to the announcement of awards. Each auction was subject to some irregularities, but both proved to be learning experiences for all participants (the GOG, A.I.D., and the bidders). It is expected that, with GOG and A.I.D. consensus on both food aid programming objectives and the auction parameters appropriate for attaining these objectives, orderly auction procedures can be established and strictly maintained.

Before examining auction events and outcomes for both years, it might be helpful to trace the evolution of the concept of using auctions to sell and distribute P.L. 480 rice in Guinea. Relying on documents available at

USAID/Conakry, the first reference to auctions appears in a cable from A.I.D./Washington to the Mission in October 1987. The cable reviewed the results of the Food for Peace program for FY 1987, which entailed administered sales to private distributors, and which suggested the introduction of a modified auction system to bring greater depth (i.e., greater number of participants) to the rice import and distribution system.

The Mission responded favorably to the idea, and a cable from the Mission to A.I.D./Washington in February 1988 states that the Mission's "primary concern is that U.S. rice be purchased and marketed directly by the private sector rather than sold on consignment by the private sector for the government." The cable goes on to say that the Mission "has an interest in promoting downward pressure on prices through competition rather than government-private sector negotiation," and at the same time in "seeing that prices not be artificially low so as to weaken supplies or otherwise put the government and populace into a position that cannot be sustained once donor rice is withdrawn." The cable concludes the discussion by noting that true liberalization of the supply and marketing of rice entails not only the free movement of rice prices, but also enterprise and market development, with improved access to finance and expertise by smaller potential importers. In early 1988, then, USAID/Conakry considered food aid auctions as a means of reinforcing private sector mechanisms with respect to both price formation and market access.

The 1988 Auction: Procedures

In 1988, 31,502 metric tons of rice was auctioned. The evolution of the procedures for the auction was traced through discussions with the GOG and USAID and through documents (essentially forms and memoranda) from both sources. It is particularly instructive to compare the procedures conceived before the auction's implementation with the auction's actual outcome.

The Transfer Authorization (TA), signed by the GOG and A.I.D. in June 1988, is the first formal document to outline the procedures for the 1988 auction. The TA specified the type of commodity to be auctioned, the general auction format, payment terms and timing, and now to calculate the reserve price (the lowest acceptable price). Eligibility criteria and specific operational procedures (such as lot size) were left for consideration by a auction oversight committee, to be composed of representatives of MICA, MPCI, and USAID/Conakry.

The rice was to be Grade 5 (the lowest marketable grade in the Title II program). Once it was sold through the auction it was to have the status of privately imported commercial rice. The reserve price was not to be less than the f.a.s. Gulf port price (in local currency calculated at the highest legal exchange rate at the time of the transaction, presumably the auction).

Bids were to be ranked from the highest to the lowest, with the transfer price being the one proposed by the lowest successful bidder. Successful bidders were to deposit at least 25 percent of the value of the rice awarded when signing the protocol agreement; an additional 25 percent was to be paid when the vessel arrived in port. The balance was to be covered by a "caution bancaire," due 90 days after the vessel's departure from port. Late payments were to be subject to a monthly charge of 5 percent.

Interestingly enough, and unlike the situation in many other countries, transfer of ownership was to occur the moment the vessel was docked (if the entire ship load was going to one purchaser) or when the designated freight forwarder assumed responsibility for the rice (if the ship's load was to be divided into smaller lots).[1]

In July and August several meetings were held among A.I.D. and GOG ministries to refine general auction procedures. In a meeting in July among representatives from MICA, MPCI, and A.I.D., it was agreed that auction procedures should support three objectives: the establishment of a market-based transfer price, the generation of a maximum amount of revenue for the counterpart fund, and the "fair and equitable" selection of recipients. MICA and MPCI, in particular, were concerned by the possibility of an oligopoly developing among rice importers and by the appearance of favoritism should former traders in U.S. rice receive awards under the auction. At the meeting, it was agreed that lot sizes below 1,000 metric tons would be very expensive to handle unless all logistical arrangements were undertaken by one company, with the receivers of rice paying the company's costs. It was also agreed that the details of the auction's implementation would be left undefined to permit their being "fine-tuned" to meet GOG and A.I.D. policy needs. Unfortunately, the duration of the fine-tuning was left unspecified.

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1. The wording of the TA makes the transfer of title to the rice more complex than would appear at first glance. Under Title II, the shipping company holds title until the rice is unloaded; title passes to the GOG only after an out-turn report (verifying the quantity of rice unloaded) is jointly completed by representatives of the shipping company and the GOG. One may presume that the title then technically passes to the bidder (as the forwarding agent of the bidder assumes control of the rice). However, the instructions for the invitations to bid in Guinea clearly state that the "operateur economique" (or successful bidder) is to receive intitally only 80 percent of his bid lot, the difference being made up of the sweepings, torn bags, and good rice remaining after all bidders have received 80 percent of their respective awards. Should disputes arise over the quantity of rice ultimately received, little recourse is practically available through the Guinean legal system.

An oversight committee approved the final auction parameters in late August 1988. These were as follows:

- Eligible bidders were to demonstrate two years of experience in importing a narrow range of commodities (rice, wheat, flour, sugar, and vegetable oil). They also had to have a good history of paying their bills promptly, put forward a bid bond of GF 500,000 (approximately $800, or less than one percent of the average final payment), and obtain a bank letter stating the presence of financial resources sufficient to cover the proposed rice purchase. Lastly, they had to have access to a warehouse with a capacity of at least 60 metric tons.

- The minimum and maximum lot sizes were set at 2,000 and 5,000 metric tons.

- The reserve price was established at the prevailing f.a.s. price for U.S rice ($302/metric ton).

- All bids were to be submitted sealed and to be opened publicly by the oversight committee 15 days after the bid was announced and 30 days before the boat was to arrive.

- The transfer price (a uniform one to avoid confusion and unfairness) was modified from the original suggestion of a step-out price, and it was to be calculated as the average of all bids submitted. However, should this average be lower than the price submitted by the last successful bidder, the transfer price was to be changed to reflect the lowest successful bid price.

- In the event of a default of the 25-percent downpayment at the moment of signing the contract, the bidder in question would lose his bid bond and the lot would be awarded to the bidder ranked below the last successful bidder.

- Each successful bidder was to receive initially only 80 percent of his bid lot, to allow an even distribution of damaged bags among all successful bidders.

- A monthly penalty payment of 5 percent was established for all late payments.

The 1988 Auction: Outcome

Despite the clarity of the procedures, the actual auction did not proceed in a smooth and organized manner, owing largely to a failure of the GOG to consider trade-offs between the administered sales and auction processes. Auctions, unlike administered sales, allow equal access by all private traders, and they favor overt competition among all interested members of the private commercial community. Delays in the auction process occurred as the oversight committee (stepping beyond its function) deliberated over the suitability of preliminary auction results and initiated steps to overcome what it felt the market could not support.

The results of the auction are presented in Figure 1, and they are described in greater detail below.

During the week of October 24, the auction was announced several times daily on the radio, and it was placed in the daily newspaper. The deadline for submission of bids, originally set for Friday, October 28, was advanced three days to overcome the effect of poor information being passed to potential bidders by MICA officials, thus limiting the number of bids. Ultimately, 25 bids were submitted for a total tonnage of 114,000 metric tons, with prices ranging from $302 to $315 per metric ton, compared to the f.a.s. price of $302 per metric ton and the CIF price of privately imported rice of $345 per metric ton. The bids were opened publicly by the oversight committee on Monday, October 31.

In a private session immediately following the public opening, the committee excluded five bidders (one for not including a bid price, one for calculating the bid price in Guinean francs, two for not having the required food importing experience, and one for not paying the bid bond). The committee set a transfer price of $307/metric ton, coincidentally the mean of all U.S dollar-denominated bids and the stop-out price, a fact that was later ignored by all those involved in the planning and implementation of the 1989 auction. The committee then ranked the bids in descending order by price, with quantities of rice being provisionally allocated as requested by the bidder. Thus selected, the successful bidders (10 in all) would have been newcomers or infrequent participants in the rice import business, which disturbed the oversight committee tremendously.

In a series of discussions over a period of five days, the oversight committee, in concert with the Minister of MICA, decided to reduce all lots to 2,000 metric tons to enlarge the pool of eligible bidders and to incorporate major/regular importers of rice among the successful bidders while still respecting the original bid ranking. A.I.D.'s representative to the committee raised an objection to modifying the auction's parameters while the auction was in progress, but he was unable to overturn the action.

Table B-1. Outcomes of Rice Auctions in Guinea

Number of bids	Original Tenders: Price ($/MT) High	Price ($/MT) Low	Price ($/MT) Mean	Quantity (MT) High	Quantity (MT) Low	Awards: Number	Price ($/MT)	Quantity (MT)	Comments
1988 Auction									
25	315	302	307	15,000	2,000	15 1	345 345	2,000 1,502	Size of Title II shipment: 31,502 MT FAS price of Title II shipment: $302/MT CIF price of privately imported rice: $345/MT Sequence of events Bids ranked in descending order by price. Bids excluded for not meeting eligibility requirements. Application of an initial uniform transfer price of $307/MT (the mean of all bids submitted). Maximum lot size reduced from 5000 MT to 2000 MT to allow broader awards. Payment terms set at 25% down payment, 75% bank letter at request of successful bidders. GOG request to form a security stock is overturned by AID referring to the language of the TA. Final transfer price set by GOG at the prevailing market price for privately imported rice to reduce potential for windfall profits among successful bidders.
1989 Auction									
117 (plus 21+)	465	200	332	21,000	300	39	350.88	400	Size of Title II shipment: 16,000 MT FAS price of Title II shipment: $350.88/MT CIF price of privately imported rice: $360/MT Sequence of events Bidders excluded for not meeting eligibility requirements. Bidders ranked in descending order by price. Bidders excluded for submitting excessively high and low bids. Application of a uniform transfer price, initially set at $332/MT (the mean of all bids submitted), then at USAID's instance at $350.88 /MT (the FAS price). Maximum lot size reduced from 1,000 MT to 500 MT to allow for broader awards and ostensibly to minimize risk of nonpayment and to accelerate unloading from ship. Initial awards made to the top 32 bidders within a price bid band of $360 to $350/MT. Inability of bidders to obtain required bank guarantee results in the development of a reserve list based on perceived ability to pay and not on bid ranking, and in the reopening of the auction to anyone capable of meeting the credit requirements (25% down, 75% supported by an irrevocable letter of credit). GOG requisitions 100 MT from each allotment for the development of a security stock, resulting in awards of 400 MT.

During the five-day interval, other procedural issues came to the fore. Two issues were quickly resolved without any intervention from A.I.D. First, on the recommendation of the freight forwarder, the committee decided to sell all the torn bags and damaged rice at a reduced price to a single receiver. Second, in response to the concern of bidders over depositing money with the government before receiving the rice, the payment terms were modified to 25 percent down at the moment of signing the contract and 75 percent in the form of a banker's acceptance.

A third issue, however, was more disturbing. It came in the form of a request from MICA that successful bidders contribute a small percentage of their rice to a national security stock. Upholding the language of the TA, A.I.D. was able to have the request denied.

A fourth and final issue was the most serious. On November 4, it became apparent that MICA intended to increase the transfer price from $307 to $345, the prevailing CIF price for privately imported rice. This was a measure calculated to limit the potential for windfall profit by the successful bidders. (By way of background, it should be pointed out that, in 1988, the world market price of U.S. rice was considerably lower than that of Asian rice, reflecting an unusual shortfall in Asian rice production for the year.) This time, A.I.D. objected formally to the government's unilateral intervention, especially midway through the auction, but A.I.D. felt it could not take specific actions other than to warn the Minister of MICA that such interventions placed in jeopardy the continuation of the U.S. food assistance program in Guinea. All of the successful bidders (all of whom had submitted bid prices far below $345) accepted the new price, reflecting either a strong desire not to forgo the purchase or lack of experience with auctions.

A total of 15 people received awards of 2,000 metric tons each, and a 16th person received 1,502 metric tons, the rice remaining from the shipment. It should be noted that in spite of the bank acceptances, many successful bidders were delinquent on their final payment for rice (due some two months after the rice was delivered to the bidder), and by early December 1989, approximately 20 percent of the funds generated by the auction still had to be collected from individuals.

The 1989 Auction: Procedures

In 1989, 16,000 metric tons were available for the auction. With respect to sales procedures and choice of receivers, the TA for 1989 differs from the TA of the previous year in two elements. There is no mention of ranking bids in descending order by price or of transfer prices, and the payment procedures follow the 25 percent downpayment and 75 percent bank guarantee distribution established during the 1988 auction.

The invitation for bid documents (as amended by the 1989 oversight committee on September 9) provide the specific elements of the auction. Underlined text signals procedural changes from the previous year and highlights the interest of the GOG in (1) increasing the participation of traders in the Title II auctions and (2) decreasing the possibility of nonpayment by successful bidders.

Eligible entrepreneurs were to have a minimum (once in five years) of experience in importing a narrow range of food commodities (rice, vegetable oil, wheat flour, and sugar). They had to demonstrate an adequate storage and transportation capacity (in the form of a sufficiently large warehouse to house their expected share of the shipment and access to two trucks) and sufficient financial resources to cover payments. In addition, they had to have a positive credit history, with no default on their record. Payment terms were modified to 25 percent downpayment and 75 percent covered by an irrevocable letter of credit.

Bid lots were to be between 500 and 1,000 metric tons. A non-reimbursable participation fee of GF 50,000 was to be paid for the invitation to bid forms themselves (five pages outlining the procedures and a two-page application). A bid bond was not required, largely because the irrevocable letter of credit was thought to be a sufficient guarantee of payment. Bid results were to be announced publicly in the conference room of the Ministry of Industry. The reserve price was to be the f.a.s. price of the rice (in local currency at the lowest prevailing exchange rate). The transfer price was to be the mean of all bids, following the precedent set during the 1988 auction.

The 1989 Auction: Outcome

The 1989 auction is just as interesting in its outcome as that of 1988. An initial 117 bids were submitted at prices ranging from $220 to $465 per metric ton for a total of 168,000 metric tons.

Bid processing started a little earlier than in 1988, on September 21 and 22. Bids were ranked in descending order according to price. Excessively high bids were eliminated for being unrealistic; excessively low bids, for being speculative or collusive. A transfer price was calculated from the mean of the original U.S. dollar-denominated bid submissions; it turned out to be $332, far below the f.a.s. price of $350.88. The committee eventually agreed to respect the wording of the TA, and it set the transfer price at the reserve price, subject to final approval from the GOG. The committee also reduced the maximum lot size from 1,000 to 500 metric tons to allow broader participation in auction awards and (ostensibly) to reduce risk of non-payment and to accelerate the unloading of rice from the ship. Initial awards were then made to 32 persons within a specific price band of $360 (the prevailing CIF price for privately imported rice) and $350.88 (the reserve price) subject to their ability to provide the committee with the appropriate bank documents. (It should be noted that use of the price band, and the extremities of the price band itself, were much debated by the committee. The upper limit was ultimately set by the Minister of MICA.)[2]

The committee gave the 32 bidders three days to finalize their negotiations with their banks, and it next met on September 25. By that date, only one company (a major rice importer) had submitted the required bank guarantee. The committee was also given to understand that MCEF and MEF wished to have 5,000 metric tons of the 21,000 metric ton shipment put aside as security stock.

On the following day, the committee learned of only nine other bidders submitting the proper documentation. As the committee felt obligated to find a sufficient number of qualified bidders before the ship's arrival in Conakry, the committee then developed another list of bidders based on perceived ability to pay (and not on bid ranking).[3] Of the 16 people on this list, six fell within the original price band of $360 to $350, 2 had submitted bids below $350, 5 had submitted bids above $360, and 2 appeared to be new entrants to the auction. On September 28, the committee decided to announce by radio the reopening of the auction to new bid submissions in an effort to find a sufficient number of persons capable of procuring bank guarantees. An additional 10 persons (from the original list, the reserve list, and not on any list) submitted bank documents.

The shipment of rice arrived in Conakry towards the end of September, approximately one month earlier than the year before. On September 29, the committee asked that the freight forwarder start servicing the 16 bidders whose documents and warehouse visits had passed muster. (This consisted of 9 bidders from the original list of 32 and 7 from the subsequent list of 16.) On October 5, six more people submitted full bid and payment documentation. The committee calculated that a total of 26 submissions were good, and it decided to announce invitations to double bid volume amounts from 500 metric tons to 1,000 metric tons. It appears that only one firm was interested in this offer. By October 11, it was clear that the GOG was going to requisition 5,000 metric tons for its security stock. With 13 more submissions arriving in good order, the committee decided to divide the remaining 16,000 metric tons of rice between the 39 bidders who

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2. One senior government official explained that, from the GOG's perspective, the auction was conducted simply to know which traders were interested in purchasing rice, and not to maximize revenue or to determine exogenously a transfer price.

3. The committee knew that the GOG was not interested in taking delivery of the rice, since it had no storage facility suitable for housing the rice till it was sold.

had responded by that time. The final lot size was thus 400 metric tons, with one company receiving double the standard amount.

Successful bidders expressed disappointment with the quality of rice received, and unlike the previous year when the rice was quickly moved through the market channels, very little of the 1989 rice was sold. The 1989 rice was viewed as being too similar in quality to the less expensive Asian rice on the market. Bankers are currently seeking a 90-day extension from the GOG for the final payments on the letters of credit they extended to the successful bidders.

Impact on the Rice Market

The impact of the Title II rice auctions on operations of the rice market in Guinea is difficult to gauge owing to deep structural changes in the economy that are beginning to be observed but are not completely understood. The traditional segmentation of the rice market in Guinea, both geographically and in terms of price, is starting to blur as commercial rice imports increase in volume annually and are being distributed in ever greater quantities in the interior and across the border.

Title II shipments have always arrived in September or October, coinciding with the beginning of the rice harvest season. (Domestic rice is harvested and enters the national market between October and March, depending on the region.) To the extent that the markets for domestic and imported rice remain distinct, the influx of U.S. rice in Conakry should have little impact on the prices and trading of domestic rice. To the extent that imported rice is being re-exported or sold inland, U.S. rice (along with all of the other less expensive imported rice) has the potential to displace both, if only temporarily. Little is known about the quantity or quality of rice that moves inland, but it is clear that between 23 and 36 percent of all imported rice travels to the hinterland or to Mali, Guinea Bissau, and Sierra Leone.

It is difficult to attribute any downward movement of rice prices in Conakry to U.S. rice imports owing to a seasonal (fall) glut of rice in the urban center for the past two years. The 1988 glut was due to the sudden entry of large companies in the rice import business[4] and the simultaneous arrival of large rice shipments. The 1989 glut is largely perceived to be due to the GOG tightening surveillance over cross-border trade. All rice is currently being sold below the official wholesale and retail price, which is another reason for traders to send the imported rice to the interior (sometimes with and sometimes without government permission), where such rice can command prices significantly above the official price. U.S. rice does appear, however, to hold a very strong niche in the Conakry market.

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4. Such operations were financed by the Central Bank.

Traders, locked into long-term contracts with Asian rice suppliers, noted a decline in demand for their Asian rice stocks in anticipation of the arrival of the U.S rice.

As a percentage of all rice imports, U.S. Title II rice shipments are relatively small, accounting for approximately 17 and 8 percent of all commercial and concessional rice imports in 1988 and 1989 respectively. As one-time injections into the rice market, though, such shipments have the potential to disrupt rice market operations if they arrive at a time other than scheduled. This was the case in 1988, when the Title II rice was to arrive in July and actually arrived in October. Traders, unable to wait for the delayed shipment, arranged for rice supplies from other sources. This explains in part the glut of rice in the fall of 1988.

Auctions are clearly increasing the participation of wholesalers in the rice import market, but they are not necessarily fostering the development of a larger class of importers per se. Interviews with traders reveal that several of the large importers established special relationships or cartels with their regular wholesale clients to direct more than the "quota" of the U.S. rice to their warehouses. Other wholesalers not involved in one of these schemes participated in the auction because of the lack of commercial importers of U.S. rice and of the possibility of importing directly without jeopardizing an existing relationship with a regular importer. The continuation of U.S. rice as an alternative supply source for smaller wholesalers is subject to debate. At least three traders (from the ranks of both regular rice importers and wholesalers) expressed interest to the team in finding U.S. rice exporters on their own. Auctions are clearly engendering new business arrangements and combinations, and in this regard, they are encouraging greater sophistication in rice market operations.

Impact on Government Operations

The auctions, as managed until now, have generated uneven revenue levels for the GOG's counterpart funds. In 1988, the auction price was set at the prevailing CIF price of privately imported rice, in essence the highest value that the rice market could sustain. In 1989, the auction price was established at an amount $10 lower than the prevailing CIF price, and no revenue was generated from the rice set aside for the security stock.

MICA officials have indicated, furthermore, that the government is not committed to raising more funds than that required in the TAs (i.e., the f.a.s. price of U.S. rice). This attitude implies continued fluctuations in revenue from one year to the next, which has important financial implications for those programs sponsored by counterpart funds. This attitude could also undermine the implementation of auctions in the future, as the GOG and not the bidders would determine the final transfer price whenever the auction-derived price happens to be different from the f.a.s. price of rice.

Auction participants, both within the GOG and without, felt that the auction process could be improved. Problems as well as positive aspects of both auctions are discussed below.

Positive Aspects of the Auctions

There were several positive aspects to both of the Guinean auctions.

- The presence of detailed auction procedures in the TA. The GOG displayed a strong willingness to establish clear and complete auction parameters prior to auction implementation. Such parameters are necessary but clearly not a sufficient requirement for an orderly, well administered, and effective auction.

- Upward movement along the learning curve. Members of the oversight committees have acknowledged that they are coming to a better understanding of those who tend to participate in auctions, those who can afford to pay for the rice, and the type of problems that can be encountered in using auctions as a sales mechanism. With such experience comes the ability to implement properly auctions of a food staple with strategic significance for the GOG.

- Increasing public participation in the auction. The number of bids submitted from one year to the next rose by 368 percent, from 25 to 117 (plus) bidders, thus providing greater competition and lessening the possibility for successful collusion. The number of sucessful bidders increased by 143 percent, from 16 to 39 bidders.

Problems With the Auctions

There were also a considerable number of problems associated with both auctions. Most of the problems were of a procedural nature, and all of them have an important impact on public interest in auctions, bidding strategies, and auction results.

- Lack of transparency. Both auctions lost their transparency as they moved from bid ranking to award. The modification of award procedures during auction implementation (to ensure price stability, broader awards, the development of a security stock from Title II rice) resulted in a far different outcome in terms of rice allocation among firms than would have been the case if the auction had proceeded without intervention. Such intervention, if repeated, undermine the competitive and fair nature of auctions, and destroy their inherent economic efficiency.

- <u>Lack of sufficient dialogue between the GOG and A.I.D.</u> to establish explicit auction objectives that conform to food aid programming goals and general policy objectives. Failure to link food aid programming goals and auction design led to the partial breakdown of the auction process. This is most clearly illustrated by the decision to reduce the lot size in order to increase the number of awards during the 1988 and 1989 auctions, which, along with other interventions, curtailed the usefulness of auctions as a resource-allocation mechanism.

- <u>Confusion about the proper role of an oversight committee.</u> In modifying auction parameters after the bids were opened, the oversight committee stepped beyond its function. The very name of the committee suggests its function, specifically to ensure transparency during auction implementation. Such committees should not participate in policy decisions (these already having been made before the auction starts). Such committees should not alter auction parameters (e.g., who is eligible to bid, maximum and minimum lot size, the reserve price, the transfer price) midway during the auction, because in so doing they alter the auction's outcome.

- <u>Poor timing</u>. Both auctions suffered from tight schedules and delays, with insufficient time during the planning phase to assess the appropriateness of the auction's design, and inadequate time during implementation to allow for an orderly auction process (or, as was the case with the second auction, to allow for more than one auction should conditions warrant).

- <u>Uneven quality of rice</u>. Rice shipments to Guinea have traditionally consisted of Carolina long-grain rice, which occupies a special niche in the imported rice market. Though more expensive than the Thai, Vietnamese, and Chinese rice generally on the market year-round, the Carolina long-grain rice sells quickly whenever it is available. The last Title II shipment (consisting of rice for the 1989 auction) was only partially composed of the long-grain rice; a significant portion of the shipment consisted of medium-grain and discolored rice not sufficiently distinctive from Asian rice to warrant a price difference. Bidders who were successful in the 1989 auction now find it difficult to sell their rice, and they might be unable to meet their commitments to the banks.

Recommendations

The recommendations are presented in two categories. The first category of recommendations touches upon general considerations, such as the institutional, policy, and legal framework in which the Guinean auctions occur. The second group of recommendations addresses specific auction design and implementation issues, in essence the mechanical side of auctions as a sales mechanism. Many of these recommendations consist of re-instituting auction elements that gradually fell by the wayside during the auctions of 1988 and 1989.

General Considerations

There appears to be confusion about the difference between "invitation to bid" (a sealed or written bid) and an open outcry auction (or English auction). In the English system and in auction literature, the word "auction" encompasses both auction formats, whereas in French, a semantic distinction is maintained both formally and informally. Recognition of this difference is important when it comes to Guinean regulations and customs governing commercial activity, as embodied by the new "Code des Marches." The Code discusses invitations to bid and not auctions (and like most government procurement codes, it emphasizes purchases not sales).

The Title II rice bid-tender procedures in Guinea had their genesis with USAID., which termed the procedures "auctions" in keeping with the accepted practice of auction literature. The word was then inappropriately translated into "vente aux encheres" (or open outcry auction) rather than "appel d'offres" (IFB). Given the existence of the new Code, it would be helpful to tighten the wording referring to Title II auctions in both English and French so that there is total consistency among all documents governing their use, design, and implementation.

-70

Specific Auction Elements

Pricing

Auctions are chosen over other sales mechanisms to allow for the translation of supply and demand conditions into an appropriate market price. In both hypothetical (test) and actual situations, well-conducted auctions have repeatedly demonstrated the capacity of capturing the prevailing market value of a wide variety of goods.

In Guinea, intervention with respect to price has been a major problem. Such intervention has occurred to overcome unrealistically low (unrealistic) or high (speculative) bids.

The best way to limit low bids is never to announce (directly or indirectly) the reserve price. Such announcements exert a downward pressure on bid prices, and they encourage the development of bidding rings that hold bid prices unrealistically low. This is probably best explained by contrasting events of the 1988 and 1989 auctions. In 1988, the reserve price was publicly held information, and no bid was below the reserve price. High bids, too, were close to the reserve price (a 4-percent difference) as bidders anchored their bidding strategy on the strong probability of other bidders submitting prices within a narrow range just above the reserve price. In the second auction, which transpired without advance notice of the reserve price, the range of bid prices was extremely wide, reflecting the greater uncertainty faced by bidders with respect to the bidding strategy of others.

There are several ways to eliminate what the GOG calls "speculative bidding" (e.g. the submission of high bids to ensure selection for awards of rice). The best way is to use a pay-as-bid auction, in which each successful bidder pays the price he or she bid. It is unlikely that a bidder who pays more than the true market value of rice in Conakry will be able to sell his rice at the desired profit margin; he or she will ultimately lose money on the entire purchase and sale transaction. It is also unlikely that the same bidder will engage in the same behavior a second time. Pay-as-bid pricing is also known as discriminatory pricing.

Should the GOG remain committed to uniform pricing, however, steps should be taken to ensure that the transfer price is the stop-out price. The procedure for such auctions consists of awarding lots successively, beginning with the highest bidder, and proceeding downward until the quantity of rice available is exhausted. The price for all lots is then set at the price specified by the last bidder receiving rice.

Speculative and spurious (non-serious) bidding is more difficult to control under a uniform pricing system. Ways of making bidders accountable for their bids include bid bonds (paid at the time of bids are submitted) and partial payments (paid at the time of bid awards). Both mechanisms work best if they are pro-rated with the size of the bid submitted and are not standard amounts. Bid bonds are refunded to unsuccessful bidders; bid bonds and partial payments are both retained from successful bidders who refuse to complete their purchase.

The notion of bid bonds arose during the design phase of the first auction, but it consisted of a set amount of money and it was later discontinued owing to GOG concern with cost and potential for irregular dealings. Modifying the form of the bid bond so that it becomes an amount sequestered in a privately held bank account appears to be the best way to overcome GOG concerns.

Lot Size

Unlike prices, lot size should be decided prior to auction implementation. In theory, lot size is an important determinant for auction participation: the smaller the lot, the higher the number of traders with sufficient financial means and storage capacity to purchase the rice. A corollary to this is: the smaller the lot, the less interested the regular importers will be in participating in the auction.

It is clear that in Guinea, the correct lot size has not yet been determined for drawing the widest possible participation. Lots of 1,000 metric tons (even of 400 metric tons) attract the regular importers, but they are still too large for the majority of smaller traders to handle. However, should the lots be made considerably smaller, the interest of banks to participate in the financing of the purchase of rice would wane. The GOG is therefore at a difficult juncture. Should the GOG continue to decrease the lot size, it is likely that the number of eligible bidders will actually decrease instead of increase. The precise relationship between access to credit/bank guarantees and business size deserves a closer look.

Other Procedures

- To increase transparency, it is crucial to call off any auction that breaks down midway. Auctions tend to break down when one of two things happens: either no one or an insufficient number of people respond to the invitation to bid, or no one or an insufficient number of people meet the eligibility requirements. Should either event occur, no attempt should be made by the oversight committee to remedy the situation by inviting more people to submit bids under the same auction (as was done in 1989). It is best to examine closely the reasons for the auction's failure and to initiate another auction. The intention to follow this course of action, if circumstances call for it, can of course be announced in advance.

- To increase public confidence in the auction process, a public opening of bids should be maintained. Such openings allow bidders to see that their bids are being processed properly, and they will tend over time to generate a larger pool of bidders. It should be noted, however, that public openings also allow bidders to monitor the bids of other bidders, and as a consequence, allow bidders in collusion to see whether all members of the bid ring are maintaining the arrangement. It is believed that this possible outcome is of less import than the need to enlarge public confidence in the auction process.

- To improve auction implementation, it would be best to separate the responsibilities for auction design (or refinement) and oversight, currently ascribed to one committee. One way of achieving this goal would be to institute two committees, one to determine procedures so that the auction can accomplish its objectives, and another to review the auction's proceedings. It is expected that once the auction is properly structured to meet the policy objectives of both AID. and the GOG, the role of the first committee will be limited to fine-tuning the auction system, and the time-input of this committee will be minimal. As a corollary, there is a need to obtain assurance, if possible, that once established, the oversight committee will be allowed to act autonomously. Such a requirement should not present a policy problem to the GOG if it is pointed out that the oversight committee is simply enforcing the guidelines already agreed to by the GOG.

- To increase transparency of the auction award procedure, an alternative list for awards must be developed subsequent to bid ranking and prior to any notification of awards. The alternative list should contain the names of all eligible bidders in order of rank. Whenever a successful bidder fails to meet his obligations, then the next person on the alternative list is presented the award. Under the uniform pricing system, bidders thus selected have the right to refuse the award if their bid price was below the stop-out price. Under the pay-as-bid system, such bidders pay their bid price.

- To minimize administrative difficulties and implementation costs, the auction should be stretched out over a longer period, or at the very least be configured differently.

Under the current system, announcements are made over a period of two to five days, with the submission deadline falling on the last day of the announcements. An extended period is then spent by the oversight committee screening bidders, after which (and sometimes during which) awards are made. A different configuration is depicted below.

weeks————————————————————————

(Announcements)

(Submission Deadline)
X

(Public Opening)
X

(Committee Review)

(Award Publication)
X

(Delivery)

This sequence has the virtue of shifting the burden of proving eligibility in advance by the bidder instead of leaving it as a subject for scrutiny for the GOG at a later date. At the same time, this sequence allows bidders sufficient time to negotiate terms with banks and to gather the required documents.

- To alleviate timing difficulties, it might be appropriate for the CCC to announce to the GOG and USAID/Conakry, the exact departure date and the expected arrival date of the ship as it leaves the United States for Africa. This sort of announcement would allow the GOG to implement the auctions well in advance of the ship's arrival in Conakry, and it would minimize the pressure felt by the auction committee to conduct auctions even as they break down.

- To ensure smooth functioning of the bank guarantee system, the quality of the rice must be ascertained prior to the commencement of the auction. A broad specification such as U.S. grade number five is insufficient in a rice market that categorizes rice on subtle points such as texture once cooked, in addition to color, percentage broken, and length. Since the GOG does not own any warehouses in which to store the rice shipment upon arrival, and in as much as auctions have to occur prior to the arrival of the ship, procuring samples of the rice to be sold prior to the auction presents a difficulty. It might be best to request the CCC or the U.S. exporter to send the precise specifications of the rice to AID/Conakry and to the GOG as the rice is being loaded in the United States.

APPENDIX C

EXPERIENCE WITH FOOD AID AUCTIONS IN MADAGASCAR

TABLE OF CONTENTS

APPENDIX C

EXPERIENCE WITH FOOD AID AUCTIONS IN MADAGASCAR

Country Background: The Context for Auctions

Madagascar, with a population of nearly 11 million, is a country well endowed with natural resources but with a stagnant economy and a per capita income, estimated to be $210 in 1987 (World Bank), that is among the lowest in the world. Agriculture accounts for over 40 percent of the country's annual per capita gross domestic product, 80 percent of export earnings, and 85 percent of employment. The country's principal agricultural exports are coffee (33 percent), vanilla, cloves, and pepper, with Madagascar being the world's leading producer of vanilla. In terms of imports, rice, wheat, and vegetable oils are the most important. Rice, the country's most important staple food, is produced by approximately 70 percent of all farmers.

Until the early 1980s, government agricultural policies were characterized by tight control and intervention resulting in large public deficits, a significant external debt, and high inflation. These fiscal imbalances have resulted in economic stagnation and decline. The country's debt service payments were about 50 percent of export earnings in 1988 (USDA), and agricultural output fell in per capita terms during the last 10 years. While Madagascar was a net exporter of rice before 1970, it is now a net importer.

In 1979-80, the country began to redress some of these economic imbalances through economic policy reform. The goal of this policy reform was: (1) to return the country to self-sufficiency in rice by 1990, (2) to increase the production and quality of nontraditional crops, and (3) to encourage production and consumption of nontraditional crops. Some of the government's reforms in the agricultural sector include increasing producer prices for rice and chief exports and liberalizing the agricultural marketing system through the elimination and/or reduction of monopoly control over the marketing and export of agricultural outputs and inputs by government-controlled parastatals.

To assist with the government's liberalization efforts, the U.S. Agency for International Development in Madagascar (USAID/Madagascar), in conjunction with the World Bank and the IMF, has supported a reform program to promote increased agricultural diversification, income generation, and growth. While much of the liberalization efforts are centered around rice, USAID/ Madagascar seeks to promote private sector involvement in agricultural marketing and distribution to further reduce government parastatal monopoly control for critical imports and exports.

USAID/Madagascar and the Edible Oils Subsector

One clear example of USAID's support for agricultural policy reforms is the Mission's focus on the impact of the recent structural adjustment efforts on Malagasy consumers. Due to the importance of edible oil imports to the country's consumers in terms of nutrition and per capita income, the Mission designed a program for the reform and rehabilitation of the country's edible oils subsector through a multi-year Section 206 program to begin in FY 1988.

According to a recent evaluation report completed for USAID/ Madagascar on the FY 1988 P.L. 480 Title II Sector 206 program, the 1988 program sought to achieve the following:

- Provide continuing balance of payments support
- Encourage continued market liberalization
- Support government efforts for reform of the vegetable oil subsector
- Supply a nutritionally significant commodity at non-scarcity market prices for Malagasy consumers

The program included provisions to meet refining and market demand for vegetable oil through the middle of calendar year 1989, self-help measures to help reform in the subsector, and use of local currency generation for agricultural research and assistance for small farmers and the environment.

This case study summarizes and evaluates USAID/Madagascar's experience with one of the principal goals of the 1988 program — providing sufficient vegetable oil to meet refining and consumption requirements through half of 1989 by supplying 5,000 metric tons of crude vegetable oil for open sale (auction) to Malagasy refineries. This assistance would accomplish A.I.D.'s objectives to increase the supply of edible oils to consumers, and it would, moreover, promote private sector involvement in the subsector consistent with USAID/Madagascar's efforts to assist with the government's liberalization efforts. The focus of this case study will be the first FY 1988 auction that took place in January 1989, since written documentation was available for this auction only.

Edible Oils Marketing Structure

While no comprehensive analysis of the vegetable oil subsector has been completed, informal projections indicate that a negligible deficit existed during 1989, with the USAID "Section 206 . . . program providing 40 percent of the refined oil from non-artisanal sources consumed in Madagascar in 1989." (A.I.D. Evaluation, Report, March 1989). The remaining supply came from remaining stocks from the FY 1987 Title I program (12 percent), domestic production (30 percent), and supplies donated by the Italian government (9 percent), and other donations. The total annual vegetable oil requirement is estimated to be 11,230 metric tons.

Therefore, the FY 1988 Section 206 program was critical for maintaining a sufficient supply of vegetable oil for consumers given constant domestic production levels. Significant domestic production increases are assumed to be unlikely for the near future. More formal analysis of domestic supply and consumption, while useful for planning, would be problematic given the difficulty of collecting data on artisanal production and animal fat consumption. A formal survey of domestic production and consumption and a national vegetable oil master plan have been called for under the auspices of the Section 206 self-help measures. However, the survey has not been completed as of the most recent evaluation of the FY 1988 program. The master plan, although completed by a French firm, was not suitable for the design of an appropriate vegetable oil strategy by interested donors. Moreover, such a comprehensive planning exercise is in opposition to the market liberalization agenda of government being supported by the World Bank, the IMF, and A.I.D.

In terms of domestic marketing and processing agents, there are six principal edible oil refineries in Madagascar; four are private sector refineries and two are government parastatals. The private sector refineries are la Société d'Entreprise Industrielle de Madagascar (SEIM), la Société Commerciale et Industrielle de Madagascar (SCIM), Société Industrielle du Boina (SIB), and SICA; and the parastatals are l'Huilerie Centrale de Tananarive (HCT) and SOMAPALM. Estimates by the Government of the Democratic Republic of Madagascar (GDRM) of the relative sizes of these refineries (in terms of annual capacity for refining crude oil) are seen in Table C-1. Note that the parastatal refineries had the capacity to supply approximately 68 percent of edible vegetable oil to the domestic market in 1988.

Table C-1. Estimates of Capacities for Domestic Refineries

Refinery	Capacity (metric tons)	Share of Total (percent)
SOMAPALM	9,000.00	50.71
HCT	3,000.00	16.90
SEIM	2,500.00	14.09
SIB	1,500.00	8.45
SCIM	1,000.00	5.63
SICA	750.00	4.22
Total	17,750.00	100.00

Source: Appel d'Offres pour le 16 Août 1989, GDRM

Therefore, capacity exists locally to refine at least 17,750 tons of crude vegetable oil for domestic consumption, which is far greater than the estimated annual domestic consumption requirement. While complete information does not exist with respect to mechanisms for the retail pricing and distribution of refined oil to consumers, domestic consumer prices appear to have risen in recent years. The A.I.D. Evaluation Report suggests that these rising prices point to the existence of market-oriented pricing mechanisms.

Pursuant to market liberalization objectives, the GDRM has attempted to liberalize the domestic trade sector by replacing the former administratively allocated foreign exchange (import quota) system with a price-allocated open general license (OGL) system. The OGL, including imports of crude and refined vegetable oil, allows public and private sector refineries access to imports of crude supplies at the CIF price converted to local currency at the prevailing exchange rate. Such a strategy is an attempt to provide private and public sector agents equal access to needed inputs.

Title II Program for Vegetable Oils

The GDRM and USAID/Madagascar entered into a Memorandum of Understanding on January 30, 1989, to detail the implementation of the Section 206 program, including the allocation of the crude oil among local refineries. This memorandum established the schedule and implementation plan for the sale of 100 percent of U.S. vegetable oil by auction to domestic refineries and with auction rules acceptable to USAID/Madagascar to ensure equal access, terms, and conditions for both private and public sector refineries.

Prior Experience With Commodity Auctions

While the central focus of this current evaluation is on the auction of Section 206 crude vegetable oil from FY 1988, both the GDRM and USAID/ Madagascar had previous experience with food aid auctions. Approximately 12,000 metric tons of FY 1987 crude soybean oil was auctioned to eligible refineries with the following beneficial results as reported in the 1989 A.I.D. Evaluation Report:

- Interministerial cooperation increased, through the formation of an Audit Commission
- Private sector presence in the vegetable oil market increased
- Geographic market extension improved and consumer prices were slightly lowered as a result of the private sector participation
- The bidding process forced refineries to review their cost structure

While these benefits resulted from the first series of vegetable oil auctions, it appeared that the parastatals had a greater advantage in acquiring allotments than did the private sector refineries. This relative advantage was attributed to the more generous payment terms accorded to the parastatals. Therefore, the accepted auction procedures for the next (1989) auctions specified that both private and public sector bidding refineries would be subject to equal payment terms and conditions and that the FY 1988 allotment be auctioned competitively. The FY 1988 bidding document was revised as such.

January 1989 Auction

Based on the auction procedures agreed to in the Memorandum of Understanding, the GDRM sent the six refineries an invitation for bids (IFB) on December 8, 1988, announcing the auction of the first lot (1,840 metric tons) of vegetable oil. The bids were due on January 5, 1989. Although the selection of the consignee refinery was to be done through competitive bidding, only one refinery, SOMAPALM, offered to receive and store the shipment. By February 1988, all 5,000 metric tons of crude soya oil was imported and stored at SOMAPALM with minimal losses.

57

Auction Procedures and Requirements

The IFB set out in detail the requirements for submitting a sealed bid, and it established the reserve price or minimum bidding price for the first lot (672,000 Fmg/metric ton). Bidders were not allowed to bid for a quantity of oil in excess of their annual refining capacity. The GDRM estimated these capacities and presented them in the IFB (see Table C-1). In addition to submitting bids in local currency (Fmg) and metric ton, bidders were to include documentation of their actual annual production capacity, registration with the Ministry of Commerce, and an official business card. In addition to specifying the requirements for bidding, the IFB outlined the procedures for evaluating the bids. The bidders would be ranked according to the amount bid, and in the event of equal bids or the quantities bid not corresponding with the total allotment available, bidders would be asked to submit new bids the following day at prices no lower than those bid in the first auction.

Bidders and/or representatives were invited to attend the opening of bids and awarding of allotments, which took place in a public gathering at the Ministry of Commerce. Winning bidders were obligated to submit to the Treasury a check made out to the Central Bank of Madagascar for the full cost for the quantity allotted, to submit authorization for the pick up of the allotment from SOMAPALM, and to pay SOMAPALM in cash the fixed fee of 85,000 Fmg/mt for storage and delivery of the crude oil.[1] Allotments were to be picked up within six weeks from the date of notification of the award.

Additional general requirements were also detailed in the IFB, which required the bidders to follow a government decree issued in 1964 mandating the norms and quality of refined oils that can be sold for consumption and administering the conditions for refining oils (1969 decree). Bidders were to clearly label their products to facilitate identification by consumers. Using a model form that was included in the IFB, they were also to present a monthly declaration to the Ministry of Commerce, Ministry of Industry, Energy, and Mines; USAID; and the local Trade office, which contained an accounting of stocks, production, and sales. In terms of sanctions, bidders not following the guidelines specified in the IFB and failing to pay (in full) either the Treasurer for the allotment or SOMAPALM for the fixed fee for storage would lose their allotments, which would then be auctioned among

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1. The consignment fee was approximately 24 percent of the average price per ton paid for the allotment in the first auction. The fee covered handling, transport, and insurance (4.7 percent); customs duty (15 percent); and fee (4.4 percent). The GDRM had specified in the IFB that the crude imports would not be subject to a customs duty. However, the two shipments of the 5,000 metric tons of Section 206 soybean oil arrived at the port before the Memorandum of Understanding was signed, and thus, it was charged customs duty.

the other refineries. The defaulting refineries would then be forbidden from participating in other auctions for a period of one year.

Auction Results

Table C-2 below provides data on the results of the January auction. Clearly, these bid prices show strong evidence of collusion between the bidding refineries. Each bid varied by exactly 500 Fmg/mt or (0.06 percent) from the next highest bid, and the lowest bid was the announced minimum bid. Moreover, the A.I.D. mission heard that SICA, the lowest bidder, was not a serious bidder and, therefore, bid the reserve price.

Table C-2. Results of January 1988 Auction

Refinery	Price Bid (FMG/metric ton)	Quantity Bid (metric tons)
SEIM	877,000.00	280.00
HCT	876,500.00	610.00
SCIM	876,000.00	150.00
SOMAPALM	875,500.00	800.00
SIB	875,000.00	100.00
SICA	872,796.00	50.00
Total		1990.00

Source: A.I.D. Evaluation Report, March 1989

In terms of the quantities bid, the total quantity bid by all refineries was only 150 metric tons (1 percent) more than the total allotment available (1840 metric ton). Coincidentally, the quantities bid by the four winning refineries equaled the amount available in the first auction lot. While the parastatal refineries received 77 percent of the allotment, these refineries have 68 percent of total domestic refining capacity. Therefore, the public sector refineries maintained their relatively greater access to crude inputs.

The team that conducted the March 1989 evaluation concluded from interviews with representatives at HCT, SOMAPALM, and SEIM that there had been a prebidding conference among the six refineries to establish bidding prices and quantities. In order to ensure competition between the bidders, SEIM agreed to bid for only [illegible]30 metric tons, not the 900 tons that they had originally planned on. Part of the justification for this decision was based on SEIM's speculation that there would be another auction in one month, and its 280 metric ton bid would represent one month's input for the refinery. HCT also agreed not to bid for a larger amount to allow all refineries equal access to the auctioned lot.

Several issues also arose with respect to payment by the refineries for their allotments. It was revealed during the March 1989 evaluation that HCT had paid the Treasury for SEIM's allotment, due to the latter's inability to pay. SEIM was also unable to pay its consignment fee. Also, HCT was considering picking up the allotment awarded to SOMAPALM. Because the SOMAPALM refinery was broken, there were potential supply shortages of refined vegetable oil. In addition, SOMAPALM did not submit the necessary payment to the Treasurer in the required time period. In fact, SOMAPALM had already refined almost half of its allotment of vegetable oil since it was the consignee and it had access to the supply of crude oil. Therefore, SOMAPALM violated one requirement as specified in the IFB, that full payment was to be made to the Treasurer for the awarded allotment <u>prior to</u> taking delivery. SOMAPALM, according to the sanctions detailed in the same IFB, would be ineligible to participate in subsequent auctions that year.

Clearly, there were a number of procedural and legal issues that arose with the first auction of FY 1988. The A.I.D. evaluation team recommended that, before the next auction, an audit be conducted of the first auction to identify, address, and rectify problems for subsequent auctions. Issues to be examined in the audit were the following:

- The extent to which bidders followed the auction procedures specified in the IFB, including regulations with respect to payment to the Treasurer for awarded allocations and to the consignee for the fixed fee
- In cases where bidders failed to comply with bidding procedures, the sanctions to be applied
- The extent of collusion among bidders in auctions and the impact of collusion on auction results
- A comparison of prices paid by winning refineries to market import prices and a determination of a reasonable fee to be charged the bidders by the consignee refinery

Audit Procedures

The audit, completed by a local consulting firm, addressed the above issues by analyzing the extent to which bidders followed the auction procedures specified by various articles in the IFB and by examining the implications for collusion for producer and consumer prices and the country's macroeconomic environment. Bidders' concurrence with the IFB's Article 11 (Paiement et Enlevement), Article 12 (Reception), and Article 13 (Obligations et Sanctions) were examined through a review of available documentation and interviews with representatives of four refineries (SOMAPALM, HCT, SEIM, and SCIM).

Article 11 — Paiement et Enlèvement. This article specifies the terms for rendering payment to the Treasurer for the total cost of the awarded allotment before taking full or partial delivery of the crude oil. The Treasurer is required to deposit payment to the Central Bank of Madagascar. This article also states that the winning bidders are required to submit to SOMAPALM the commission for handling, storage, insurance, etc.

The audit found that, with the exception of SCIM, the bidders did not comply with the payment terms in Article 11 for either the cost of the awarded allocation or the consignment fee to SOMAPALM. The audit team found that the refineries' technical and financial constraints, in general, make if difficult to pay in full for a complete shipment of crude vegetable oil, and that SOMAPALM had failed to present the winning refineries with complete invoices for the consignment fee. The audit team recommended that Article 11 be amended to allow the winning bidders to submit payment to the Treasury for the quantity to be obtained from the consignee, allowing up to three separate deliveries of their winning allocations. The team also recommended that SOMAPALM submit full invoices to the winning bidders in advance of delivery of allotments, since all costs such as shipping, taxes, and insurance should be known in advance.

Article 12 — Réception. This article is concerned with the terms for the delivery of oil to the winning bidders from the consignee. Winning bidders were requested to pick up winning allotments from SOMAPALM stocks within six weeks of being notified of an award from the auction. The audit team found that winning refineries did not, in fact, complete full delivery of their allocations within the time period of January 5 to February 20, 1989. HCT took delivery between January 13 and March 7, SEIM between February 13 and February 21 1989, and SCIM completed pick up of its allotment by January 27, 1989.

The audit concluded that the bidders assumed that the terms for the timing of reception of oil allotments specified in Article 12 applied to the payment terms, since Article 11 did not specify the required timing for payment. Therefore, winning refineries assumed they were required to complete full payment for, not delivery of, their allotments within six weeks of notification of award by the government.

The audit report recommended amending Article 12 to ensure better compliance by bidders with both payment and delivery terms specified in the IFB. Article 12 would be amended to allow winning refineries to take partial delivery of winning allotments with full delivery of winning lots completed within six weeks of the date of notification by the government of an award — or the completion of a contract with the GDRM for a winning allotment.

Article 13 — Obligations et Sanctions. This last Article covered obligations rendering refineries eligible to participate in the auctions and sanctions imposed upon participants failing to meet the terms specified in the auction IFB. The obligations specified in Article 13 ensured that bidders should (1) respect the norms and quality for edible vegetable oil delineated in a 1964 public [illegible]ment and regulations concerning the refining of edible oil and oilcake as specified in 1969, (2) ensure proper labeling of refined oil products to assist consumers in the identification of oil products, and (3) complete a monthly statement to be submitted to the Ministry of Commerce of shipments, stocks, production, and sales and destinations according to a model specified in the IFB.

Sanctions would be applied for the following violations: (1) failure to submit the monthly report cited above, (2) non-payment to the Treasurer of the total cost of winning allotments, and (3) non-payment to SOMAPALM for the consignee fee. Auction participants having violated one of these conditions would be subject to sanctions, including cancellation and seizure of winning allotments by the government to be subsequently sold by auction to other refineries and ineligibility to participate in subsequent auctions for a period of one year.

The audit team was confident that the refineries had met obligations with respect to refining edible vegetable oil and quality thereof and that they have, generally, submitted the required monthly operational reports. The audit report recommended the submission of a photocopy of a formal certificate, prepared by the Laboratoire des Fraudes Alimentaires, attesting to the quality of oil refined by bidders and requiring refineries to maintain daily statistics concerning stock, production, and sales and distribution levels to be reported on an intermediate basis to the Ministry of Commerce.

Collusion Among Bidders

The audit report concluded that the alleged collusive behavior by bidding refineries had implications for prices paid by bidders and consumers and on the country's balance of payments. This section will summarize the impact of the January 1989 auction results in these three areas as stated in the audit report.

Producer and Consumer Prices. The prices offered for the auction lot indicate collusion among the bidders due to both their similarity and constant variation from the lowest to highest bidder (see Table C-2). Moreover, these prices are surprising, given the varied production quantities, level of end-product demand, and production costs between bidding refineries, which should have resulted in more varied bid prices. It is likely that a pre-bidding meeting took place between the bidders, and the audit team maintained that the domestic edible oil refining sector is interdependent and oligopolistic, which would justify some level of collaboration between refineries. Examples of collaboration between refineries include (1) HCT paying the Treasury for SEIM's allotment and (2) HCT offering to refine some of SOMAPALM's allotment since the refinery was broken and offering to reimburse SOMAPALM for this quantity after the next auction.

There are unique technical, financial, and sectoral constraints to bidders submitting competitive prices that would have allowed enough crude oil to be processed to meet domestic demand. Low profit margins in the refining sector would have enabled only the refineries with the largest capacities (parastatals) from submitting bids low enough to win allocations but high enough to guarantee positive profit margins.[2] Other refineries, therefore, would have been unable to bid, and the domestic supply of consumer vegetable oil would have been at risk with substantially higher consumer prices. The audit study estimates that all but two of the refineries would have been forced out of the auction, should competitive prices have prevailed. Therefore, it appears that competitive auction prices would have limited the ability of private sector refineries to compete with the public refineries for equal access to crude inputs.

Price collusion by bidding refineries would result in unfair competition between refineries having access to auctioned imports and those obtaining imports commercially. Since the reserve price established for the auctioned commodities was the CIF world market import price, the prices paid by the winning refineries were higher than the free market import price and, therefore, winning bidders paid more for obtaining crude oil inputs through the auction system than through commercial means, assuming no foreign exchange constraint. However, given the likelihood of significant foreign exchange shortages restricting commercial imports through the OGL system, refineries would have greater access to crude inputs under the Section 206 program.

Other impacts. The impact of the FY 1988 auctions on the last objective of the auction, balance of payments support, was positive. The support the program has provided against the country's balance of payments is estimated to be around $3 million at CIF world market prices.

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2. The audit report estimated profit margins for the refining of crude vegetable oil to be close to 5 percent.

Summary and Conclusions

The FY 1988 auction of Program 206 commodities held in January 1989 yielded mixed results measured against the initial objectives outlined by the GDRM: providing continuing balance of payments support, encouraging continued market liberalization, supporting government efforts for reform of the vegetable oil sub-sector, and supplying a nutritionally significant commodity at non-scarcity market prices for Malagasy consumers. Some of these results are summarized below, along with procedural difficulties that arose during the auction, which reduced the effectiveness of the auction in meeting its objectives.

While the auction did result in balance of payments support and increased supply of edible vegetable oil to consumers at non-scarcity prices, the auction had a negative effect on the country's efforts at market liberalization and reform in the vegetable oil subsector. The market pricing mechanism for crude oil inputs was not liberalized, witnessed by the collusion which took place among bidders. Therefore, the auction resulted in an administrative, not market, mechanism for allocating input commodities. Collusion had a beneficial result, however, since it provided the private sector refineries greater access to the auctioned allotment. Had the bidders submitted bids without colluding, the two parastatals would have received the entire allotment and the GDRM's objective of promoting equal access across refineries in inputs would not have been met. Therefore, it appears that the oligopolistic nature of the vegetable oil subsector would prevent auctions from being administered without collusion. In the absence of short-term support for the private sector refineries, auctions of Section 206 inputs would promote the continued dominance of public refineries in the sector. One possible solution to the problem of collusion by refineries and potential dominance by parastatals is to import and auction refined oil, rather than crude. This would presumably increase competition in the subsector since the bidders would have fewer barriers to entry than those faced by bidding refineries. However, not much is known about the edible oil subsector on the marketing and distribution level.

While the bidders complied generally with the administrative and procedural requirements of the auction set out in the IFB, some problems undermined the auction's effectiveness. While the auction was conducted with sufficient advance warning, misinterpretation of key clauses in the IFB and technical and financial constraints faced by refineries reduced their ability to follow the auction rules precisely. The most common breach of auction rules were payment delays by the winning bidders to both the GDRM and the consignee. This was due to both financial constraints faced by bidders, which make it impossible to submit a full deposit for their winning allocation, and misinterpretation of the rules in the bid document regarding payment. The auction payment procedures could be improved by allowing the winning refineries to make partial payments for shares of their winning

77

allotments before taking delivery within a given time period (such as six weeks). After this period, any allotments for which full payment had not been made could be sold in the next auction. Finally, the bid document should be amended to designate the exact time period during which payments should be made for winning allotments. This measure would increase transparency in auction rules among bidders and improve auction effectiveness.

A second procedural issue, which hurt the auction results, was the confusion among the bidders with respect to the delivery terms. A number of the bidders did not take full delivery of their winning allotment within the time period specified in the IFB. Again, the bid document should be revised both to clarify the delivery instructions and to allow for partial deliveries. Further, SOMAPALM took delivery on part of its allocation before payment had been made, which resulted in the refinery being ineligible from participating in subsequent auctions that year. The early access was possible because SOMAPALM was also the consignee and, therefore, had ready access to the allotment. This situation could have been avoided through more careful monitoring of the shipment and monthly operations reports by the GDRM. In this case the early delivery by the violating refinery was detected through the review of the refinery's required monthly report by the government.

In general, the auction of the P.L. 480 crude soybean inputs had mixed results, which were attributed to financial and technical constraints faced by refineries, the oligopolistic nature of the vegetable oil subsector, and lack of transparency in the auction procedures among the bidders. Serious thought should be given to the relative merits of auctioning refined edible oil based on the results of a subsector analysis. The auction did, however, yield positive results in terms of increasing the supply of edible oil to consumers and assisting the government with its balance of payments.

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APPENDIX D

EXPERIENCE WITH FOOD AID AUCTIONS IN MALI

TABLE OF CONTENTS

90

APPENDIX D

EXPERIENCE WITH FOOD AID AUCTIONS IN MALI

Country Background: The Context for Auctions

Mali is a landlocked Sahelian country with a population of close to nine million. Although the country was self-sufficient in cereals in the 1960s, population increases and recurrent droughts have made it necessary to import wheat, rice and, in most years, coarse grains (millet, sorghum, and maize) to meet the population's needs. In years of high rainfall, however, Mali produces sufficient coarse grains for local consumption, and it has the capacity to export to neighboring countries.

Throughout the 1970s, Mali pursued policies that emphasized the role of the state as the leading economic actor and that favored residents of the urban areas over farmers and other rural residents. In keeping with many of its neighbors, the Government of the Republic of Mali (GRM) repressed private trade and established fixed prices for agricultural products that served to transfer income from the rural areas to the cities. Recognizing the negative impact that these policies were having on production and equity, the GRM moved in the 1980s to implement a wide-ranging reform program. With the assistance of the donors, the GRM has undertaken a number of policy measures to strengthen the role of the private sector in grain marketing and to improve efficiency, production, and incomes in the grain sector.

The multi-donor Projet de Restructuration du Marche Cerealier (PRMC) has played a major role in this process. Under the leadership of the World Food Program (WFP), the major food aid donors (including the United States) made a multi-year commitment to provide food aid to Mali. In return for this, the GRM agreed to liberalize the grain market and to take other actions intended to increase farmer incomes and to improve the efficiency of public sector organizations in the sector, including the Office des Produits Agricoles du Mali (OPAM), the parastatal responsible for managing food aid and domestic grain marketing. Revenues from the sale of food aid provided under the PRMC were used to support the reform. A.I.D. participated in the program through the provision of rice under Title II, Section 206.

Cereals Marketing Structure

Because of the suppression of private trade in cereals until 1981 and the generally low level of economic activity in Mali, the cereals marketing structure remains somewhat underdeveloped. Marketing channels for coarse grains differ from those for rice, but there is also considerable overlap between the various actors in each area. As rice trade becomes more fully liberalized, there is also a tendency for the two channels to merge.

In the past, Malian law identified seven classifications for cereal traders, depending on their sales volume, and it imposed different requirements for each under the system of commerçants agrées. This system has been dismantled, and traders are distinguished only by the size of their total operation (annual sales volume), which determines the level of annual registration tax (patente) they must pay. Nonetheless, the informal distinction among wholesalers (grossistes), small wholesalers (demi-grossistes), and retailers (detaillants) continues.

In the case of rice, the two large traders who have traditionally dominated the market continue to account for the lion's share of commercial imports, but they have been joined by a number of new entrants drawn from the ranks of general import-export traders and senior bureaucrats. The two large traders continue to retain an advantage, given their superior financial strength and their extensive distribution network. The latter includes both small wholesalers linked to the large traders by longstanding credit arrangements and their own in-house distribution system, which for at least one of the traders extends down to the retail level.

The coarse grains market is much more competitive and fragmented, by its very nature. Unlike the rice market, which channels an imported product to consumers concentrated in the urban centers, the coarse grains market serves to collect goods produced throughout the country and resell them to consumers who are likewise distributed throughout the country. The Bamako market is dominated by 5 to 10 large wholesalers, but additional large wholesalers are based in the provincial market centers, and there is a very large network of small wholesalers (with estimates running up to 200 for Bamako alone).

In both markets, traders strive for maximum turnover and minimal storage, in response to market volatility. Market conditions such as falling prices or a temporary glut might force them to hold grain for more than two months, but they generally prefer to buy only what they can sell in a period of one to two months. In the coarse grains market, some small wholesalers make purchases almost entirely on the basis of orders from larger wholesalers (or exporters in the current situation), who commit to buy a fixed amount for a fixed price with delivery in one to two weeks. Such operations make heavy use of suppliers' credit, with full payment at each level of the market chain only after the final transaction has been completed. The purchaser may make an advance payment, however, to facilitate the collection process. In the rice market, small wholesalers often take rice on consignment from the large importers, with payment only after the rice is sold. The price that the small wholesaler will pay to the importer is agreed in advance, but the rice is considered to belong to the importer until actually sold.

There is no generally accepted grade and standard for either rice or grain. Although observers differed as to the importance of quality differentials for rice versus coarse grains, they generally argued that quality premiums are low in Mali and that price is the overriding consideration for most consumers.

Informal credit from buyer to seller and seller to buyer is thus a central feature of market operations. Written contracts are virtually unknown. Only the larger and more experienced traders maintain bank accounts or make use of formal bank lines of credit.

Experience With Food Aid Auctions

Under the auspices of the PRMC, several attempts have been made to use the auction mechanism to sell grain stocks held by OPAM. Attempts at auctions, some rather half-hearted, have also been made by regional development parastatals, including the Office du Niger (ON) and Operation Riz Segou (ORS). In the PRMC cases, the basic method used has been the Invitation for Bids (IFB or Appel d'Offres) rather than a public auction. Experience with sale of food aid by true IFB is limited to three sales by OPAM (one in January 1989, one in April 1989, and one in June 1989), and two sales by the Stock Nationale de Securite (SNS) (one in 1987 and one in September 1989). Table D-1 summarizes the grain auctions that have been held to date.

The actual experience with auctions (or IFBs) to sell grain in Mali is considerably less broad than this listing might imply. In only three cases did the auction result in the actual sale of the grain to the highest bidder. In most cases, the procedure defined fell far short of the minimum requirements for a well-organized auction, as discussed below.

Basic problems common to many of the auctions organized under the PRMC program were the weak market for the commodity in question and the absence of agreement among the seller, the PRMC, and potential buyers regarding its value. In several cases, the parastatal agreed to conduct an auction as a last-ditch effort to sell grain after other attempts had failed. In other cases, the commodity being sold was already degraded or of marginal

Table D-1. Summary of Auction Experience in Mali

Organization	Date	Commodity	Quantity	Locations	Comments
Auctions by the ODRs:					
Office du Niger	Nov-86	Local rice	NA	Segou	Five bids received for a total of 6090 T., with the largest being for 4000 T.
Operation Riz Mopti	Nov-86	Local rice	NA	Mopti	Three bids received
Operation Riz Segou	Feb-87	Local rice--RM 40/BB	2000 T.	Dioro	Report indicates contracts signed for 4355 MT and 4200 MT delivered
Office du Niger	Feb-87	Local rice--four grades	4200 T.	Segou	Highest bidder could not finance purchase and dropped out; subsequently awarded to four other bidders
Operation Riz Mopti	Apr-87	Local rice	400 T.	Mopti	Cancelled due to absence of bidders above reserve price
Operation Riz Mopti	May-87	Local rice	400 T.	Mopti	Indication that 254 T. sold
Operation Riz Mopti	Jun-87	Local rice	NA	Mopti	385 T. sold during June-August period
Operation Riz Segou	Jul-87	Local rice	NA	Segou	4355 T. sold
Office du Niger	Jan-88	Local rice	5000 T.	Various	Lots of 200 T.; outcome unknown
Office du Niger	Jan-89	Local rice--RM 40	8300 T.	NA	All purchased by single buyer; not clear that formal IFB issued
Auctions by OPAM:					
National Security Stock	?-87	Degraded EEC/Chinese maize	4500 T.	NA	For export or animal feed only
Donor rice	Jan-89	US/WFP RM 40 & USSR BB	6800 T.	13 cities	See following table
Donor rice	Apr-89	US RM 40	500 T.	Gao	See following table
Donor rice	Jun-89	US/WFP RM 40 & Japanese BB	4200 T.	4 cities	See following table
National Security Stock	Sep-89	US maize and local coarse grain	15630 T.	5 cities	23 bids; negotiations still underway at time of team visit

quality, reducing demand to a point where competitiveness could not be ensured.

Auctions Held by OPAM, 1989

OPAM conducted three auctions of donor rice during 1989: an offer of 6,800 tons of USSR broken rice and USAID/WFP RM 40 in 13 locations in January, an offer of 500 tons of USAID RM 40 and WFP rice in Gao in April, and an offer of 4,200 tons of USAID and WFP RM 40, and Japanese broken rice in June. Details on each auction are presented in Table D-2.

Although OPAM appears to have made a good-faith effort to conduct the process openly and systematically, the overall results cannot be judged a success. The problems experienced appear to derive equally from the inexperience of OPAM and the traders themselves with the auction process, the nature of the grain market in Mali, and the absence of donor support.

Procedure

The formal record contains little evidence of any attempt by the donors to support the auction process. Communications from the donors allude to universally accepted procedures, throwing the responsibility wholly on the GRM to deduce what these procedures might be. At no time was a set procedure formally established either within OPAM or by agreement with the donors. It appears that no discussions were held with traders to develop a procedure meeting their needs, nor were any training sessions held to acquaint traders with the procedure developed.

In the event, all three auctions followed essentially the same procedure. Invitations for bid were issued by advertising in the newspaper and over the radio, with the bid opening set 5 to 15 days after the announcement. Notice of the IFB was provided to the Chamber of Commerce and, in some cases, to selected traders as well. A committee of OPAM officials was formed to review the bids, which were opened publically at the announced time. Bids were ranked in descending order by price, and recommendations were made as to which traders should be awarded contracts. Contracts were to be signed on a pay-as-bid basis, although this was never formally specified.

Samples were available for examination prior to the bid and, although this fact was not included in the announcement, most traders were aware of the availability of samples and appear to have taken advantage of it. Samples were particularly important in the case of the USAID rice, which had been in storage for some time and therefore was of unknown quality.

Minimum lot sizes were set at 100 metric tons for the second auction and 50 metric tons for the third (minimum lot size, if any, for the first auction is unknown). There was no limit on the number of lots for which a

85

Table D-2. Experience in Mali with Auctions of U.S. Food Aid

Auction Date	Location	Commodity Offered(a)		Bids Received (b)		Bids Retained		Number of Contracts		Amount Contracted	
		Type	Quantity	Number	Tonnage	Number	Tonnage	Initial	Follow-up	Initial	Follow-up
Jan-89	TOTAL		6800	15	5870	12	4242	9	6	4170	2042
	Bamako	US (+ other?)	2630		2630	NA	NA	1? (c)		1000?	
	Bandiagara	W	108		0	NA	NA	1		108	
	Djenne	W	25		25	NA	NA	1		25	
	Gao	W)	1000		1000	NA	NA	2	1	500	500
		US)						1 (d)		500	
	Kayes	B)	1150		1150	NA	NA	2	1	180	92
		US)						1 (e)	4	970	950
	Kenieba	W)	135		135	NA	NA	1		55	
		B)						1		80	
	Kita	B	90		90	NA	NA	1		90	
	Kolokani	W)	40		40	NA	NA	1		12	
		US)						1		28	
	Macina	L	60		60	NA	NA	1		60	
	Mopti	US	500		500	NA	NA	1 (e)	1	500	500
	Niono	US	22		0	NA	NA	1		22	
	Tombouctou	US	1000		0	NA	NA	0			
	Tominian	L	40		40	NA	NA	1		40	
Apr-89	Gao	US	500	10		5	500	NA		NA	
Jun-89	TOTAL		4000	52	22900	9	4200	10		4300	
	Bamako	J	1000	18	10350	2	900	1 (f)		1000	
		US	1000	6	3750	2	1500	3 (f)		1550	
	Kayes	J	500	16	5250	1	500	3 (f)		750	
	Mopti	US	500	6	1400	2	800	1 (f)		500	
	Tombouctou	US	500	0							
		W	500	6	2150	2	500	2 (f)		500	

Notes:

a. US = USAID RM 40; W = WFP RM 40; L = local rice; B = USSP brokens (of Vietnamese origin); J = Japanese brokens (of Thai origin)

b. Reported as "Quantity bought" in USAID internal report; OPAM report of 9-May-89 does not include Bamako sales, but shows total retained bids as 4242 MT.

c. Contract for 1000 MT with major dealer reported in text, but not on official list; contract later suspended due to disagreement on quality and price.

d. Contract annulled.

e. Contracts suspended, due to dispute noted in note (c).

f. Purchaser(s) differ from retainees and may or may not have been among original bidders; Mopti purchaser also bought 500 tons of WFP rice.

single trader could bid. Limitations on payment terms and delivery periods were generally left open, although the Gao IFB specified payment in cash or 30-day guaranteed bank note and that the buyer must take possession within 15 days. Bid bonds were not required (performance bonds were required following signature of sales contracts, although this was not stated in the IFBs; the amount required was variously reported as CFAF 500-1,000 per metric ton, less than 1 percent of the purchase price). An effort was made to limit participation to serious bidders by charging for the IFB documents (a one-page sheet of instructions and a simple form), at prices ranging from CFAF 10,000-25,000 (roughly $30-80). OPAM officials viewed this procedure as ineffective.

No limitations were placed on eligibility to bid in any of the auctions or on the subsequent sale of the goods purchased (except for the IFB for the Gao auction, which specified that goods could not be transported outside of the region). Credit was not offered in conjunction with the auction sales.

In two of the three auctions, lots of different qualities of rice and in different delivery locations were offered, but each lot was treated in effect as a separate auction. Traders were free to bid on any or all of the lots, and bidding was not restricted to traders from the region. No formal reserve price was set, although OPAM established a rough acceptable range on the basis of its market information system.

Following the opening of the bids, a list of winners was prepared and approved by the OPAM director. In theory, contracts were then to be negotiated with the winners, but, as discussed below, practice departed widely from this theory.

Outcome

The Malian experience underscores the importance of monitoring the auction process from before issuance of the IFB through final completion of the transaction. Few problems were experienced with the issuance of the IFBs and the receipt and ranking of offers. Once the point of signing sales contracts was reached, however, the process began to deviate sharply from the theoretical ideal.

Both OPAM and the traders tended to view the announcement of bid "awards" as just the first step in a process of negotiation. Neither side viewed the offers as truly binding. OPAM felt justified in negotiating with the winning bidders at the low end of the scale to raise their price to that of the highest bidders. For their part, many of the bidders regarded their offer as, in effect, an option to buy rather than a commitment, and they were willing to sign contracts only if, following notification of the award, they were able immediately to line up purchasers for at least a major portion of the grain. Because many of the bidders - particularly those who bid high

— were not established grain traders, they lacked the market connections to line up buyers. Therefore, they were unwilling to sign contracts or unable to perform if they did. The presence of these speculators in the auction process, moreover, apparently discouraged some potential serious bidders.

In both the first and third auctions, OPAM was unable to sign contracts with all of the traders initially selected for award. In the third auction, where quantities were much higher than in the other two, OPAM was not able to execute contracts with any of the initial winners. OPAM was therefore forced to work its way down through the bidders or even to seek new buyers by direct negotiation with major wholesalers (or else to cancel the tender, which it was unwilling to do).

As might be expected, this procedure caused problems. In the first auction, for 6,800 metric tons of rice, there were only 15 bidders and awards were made for only 4,242 metric tons. First-round contracts were actually signed for only 3,170 metric tons (or 4,170 metric tons, including a contract in Bamako for 1,000 metric tons that does not appear on the list), of which 1,970 metric tons (or 2,970 metric tons) were accounted for by two traders. The smallest of these contracts, for 500 metric tons, was cancelled when the buyer could not perform. The remaining contracts, totalling 2,470 metric tons, became the subject of a dispute that is a case study in itself. Although somewhat complex, it offers valuable lessons for future auctions.

Two mistakes were made by OPAM at the outset. First, the tender stated that the rice was in conformity with established grades and standards in effect in Mali, but the rice (USAID RM 40) in fact contained a higher percentage of foreign material and more broken grains than the official standard (ignored by everyone) allows. Second, the period for responses to the IFB was only two weeks, with little advance notice that the IFB was about to be issued. The trader involved was outside the country when the tender was issued, and, given the limited time available, he delegated a junior member of his staff to examine the samples and prepare the bid. Contracts were ultimately awarded and signed for 2,470 metric tons of USAID rice, but, after taking partial delivery, the trader alleged that the rice did not conform to the quality standard agreed upon and he demanded a 10-percent reduction in price. OPAM ultimately agreed to reduce the price for the 450 metric tons already delivered, and it suspended the remainder of the contracts.[1] OPAM subsequently signed contracts with 6 additional bidders, with the result that 12 of the 15 bidders were awarded contracts. As of May 1989, however, the purchasers had paid for and taken delivery of only half the planned amount.

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1. Under Roman civil law, the buyer is within his rights to impose a reduction in the purchase price for goods found to be nonconforming after the contract has been signed. Under the rule of *quanti minoris*, this reduction in price plays a role parallel to suit for damages under common law. Damages may be sought only if the seller acted fraudulently.

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88

Another problem, this time a political one, arose during the first auction. In Kayes and Gao (both remote areas), it was alleged that Bamako traders had outbid the local traders and then transported the rice to Bamako, where prices were higher. The truth of this allegation could not be ascertained, but in any case sufficient sensitivity was aroused to cause the Gao governor to restrict the second auction to the local market. An article criticising OPAM's actions in Kayes also appeared in the local press.

Problems with grain quality arose in the second auction (held in Gao). Although the offer was initially limited to USAID rice, trader complaints regarding its quality led OPAM to agree to accept bids for both USAID rice and WPF rice. Winning bidders then received mixed lots of half USAID rice and half WPF rice at a blended price reflecting the average of the high USAID bid and the high WPF bid.

Although details on Gao are sketchy, there is some evidence that collusion occurred, as might be expected in such a limited market. Local dissemination of information on the IFB was delegated to the local Chamber of Commerce head, who limited his efforts to those he felt had the means to bid. Given this problem, the restriction on selling the goods outside of the Gao region, and the short notice provided (five days), only 10 bids were received for the five lots (100 metric tons each) on offer. Of these, one was eliminated on the basis that the bidder did not have the financial means to perform. The lots were then awarded to five bidders who had each bid the same price. The final price — CFAF 150 for WPF rice and CFAF 130 for USAID rice — was somewhat low, further indicating the possibility of collusion. Prices for imported rice in the January auction had ranged between CFAF 125 and CFAF 160 (with the largest purchaser initially agreeing to pay CFAF 160 for the inferior USAID rice and ending up paying CFAF 144). In the third auction, the contract prices were CFAF 135 for USAID rice in Mopti and CFAF 150 for WPF rice Tombouctou.

The third auction followed a course similar to the first. Fifty-two bids were received from 29 traders, ranging from 6 bids each for the USAID rice in Mopti and the WFP rice in Tombouctou to 18 bids for the Japanese brokens in Bamako. (No bid was received for the USAID rice in Tombouctou.) The degree of oversubscription ranged from 2.8 for the USAID rice in Mopti to over 10 for the Japanese brokens in Bamako.

Many of these bids were from non-serious offerors, however, as evidenced by the fact that not one of the six traders initially awarded bids signed a contract. The team was able to locate only one of the bidders initially awarded a contract; their names were unfamiliar both to Michigan State researchers conducting a survey of traders and to the larger traders contacted. Table D-3 compares the initial awards with the contracts actually signed.

Table D-3. Initial and Final Results of OPAM Auction, July 1989

Location	Quality[a]	Initial awards			Final contracts		
		Bidder initials	Quantity metric tons	Price CFAF/ kilograms	Bidder initials	Quantity metric tons	Price CFAF/ kilograms
Bamako	J	AD	500	161	MN	1000	150
		MT	400	157.5			
	US	YK	500	155	MN	1000	145
		DS	1000	155	AD2	200	145
					MM	300	145
Kayes	J	AD	500	162.5	CB	500	155
					HN	100	155
					AN	150	155
Mopti	US	MD	300	135	AD2	800	135
		ZC	500	135			
Tombouctou	W	MT	300	165	H	350	150
		MD	200	155	BK	150	150

a. See quality codes in Table D-2.

Several features of this outcome are worth noting. First, the final sales price was generally well below the level initially reported. OPAM generally moved down the list of bidders following standard practice until a serious buyer was identified, reaching the seventh bidder in the case of the Japanese brokens in Bamako, for example, and the sixth and lowest bidder in the case of the USAID rice in Bamako. Second, even this procedure was ineffective in four cases, where contracts were awarded to traders who did not participate in the initial bidding at all. Third, OPAM refused to accept the prices bid in cases where legitimate bidders had offered higher prices, and it negotiated successful bidders upwards. Of the six contracts signed with traders who had entered bids, two went to traders at prices above their bids.

The degree to which the sales process was actually completed remains unclear. Although the team visited Mali in October, three months after the bid opening, traders had still not taken delivery of all rice under contract. Whereas traders reported that the WFP rice and the Japanese broken rice sold well, and that it had generally already passed through the marketing channels, both purchasers of USAID rice contacted by the team indicated that they had taken delivery of only 30 to 60 percent of the latter, because of the difficulties experienced in selling it. It remains to be seen whether the rice market will firm up sufficiently to permit profitable sale of the USAID rice, whether the traders will ultimately sell the rice at a loss, or whether they will choose to forfeit their performance bonds.

In other words, both OPAM and the traders viewed the IFB as just the first step in what remained essentially negotiated sales, with no hard and fast obligations on either side. The transparency of the IFB procedure was clearly a casualty of this process.

Auctions Held by the SNS,
1987 and 1989

The SNS held two auctions to date, both for the purpose of rotating the security stock, which is managed as a separate program under OPAM's supervision. The SNS stock consists primarily of local coarse grains intended to serve as a buffer during the period between identification of an emergency and arrival of donor or other cereals. The SNS has also issued IFBs for the purchase of local grains to reconstitute its stocks.

SNS's first auction was held in 1987. The grain sold, degraded maize of EEC and Chinese origin, had deteriorated below the standard for human consumption, forcing an immediate sale. Given the limitation that the grain be exported or sold for animal feed, the IFB solicited few bids. The 4,500 metric tons on offer were sold, however, and exported by Malian traders to Côte d'Ivoire and Senegal.

The second auction was still under way when the team visited Mali. Although the bid opening had taken place more than one month earlier, the low prices and limited number of bids had led OPAM to retreat into a negotiated sales procedure. A total of 23 submissions had been received for 15,630 metric tons of coarse grains in five locations, including several at prices regarded by OPAM as unreasonably low or impossibly high. Prices ranged from CFAF 12 to CFAF 51 per kilogram, whereas prices in the range of CFAF 30 to 45 were viewed as reasonable. At the time of the team's visit, OPAM had negotiated six contracts with five traders for a total of 6,750 metric tons, but delivery was still not complete. As in the case of the third rice auction, OPAM did not respect the bids submitted but attempted to negotiate a higher price if possible. While the desire of OPAM and SNS management to get the best possible deal for the organization is certainly understandable, reopening negotiations on price and quantity after bidding tends to undermine the bidding process.

SNS experience with use of IFBs to reconstitute its stock has been generally positive. Traders reported that they were satisfied with this process, although kickbacks were alleged by one participant. The three IFBs issued between November 1988 and March 1989 resulted in 103 submissions, of which 33 were awarded contracts, spread among 16 suppliers. All 33 resulted in signed contracts, but 6 additional contracts had to be signed to cover 5 defaulting suppliers. The 34 contracts resulting from this process covered quantities up to 2,000 metric tons, and they were all essentially honored in full, although there were some late deliveries.

Auctions Held by the ODRs, 1986-1989

Between November 1986 and September 1989, 10 IFBs were issued by one or another of the regional development parastatals (ODRs). In all cases, the commodity sold was rice produced and milled on the ODR. Operation Riz Segou issued two IFBs (February 1987 and July 1937), Operation Riz Mopti issued four IFBs (November 1986, April 1987, May 1987, and June 1987). The Office du Niger issued four IFBs (November 1986, February 1987, January 1988, and September 1989).

Complete information on the outcome of these auctions could not be obtained by the team in the field. It is clear that very few of these auctions met the requirements for a successful auction, however, and that not all of the auctions led finally to sales to one or more of the bidders at the price bid. Nearly all of the IFBs issued by the ODRs suffered from overly stringent limitations on the bidders that constrained or eliminated competition. In some cases, the ODR set a reserve price that was well above the market price, even announcing this price in advance in a few instances, a procedure that ensured the failure of the process.[2] As a result of the unattractive limitations placed on bidders, only five or fewer bids were received in many of the ODR IFBs, and sometimes no bid was received at all.

A second problem associated with these auctions was the high minimum lot size, which ranged up to 200 metric tons. Traders contacted by the team were virtually unanimous in their view that such large lots were out of the reach of all but the largest traders. Lots were also defined with a view to the convenience of the ODR, not the generation of maximum buyer interest. For the January 1988 auction by the Office du Niger, for example, lots were defined as 200 metric tons, made up of four different grades of rice spread among at least two different locations. Bidders had to bid for these composite lots rather than for the grades and locations of most interest to them.

The IFBs differed in the degree of compliance with the requirement for adequate notice to potential bidders, but notice was generally not adequate. Although full information was not available to the team, evidence of a sincere effort to inform and interest bidders is absent. It appears that only the February 1987 auction by Operation Riz Segou was publically advertised in the leading newspaper. For the May 1987 IFB by Operation Riz Mopti copies were sent to the chambers of commerce in the principal cities and announcements were made over the radio in French and Bambara, the principal local language. The inadequacy of IFB publicity is demonstrated by the poor response and by the fact that the rice traders contacted by the team were generally unaware that the ODRs had ever issued IFBs.

Like the OPAM auctions discussed above, the ODR auctions suffered from a shortage of serious offerors. In the case of the February 1987 auction by the Office du Niger for 4,000 metric tons of rice, for example, the buyer initially awarded the sale was unable to negotiate financing. At least part of the rice was ultimately sold to four other buyers. The April 1987 IFB issued by Operation Riz Mopti was cancelled and reissued in May, but it

2. The ODRs found themselves in something of a bind when OPAM ceased purchasing their product at a price set by the GRM. On the one hand, they were greatly in need of cash, which could only be generated by selling their only product, rice. On the other hand, their high cost structure resulted in a break-even sales price that was well above the market price. As neither the GRM nor the donors had made a definite commitment to cover the gap between sales revenues and costs, an open IFB process could be expected to transform a book profit (based on rice carried on the books at its official price) into an actual loss. Faced with this choice, as well as pressure not to lose money, the ODRs preferred to go through the charade of conducting IFBs with reserve prices that excluded serious bidders, even though this placed them in an extreme cash flow squeeze.

appears that only 254 metric tons out of the 400 on offer were actually sold in the second round.

Although the record is somewhat murky, there is little evidence of technical input into the issuance of IFBs by the ODRs. It would appear that the PRMC stopped at the insistance that IFBs be issued, but it did not assist in developing procedures, review the procedures used by the ODRs, or follow up to determine whether the process worked. In many cases, the bid announcements are sketchy on such vital issues as the availability of samples for examination, the payment terms that will be acceptable or the way that alternative payment schemes will be compared, the period during which delivery and payment must occur, and the requirements for bidders. Although it is clear that the ODRs did not always act in good faith, the lack of experience with open bidding on both sides suggests that additional support from the donors would have been warranted.

Impact on the Food Market

The information available to the study team does not permit any conclusions regarding the short-term impact of the Malian food aid auctions on the cereal market or the long-term effects on the structure of this market. In particular, the impact on prices is difficult to determine because of the lag between the auction and the time the grain actually hit the market. As noted above, even three months after the latest auction, only a portion of the USAID rice has moved into market channels and it is reported that very little of this has been sold.

OPAM officials expressed the view that the first auction of rice in Kayes had resulted in a lowering of the millet price on the market, and they cited a news story to this effect. The assessment of the auctions' impact is further complicated by the glut of rice on the Mali grain market, which has existed throughout the period during which the auctions were conducted. This glut is the product of an unusually good production year for local rice, renewed private imports (reportedly well in access of the official licenses granted), and donor supplies from various sources, including the auctions. Several traders complained that the OPAM auctions constituted unfair competition by the GRM, in that the traders had earlier signed contracts with the ODRs to purchase their rice at relatively high prices with an explicit — though verbal — understanding that the government would not import rice in competition with them. Not without reason, they viewed the OPAM sales of donor rice as a breach of this agreement. It should be noted, however, that many of the ODR-trader agreements were signed under the jumelage (twinning) program, which linked issuance of licenses for private rice imports to contracts for purchase of ODR rice. Whether these contracts will in fact be honored remains to be seen.

This situation illustrates the complexity of Mali's rice market, and indeed of cereal markets generally throughout the Sahel. This complexity results in part from the high variability of supply and market demand, which discourages traders from developing the capacity to manage surplus efficiently and makes the market highly vulnerable to gluts. This underlying structural problem is greatly complicated, however, by continuing and often apparently random shocks generated by donor and government action. Auctions are one, but only one, such action.

In general, it would appear that the timing and other design parameters for OPAM and ODR auctions have been set with the convenience of the donors and the parastatals in mind, rather than with a view toward limiting disruptive influences on the market or exerting a stabilizing influence. In principle, these two considerations should be compatible, because OPAM's goal of revenue maximization can best be achieved by selling into a strong market, rather than a glutted one. In practice, however, OPAM and particularly the ODRs are perenially cash-poor and under pressure to generate local currency for donor-supported projects, as well as their own operations.[3] Thus the first and largest OPAM auction was held in January, right in the middle of the harvest season, and 4 of the 10 ODR IFBs were issued during the critical January-February marketing period for local rice. (These sales, it should be recalled, were held to liquidate stocks carried over from the previous year.) Several of the traders complained that OPAM sales added to an already difficult oversupply situation. The arrival of new Section 206 rice, which took place during the team's October visit to Mali, appears destined to fall into the same pattern unless USAID intervenes.

There are some indications that the auctions are helping to broaden participation in the rice market and reduce the dominance of the larger traders. Established traders argue that many of the non-cereal traders who have participated in the auctions are only in a quick profit from a one-off operation and are unwilling to make a long-term commitment to the cereals market. They view these newcomers as disruptive influences rather than stabilizers, a view that is partially justified by experience. Some of these traders can be expected to stay in the business, however, if their initial experiences prove positive.

Perhaps more important is the development of alternative supply sources for small wholesalers in the rice market. Established small wholesalers figure prominently in the ranks of those actually signing contracts with OPAM. OPAM auction sales thus offer these traders an opportunity to increase their independence from the two importers who dominate the rice market, an important step toward ensuring competition in the rice market. As

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3. The head of the World Food Program in Mali commented that commercial imports should be limited because they are cutting into food aid levels and making it harder to generate local currency for their projects.

long as auction sales operate on a cash-only basis, however, the ability of the small wholesalers to operate with real independence will be limited by their dependence on the large importers for financial support.

Impact on Government Operations

Auction sales have not been as effective as originally hoped in generating revenues for OPAM, although some of the problems experienced have been due to market conditions rather than the auctions themselves. Revenues were reduced in the first auction by the absence of sufficient bids to sell the full amount offered, while slow offtake by the traders in the third auction slowed OPAM's receipts. Compared to the previous experience with negotiated sales to government institutions, some of which still have outstanding debts with OPAM, the auctions have performed adequately.

Participants at all levels of the system generally felt that the auction process had been well managed and that administrative requirements were reasonable. Minor problems in this area area noted below.

Problems and Possible Solutions

Use of the IFB or auction process for grain sales in Mali ran into problems in four main areas:

- Transparency of the procedure. While the initial steps in the IFB process were open and transparent, the process lost transparency once it moved into the contracting stage.

- Timing of sales. Sales were poorly timed relative to market conditions, increasing the potential for negative impacts on local producers and commercial imports.

- Limited participation. Given the limited number of small and large wholesalers in Mali, successful use of auctions requires that further measures be taken to ensure maximum participation.

- Lack of prequalification. Conversely, the failure to screen out non-serious bidders contributed to the collapse of the contracting process and discouraged serious bidders, the very target OPAM was trying to reach.

Several measures could be considered to improve auction of food aid grain in Mali:

- Reduce lot size. Small wholesalers indicated that a lot size of 5 to 10 metric tons would make participation more attractive and more feasible. Larger bidders should be allowed and encouraged to bid for multiple lots.

- Hold smaller but more frequent auctions. Given the difficulty of controlling the timing of OPAM's sales, the most expedient approach to increase participation, raise revenues, and reduce negative impacts on the market would be to spread auction sales more evenly across the year. Monthly or bi-monthly auctions announced in advance would encourage participation of smaller wholesalers who are interested in buying only what they can sell in this time frame. A regular schedule would also increase trader awareness of the auctions. The quantity offered in any one auction could be varied to reflect market conditions. A final advantage of this approach is that it would permit OPAM to cancel an individual auction if problems developed, holding the cereals over until the following auction, without experiencing a major delay in offtake of cereals.

- Establish clear procedures for all stages of the auction process. OPAM should develop standardized procedures for issuance and processing of IFBs. Both donor and trader input should be sought in developing these guidelines. The guidelines should specify, among other things, what notice procedures will be followed, the period between announcement and due date, norms for commodity specification and examination of samples, the procedure to be followed in selecting initial and replacement bidders for award, acceptable payment terms and the way that different terms will be weighted in comparing offers, requirements for taking delivery and making payment, penalties for non-compliance, and a procedure for dispute resolution.

- Clarify the pricing procedure. The procedure for setting the price should be either pay-as-bid or, ideally, pay at the margin (as used in Somalia). Continuation of the current practice, wherein all awarded bidders are asked to pay the price bid by the highest successful bidder rather than the lower prices they themselves bid, impedes the price formation process and is not consistent with maximizing OPAM's revenues over time.

- Minimize negotiation after award. An IFB process wherein both bidder and seller are free to continue negotiating price, quantity, quality, and other material terms after award is bound to deteriorate.

- Introduce a procedure to screen out non-serious bidders. Traders indicated their willingness to pay a bid bond (on the order of 2 to 5 percent), as long as they are assured that the bonds will be returned to low bidders. Such bonds, which are standard procedures for the international tenders in which some of the traders now participate, were viewed as likely to exclude non-serious bids. Alternative procedures, such as bank recommendations or a requirement that bidders have a warehouse, could be considered, but they carry the danger of excluding smaller whole salers and increasing implementation problems.

- Pay greater attention to product quality. Demand, and therefore trader competition, is naturally stronger for commodities of good commercial quality. Some of the USAID rice imported has been Grade 5 (the lowest marketable grade), creating problems both for the seller and the ultimate buyer. The reputation of U.S. rice also might be harmed by this practice, jeopardizing present and future commercial imports. Additional attention to packaging is also necessary for commodities that are destined for the market.

The team does not recommend substituting an open outcry auction for the IFB process at this time. The current regulations governing public auctions in Mali were developed for auctions of goods seized in relation to judicial actions, not for commercial auctions. They require that a 12 percent tax be deducted from the revenue generated, which, when added to the auctioneer's fee, makes them financially unattractive as a sales mechanism. While spokespersons for the Ministry of Finance and Commerce indicated their willingness to revise the auction regulations to encourage commercial use, the IFB mechanisms should work very well, once the problems are worked out of it.

Bibliography

No document containing more than a passing reference to the auction experience was identified by the team.

110
98

APPENDIX E

EXPERIENCE WITH FOOD AID AUCTIONS IN SOMALIA

TABLE OF CONTENTS

APPENDIX E

EXPERIENCE WITH FOOD AID AUCTIONS IN SOMALIA

Country Background: The Context for Auctions

Somalia, which is approximately the size of Texas and has 5 million people, is a poor country, highly dependent on external support, and subject to a harsh climate. Agriculture, composed of a small commercial sector and a large subsistence sector, accounts for more than 55 percent of GDP, 80 percent of employment, and almost all of export earnings. Livestock herding is the predominant activity within agriculture; dryland production is limited largely to sorghum. Irrigated production focuses on bananas, rice, and sugar on large-scale farms, and maize and sesame on smallholdings. In general, agricultural yields are constrained by uneven and low levels of rainfall, poor cultivation practices, and low use of commercial inputs. During years of sufficient rainfall, Somalia can produce enough food to feed its population.

Since Independence in 1960, Somalia's economy has been pointed towards free markets, then "scientific socialism," and once again towards free markets. The last turning point occurred in 1981, subsequent to the Ogaden War of 1977 (marking the end of Somalia's relationship with the Soviet Union) and two years of drought (leading to extreme foreign exchange shortages). At that time, the Somali government initiated a structural adjustment program (SAP) with support from various donor agencies, including the World Bank, the International Monetary Fund, and USAID. The SAP, which effectively ceased to exist in the late 1980s owing to internal political turmoil, had two underlying themes, liberalization and stabilization. It sought to strengthen public finances, reform the parastatal sector, adopt a realistic exchange rate, ease foreign exchange controls, relax price and import controls, promote private sector activities, and encourage agricultural production.

Though donors in favor of the SAP did not always agree on the means of achieving SAP's goals,[1] a significant number of policy reforms had a dramatic impact on economic production, especially within the agricultural crop sector as farmers responded to the new incentives between 1981 and 1987.[2] Grain production more than doubled between the late 1970s and 1985, largely in response to higher market prices.

USAID's response to these changes was to modify its Title I program so that a greater percentage of the commodities would be channeled through the private sector "to encourage private sector participation in food distribution" and to leverage policy reform initiatives in favor of a market-driven economy.[3] Auctions were selected as the most responsive sales mechanism for the purpose, and between 1984 and 1986, auctions were held for up to 40 percent of annual total Title I food imports. In 1987, the Title I program was discontinued owing to Somalia's growing external account deficit, and a Title II program was implemented. Between 1987 and 1989, private auctions were held for up to three-quarters of Title II, Section 206 commodities.

The Grain Marketing Structure

Most of the information available to the study team describes the marketing of grains in Somalia from a historical perspective. Between 1971 and 1982, a single parastatal, the Agricultural Development Corporation (ADC), held a monopoly over the domestic grain trade, as all farmers were to sell to it staple products like sorghum and maize. Between 1982 and 1985, as the government relaxed restrictions on private cereals trading and as prices moved towards free market levels, ADC lost most of its market to the private sector. By 1984, ADC's share of of the market had dropped to 1.6 percent while total production of grains had doubled.[4] ADC became a buyer of

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1. Disagreements centered on specific measures, such as whether export taxes should be levied to improve Somalia's foreign exchange position, whether the exchange rate should be managed or allowed to float freely, and whether the parastatal responsible for grain marketing should be completely or partially dismantled.

2. The activities of marketing parastatals were curtailed in 1981-82, producer price ceilings were increased between 1981 and 1985, and price controls were eliminated in 1985.

3. Prior to 1984, Title I commodities were directed to two parastatals, which in turn sold the food items to various government agencies for distribution to the military and public civil servants.

4. The total domestic production of maize and sorghum alone increased from 251,000 tons in 1980 to 491,000 tons in 1984.

last resort, responsible for national food security and cereal price stabilization for producers and consumers.[5]

During the same period, the role of the National Trading Agency (ENC), the parastatal responsible for the distribution of imported foodstuffs to the private sector, was modified to allow greater private sector involvement. Between 1980 and 1984, ENC's imports of grains halved, and it retained a competitve edge only with food aid imports which, it sold at concessionary prices. It is impossible to state the degree to which private traders are responsible for total food imports, but it is clear that their role is substantial, especially during intervals when concessional food imports decrease.[6]

Experience With Food Aid Auctions

Six auctions have been held in Somalia for (at various times) flour, rice, vegetable oil, wheat, and corn. The auctions occurred in fall and early winter (between September and January) of 1984 through 1989, following the arrival of the Title I, and later Title II, commodities in country. The Government of the Somali Democratic Republic (GSDR) was responsible for offloading and storing the commodities between the time of arrival and the sale. Auction parameters were essentially determined during the summer before the arrival of the commodities by GSDR (MOFT) in concert with advice from USAID, and they were detailed in a memorandum of understanding between them.

Two auction sites (Mogadishu and Berbera) were used in most cases as a result the isolation of the northern region from the national market and of pressure from traders as well as from within the government for the widest distribution of food commodities at the wholesale level[7]. When more than one site was involved, the auctions were administered by separate oversight committees, one per site, and they were staggered, with refinements in auction procedures generally being developed during the initial auction and integrated into later ones.[8]

Although only the general parameters and results of certain auctions (specifically those of 1985, 1987, and 1988) are available to the study team in

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5. In 1985 and 1986, for instance, when rain led to a bumper crop of maize and sorghum, ADC purchased some 15 to 20 percent of the crops in an effort to counteract the fall of maize and sorghum prices.

6. Such was the case from 1985 to 1988, when domestic production was sufficiently strong to caution against continued high levels of food assistance.

7. The number of auctions has generally been two, though regional sites were used in 1984 and one site in 1988.

8. The main exception to the trend of self-improvement appears to be the 1984 auction.

Washington, it is evident that, in contrast to most of the other cases studied, the parameters of the Somali auctions were quite sophisticated from the start and needed very little refinement with respect to bidding, award, and payment procedures. Auctions in Somalia, however, were initially handicapped by poor commodity selection and were generally marred by intervention with respect to allotment, which in turn affected transfer prices.

The Auction of 1984

The auction of 1984 is noteworthy as being as being the first auction sponsored by USAID for agricultural commodities in Africa. It suffered from collusion as bids were submitted over a period of many days, high administrative costs and uneven revenue generation owing to multiple auction sites, and inappropriately derived transfer prices (calculated as the average of the highest and lowest winning bids). All of these factors were taken into account in the design of the 1985 auction.

The Auction of 1985

To compensate for the fragmented food distribution system, only two auction sites were selected, Mogadishu, the capital and largest port in the southern region along the Indian Ocean, and Berbera, the largest port in the north east along the Aden Sea.

Lot sizes were designed to spread awards, with small amounts for each lot and ceilings on the total number of lots per trader. Lot sizes ranged from 25 drums for vegetable oil, to 10 metric tons for rice, flour, wheat, and corn, and traders could request up to 2 lots of vegetable oil and 10 lots of grain or flour.

To eliminate spurious bids, deposits or bid bonds correlated with bid quantities were requested. To ensure proper recording, these deposits were collected separately from the bids, and they were entered into a special account at the government-owned commercial bank. Successful bidders not wishing or unable to pay the balance for the commodities they won would lose their deposits. Unsuccessful bidders would have their deposits refunded as soon as bid awards were announced.

A reserve price, reflecting custom duties as well as transportation, port clearing and storage costs, and prevailing market prices, was calculated by both the GSDR and USAID. As the GSDR favored low domestic food prices and ultimately refused to acknowledge the potential for windfall profits by the traders, its reserve price for most commodities was lower than that suggested by USAID. The GSDR's reserve price was announced prior to the auction as the lowest acceptable minimum bid price, in part to ensure the recuperation of cost, and in part to establish a standard for offers within the private sector, given the significant presence of donor food at concessional prices.

Traders with valid licenses were designated as eligible bidders, and all interested traders were required to register for a specific auction to prevent their participation in more than one. Once screened for eligibility, all bids were to be ranked in descending order by bid price, with the lowest successful bid determining the uniform transfer price.[9] In the event of more than one bidder submitting bids at the transfer price and an insufficient number of lots remaining to award each the quantity requested, partial awards would be made to all who set the transfer price. Successful bidders had to complete their purchase before picking up the commodity.

The auctions themselves occurred between September 22 and October 19 in Mogadishu and between October 7 and November 6 in Berbera. The long interval between bid submission and food distribution was due to various interventions, such as an attempt by the military of the north to confiscate the vegetable oil earmarked for the Berbera auction. These intervening actions (described below) entailed much deliberation within the government and between the government and USAID, and they had the unfortunate effect of postponing award claims and of tying up the funds of traders for a longer than anticipated period of time.

A variety of commodities were for sale: 15,140 drums of vegetable oil, 6,582 metric tons of rice, 5,259 metric tons of flour, 3,314 metric tons for (hard and soft) wheat, and 5,627 metric tons of corn.[10] A total of 2,594 traders submitted bids (780 for vegetable oil, 773 for rice, 1,025 for flour, 7 for wheat, and 9 for corn). The number of bidders per commodity reflected perceived product quality, consumer demand and lack of acceptable substitutes, and the potential for profit given the reserve price and prevailing wholesale prices. Awards were ultimately made to 981 bidders (586 for vegetable oil, 263 for rice, 116 for flour, 7 for wheat, and 9 for corn). The actual number of successful awards was determined not by the auction but by an intervention of the Vice Minister of Commerce, who unilaterally reduced lot amounts by one half in Mogadishu to increase the number of

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9. Contrast this widely accepted method with that of the 1984 auction in which the transfer price was an average of the lowest of the highest and the lowest winning bids, the GSDR having first eliminated too high or "speculative" bids.

10. The amounts quoted were those available for sale, close to 40 percent of the clean landed goods as opposed to 40 percent of the goods leaving the U.S., as originally agreed upon with the GSDR. The difference in the quantity offered was due to losses incurred during shipment, specifically while using splash barges to convey the food to Berbera, and having one ship run aground in Mogadishu.

winners, overall and from the regions.[11] As the awards still favored traders based in Mogadishu over other areas, the same official subsequently and unsuccessfully tried to enforce a system whereby all bidders would receive a share of the goods available for sale. Some unsuccessful bidders objected to a change in lot size affecting some but not all bidders, and they demanded commodity delivery rather than deposit repayment.

Reducing the lot size also altered the auction's outcome with respect to revenue generation. Though the original bid ranking remained intact, a new transfer price was obtained by following the demand curve to the new stop-out price. The new transfer price was slightly lower than both the old one and the wholesale prices prevailing for vegetable oil, rice, and flour in Mogadishu and Berbera. The noncompetitive reserve price of wheat and corn, moreover, biased the bidders for such commodities against final commodity collection and payment. In two instances, bidders for wheat and corn used their deposit for wheat to pay for their purchase of flour and rice.

In the final analysis, only the flour (which was of high quality and in relatively short supply) was completely sold. The wheat and corn remained largely unsold and all unclaimed, and a small but significant percentage of the rice was not collected by bidders owing to its extremely poor quality. Vegetable oil sales were hampered by fear of confiscation by the military and by concern of adulteration and low quality (because of confusion over the packing and expiration dates and because the GSDR left the drums out in the hot sun). Approximately half of the commodities initially earmarked for private sector distribution were channeled back into the public sector.

The Auction of 1987

The 1987 auction entailed the sale of Title II Section 202 flour and vegetable oil in Mogadishu and Berbera. The auction in Mogadishu was considered by USAID to be a success, with no intervention whatsoever. However, several problems were encountered in Berbera. The military confiscated 25 percent of the vegetable oil and 20 percent of the flour available for the auction (thereby proportionately reducing final awards), and it also had the oversight committee eliminate the highest-ranked bids to reduce the final transfer price (thereby reducing the transfer price). Moreover, the municipality inappropriately imposed a 5-percent surtax on all commodities auctioned. (Incidentally, this last action recaptured the revenue lost when the highest 62 bids were excluded.) USAID, along with the MOFT, was able to resolve the first two problems to their mutual satisfaction. The military

11. The oversight committee in Berbera was directed to follow suit, but given the ambiguous wording of the order by the Vice Minister, it allocated awards in slightly different configurations depending on the price offered and the quantity requested by each bidder.

returned the confiscated commodities, replacing those already sold with slightly inferior goods. Despite the lower quality, these commodities were then offered to the disqualified (a total of 62 traders) at the auction-determined transfer price.

Another factor, initially expected to invalidate the auction's outcome, was the establishment of price controls at the wholesale and retail levels midway through the auction process, after bid ranking and prior to bid awards. However, the auction-determined transfer prices for wheat and flour in Mogadishu were respectively 14 and 19 percent lower than the government-set prices; the transfer prices in Berbera were even lower (owing to the interventions mentioned above). Rumors of the imminent price controls might have been sufficient to lower bid prices to realistic levels.

The Auction of 1988

Unlike previous auctions in Somalia, the one in 1988 entailed one P.L. 480 Title II, Section 202 commodity (vegetable oil) and one site (Mogadishu). The auction proceeded very smoothly with no intervention. Lots were set at 15 drums, and bid amounts were limited to a maximum of seven lots. A total of 19,962 drums (or 75 percent of all Title II, Section 202 imports for the year) were available for sale. Some 624 traders registered for the auction (including 101 traders from outside the capital), of which 492 traders submitted deposits and 488 submitted bids. The drums were sold at the auction-determined transfer price, which appeared to reflect prevailing supply conditions. The larger traders tended to submit more conservative bids than the smaller traders, and some 26 percent of the successful bidders were women.

The success of the auction was attributed by USAID to program simplification, to GSDR acceptance of auctions as a pricing and distribution mechanism within the private sector, and to increasing familiarity within the private sector of the auction process.

Impact on Marketing Structure

The auctions in Somalia have had some desirable impact on market operations, especially in the areas of price formation and general access. The price formation function was and continues to be important in a market subject to the availability of large quantities of food commodities at concessional prices, with considerable fluctuations in supply and corresponding fluctuations in price. In terms of access, auctions are providing an important alternative supply source for all traders, especially the smaller ones who are willing to submit slightly higher bid prices in order to increase the chance of bid awards.

\19
101

The timing of the commodity shipments, however, has been the subject of much concern, especially during the years of the Title I shipments, when the commodities were many and were frequently put on the market during the post-harvest season. Different assessments have in varying degrees criticized the auctions as ill-timed, serving to depress market prices of domestically grown grains. Though justified in theory, these criticisms are perhaps not as serious as they appear. Factors appearing to counter the criticisms include the unwillingness of traders to purchase commodities with a low potential for fast turnover (as was the case, for example, in 1985, when bidders refused to buy corn and wheat given the general glut); and low substitutability between certain imported commodities (such as rice and flour) and domestically grown grains (such as maize and sorghum).

Impact on Government Operations

In general, private sector auctions have generated higher revenues than the public sector sales, as indeed was the intention. Interventions to stabilize prices at artificially low levels have resulted, however, in lower revenue levels than would have been the case had the auctions been allowed their original outcome. Interventions have also prolonged the auction process, thereby increasing the direct administrative costs. Generally, though, the government's ability and willingness to conduct auctions improved over time as shown in the next section.

Problems and Modifications

Problems impeding the auction process occurred in a variety of forms, some of them closely related. These, as well as some of the solutions employed by USAID and GSDR, are as follows:

- <u>Improper pricing policy</u>. The GSDR was for many years clearly less interested in raising maximum levels of revenue (which may be accomplished through auctions) than in supporting low consumer food prices (which is very difficult to accomplish through auctions), and it preferred trying to keep auction prices lower than the prevailing market prices, as a misguided way of passing the subsidy to the consumer. In 1988, however, the GSDR did not reduce lot size midway through the auction process, and it appeared to be willing to let the auction capture the market value of the commodity available for sale. It is too early to know whether this attitude is permanent or temporary, as the results of the 1989 auction are not yet available in Washington, D.C. In general, unless the GSDR demonstrates a full commitment to the auction process, serious traders (would-be buyers) will remain inclined not to participate in the auctions.

- Lack of transparency. During the early auctions, as the manner of calculating the transfer price changed from an average of all bids submitted to the stop-out price, the GSDR sought to make the auction process as obscure as possible for prospective bidders, mistakenly thinking that an imperfect understanding of auction procedures would lower bid prices. Such an attitude had the effect of increasing uncertainty, discouraging serious bidders, and giving rise to speculative (very high and very low) bids.

- Delays in auction implementation. These delays, caused by either government interventions or operational bottlenecks, resulted in a considerable loss of public confidence in the auction system during the initial years. Traders became concerned as their bid bonds or deposits became tied up for periods longer than expected and as their ability to claim their goods in a timely manner (or even to claim goods at all) diminished. Such delays were minimized by employing a single auction site in 1988, which was also under the direct influence of the government agencies responsible for implementing the auctions.

- More than one auction site. In trying to broaden the distribution of auctioned commodities over a fragmented food market and into food deficit areas, the GSDR insisted on at least two auction sites in all years prior to 1988. This resulted in lower competition, greater collusion among bidders, higher administrative costs, and poor coordination among oversight committees. When more than one site is required for political reasons, it is clear that each site should be treated as a separate auction, with independently derived parameters such as reserve price and eligibility.

- Poor commodity selection. Initially, a wide variety of food commodities was shipped in for the auction sales, complicating the auction process considerably for all participants (implementors as well as participants). Furthermore, not all commodities were entirely appropriate for private auction sales, as highlighted by the absence of wheat and corn sales in 1985. As a result, commodities were gradually eliminated, leaving vegetable oil as the auction commodity of preference. (Vegetable oil is a high-value commodity, with apparently a well-defined market niche among cooking oils and consequently a lower impact on locally produced oils such as sesame.)

- High losses and uneven quality of commodities. Initially, lack of care in transporting and storing the various food commodities by the GSDR — compounded by the poor quality of certain commodities selected for shipment from the United States — resulted in significant losses (both physical and in terms of sales). In later years, as the quality of the commodities improved, losses still occurred owing to negligence. In 1988, for example, USAID had to caution the GSDR, as it initially allowed more drums than normal in strictly commercial transactions to be damaged as they were unloaded, first stored in the quay alongside the ship, and later stored in public storage facilities.

A final problem, under review by USAID, is the slowness with which the GSDR deposits the revenues generated by the auctions into the account for counterpart funds. Delays of three months have been recorded as recently as 1988, hampering to some extent the smooth disbursement of funds throughout the year.

Bibliography

USAID/Somalia. *Final Auction Report of P.L. 480 Title I Commodities.* April 1986.

APPENDIX F

BIBLIOGRAPHY: FOOD AID AUCTIONS

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BIBLIOGRAPHY: FOOD AID AUCTIONS

Surveyed Reading

Amihud, Yakov, ed. *Bidding and Auctioning for Procurement and Allocation.* New York University Press, New York, 1976.

This compendium of articles on the theory and application of auctioning and bidding contains papers addressing auctions and economic theory, auctions for contracting and allocating securities in money and financial markets, and commodity auctions.

Arthur, H. B. "The Structure and Uses of Auctions." In *Bidding and Auctioning for Procurement and Allocation,* edited by Yakov Amihud. New York University Press, New York, 1976.

This is one attempt to designate the necessary conditions for successful auctions. The author outlines the structural and conceptual anatomy of auctions and a modification of a pure auction. Finally, the author presents advantages and limitations of using auctions to allocate agriculture and foods.

Ashenfeiter, Orley. "How Auctions Work for Wine and Art." *Journal of Economic Perspectives,* vol. 3, no. 3, summer 1989, pp. 23-26.

The paper reports various empirical regularities observed in the auctioning of wine and art. The author comments that risk aversion and quantity constraints significantly determine auction results and that bidders will react more competitively with more information about the goods, which will result in higher revenues for the seller.

Baker, Charles C. "Auctioning Coupon-Bearing Securities: A Review of Treasury Experience." In *Bidding and Auctioning for Procurement and*

Allocation, edited by Yakov Amihud, pp. 146-51. New York University Press, New York, 1976, pp. 146-51.

The author reviews the experience with auctions in Treasury financing activities. The uniform price auction and the factors that influence the coverage of an auction offering (the volume of bids received in an auction) are evaluated. Under a uniform price auction, bonds are sold at uniform prices determined by the scale of bids received. Such a system allows the market to determine the average yield, and it minimizes the bidding risk and post-award market risk associated with bond sales. Such a system will also increase investor interest in bidding, which will offset the higher costs of this auction form. While data constraints prevented the author from completing a detailed empirical analysis of the efficiency and effectiveness of uniform price auctions, tentative conclusions were drawn.

Boatler, Robert W.; Goldstein, Henry; and Kaufman, George. "Treasury Bill Auction Procedures: An Empirical Investigation: Comment." *The Journal of Finance,* vol. 30, no. 3, June 1975, pp. 893-94.

This is a response to an article by S. Bolton that quantified the increase in demand for 91-day Treasury bills that would be required to offset the loss of profits with the adoption of the Dutch auction system by the discriminatory auction procedure. The author calculated that Bolton's results, which were based on data for only one year (1968), could vary by as much as 50 percent relative to the degree of uncertainty in prices of that year.

Boyes, William J. and Happel, Stephen K. "Auctions as an Allocation Mechanism in Academia: The Case of Faculty Offices." *Journal of Economic Perspectives,* vol. 3, no. 3, summer 1989, pp. 37-40.

The authors describe how a sealed bid auction scheme was used to allocate offices in the academic environment characterized by few premium locations and little information with respect to the value of the offices available for auction.

Cassidy, Ralph. *Auctions and Auctioneering.* Berkeley: University of California Press, 1967.

This was a preliminary attempt to explain the role of auctions in market distribution. Citing data collected in 25 countries by observing auctions and interviewing auction participants and sellers, the author sought to explain aspects of price making by auction method. One hypothesis stated that the auction method was essential to resolve certain marketing problems, such as

113

setting market prices for goods characterized by unstable prices. The author compared various auction forms using theoretical and empirical analysis and controlled experimentation to examine the relative efficiency of various auction methods. Efficiency was measured in terms of the success of each method in terms of (1) price determination, (2) speed of selling, and (3) confidence each systems instills in buyers.

Engelbrecht-Wiggans, Richard. "Auctions and Bidding Models: A Survey." *Management Science*, vol. 26, no. 2, February 1980, pp. 119-42.

This is a survey of the main theoretical results and research on the literature on auctions and bidding. The author describes the major ideas related to auctions and bidding, and he classifies and describes various auction and bidding models into four areas — players, objects, payoff functions, and strategies. Finally, the author presents areas where further research is warranted, including the effects of auctioning more than one object simultaneously, the equilibrium nature of bidding strategies used, and the effects of asymmetries in bidders' information or utility functions.

_______ and Weber, Robert J. "An Example of a Multi-Object Auction Game." *Management Science*, vol. 25, no. 12, December 1979, pp. 1272-77.

The authors examine auction results and efficiency for simultaneous multi-object auctions with bidders with non-linear utilities. In general, the study found that conducting multi-object auctions as simultaneous single-object auctions might be inefficient, since bidders might bid differently on different auctions. Such bidding variance, nonlinear utility, for identical objects arises from bidders' budget constraints. Therefore, nonlinearities in bidders' utilities might lead to nonadditivity of auction equilibrium bidding strategies. Nonadditivity implies that the buyer's value for a set of objects is not simply the sum of the values of individual objects, since the bidder's value of winning one object depends on what other objects are also won.

Goldstein, H. "The Friedman Proposal for Auctioning Treasury Bills." *Journal of Political Economics*, vol. 70, 1962, pp. 386-92.

The author examines a proposed method for modifying the current auctioning scheme for Treasury bills. This new scheme, called the Friedman proposal, would award Treasury bills at the stop-out price instead of at differing prices until this stop-out price. The stop-out price is the price that just covers the amount offered for competitive tender. Friedman maintains that this revised auction scheme would increase government revenue from the auction of Treasury bills through a reduction in collusive bidding, an increase in the numbers of bidders, and an increase in the value of bids submitted. The author examines the Friedman proposal, and he finds that the modified auction procedure would not reduce the Treasury's debt management costs for the following reasons: (1) while it would reduce collusion, the likelihood of collusion under the current system is extremely small; (2) the increase in the numbers of potential bidders under the modified scheme would be small; and (3) increased revenues due to higher bids would be more than offset by the government's inability to use price discrimination as it is currently practiced. The paper presents these counter arguments in detail.

________; Kaufman, G.; and Boatles, Robert. "Treasury Bill Auction Procedures: A Comment." *Journal of Finance*, vol. 30, 1975, pp. 895-99.

The authors find unconvincing Bolton's conclusion that more revenue would accrue to the government by using the Dutch system rather than the discriminatory scheme for auctioning Treasury bills. The authors assert that the variables and constant term of the demand function are questionable and improperly identified and that simulations alone cannot be used to justify a change in auction procedures.

Hansen, Robert G. "Empirical Testing of Auction Theory." *American Economic Review*, vol. 75, no. 2, May 1985, pp. 156-59.

The author reviews research results on auctions derived from the application of pure and applied auction theory as a predictor of revenue from sealed bid versus open bid auctions, and bid level as being determined by the number of bidders or competition. The author examines empirical work using auction theory to explain the means of payment in auctions and the effectiveness and strategies of cartels. The results indicate that stock bidding yields higher revenue than cash bidding and that sealed bid auctions with a reserve price reduce the likelihood of bidders' cartels.

________. "Sealed-Bid Versus Open Auctions: The Evidence." *Economic Inquiry*, vol. 24, no. 1, January 1986, pp. 125-42.

The author tests Vickrey's proposition (the revenue equivalence theorem) that sealed bid and open auctions yield equal revenue. The hypothesis is tested by analyzing U.S. Forest Service auction data during 1977, using ordinary least squares, two stage least squares, and maximum likelihood regression analysis. The results demonstrated that sealed bids yielded marginally more revenue than open auctions, but not enough to warrant selecting one auction format over the other.

Harris, Milton and Raviv, Artur. "Allocation Mechanisms and the Design of Auctions." *Econometrica*, vol. 49, no. 6, November 1981, pp. 1477-99.

The authors develop a theoretical framework to examine two issues related to auctions: (1) why auctions are used to allocate resources in certain environments, and (2) which type of auction is efficient and yields the highest expected revenue. The authors assert that any mechanism is equivalent to some form of sealed-bid auction in a certain simple environment. To answer the second question, the competitive and discriminating auctions (the two most examined auctions) are examined. Using a simplified form of the model in which there are only two risk-neutral buyers who know the seller's reservation price, the authors conclude that both competitive and discriminating types of auctions yield the highest expected revenue. Adapting the framework to allow for N potential risk-adverse buyers, each bidding for a single unit of the commodity to be sold, the authors conclude that the discriminating auction yields the most revenue to the seller. The authors conclude that, in general, the discriminating type of auction maximizes the seller's revenue.

________. "A Theory of Monopoly Pricing Schemes with Demand Uncertainty." *The American Economic Review*, vol. 71, no. 3, June 1981, pp. 347-65.

Using a theoretical model, the authors derive the form of an optimal marketing scheme for three types of marketing mechanisms, and they identify the conditions under which each scheme should be used. The three marketing schemes discussed are (1) simple single-price strategy (the seller posts a single price at which buyers can purchase product); (2) auctions (sealed or open bid, second price, and discriminating auctions); and (3) priority pricing (various prices are charged, with buyers paying higher prices assigned higher priority for receiving the product).

The model consists of one seller, N buyers, asymmetric information among buyers, and a homogeneous product with constant marginal production costs up to a capacity limit. The results demonstrate that the optimal marketing scheme is a function of assumptions regarding capacity as follows: (1) a priority pricing scheme is optimal when potential demand exceeds capacity; (2) a single-price scheme is optimal when capacity exceeds potential demand; and (3) a single-price scheme is optimal when capacity can be chosen by the seller.

Hausch, Donald B. "Multi-Object Auctions: Sequential vs. Simultaneous Sales." *Management Science*, vol. 32, no. 12, December 1986, pp. 1599-1610.

The author utilizes a simple two-signal model to demonstrate the relative benefits of using sequential versus simultaneous bidding strategies for auctioning goods. The results indicate that the seller might prefer to auction goods simultaneously rather than sequentially, since low bids — submitted during sequential auctions — would be used to deceive other bidders for subsequent auctions. This would, therefore, reduce the seller's profits. However, in some cases, the information released during sequential auctions might benefit the seller in subsequent auctions, which would lead the seller to prefer sequential auctions to maximize revenue. Therefore, the seller may chose either the sequential or simultaneous auction method, based on the relative dominance of either the information effect or the deception effect, using the winner's curse to select the best approach for maximizing revenue.

Hendricks, Kenneth and Porter, Robert. "An Empirical Study of an Auction With Asymmetric Information." *American Economic Review*, vol. 78, December 1988, pp. 865-83.

The authors apply the Bayesian-Nash equilibrium theory to auctions of federal offshore oil and gas drainage lease sales characterized by asymmetric information. The results indicate that bidders owning tracts in proximity to those being auctioned have an information advantage over bidders without neighboring tracts and they often bid jointly.

Jarecki, H. G. "Bullion Dealing, Commodity Exchange Trading and the London Gold Fixing: Three Forms of Commodity Auctions." In *Bidding and Auctioning for Procurement and Allocation*, edited by Yakov Amihud. New York University Press, New York, 1976.

This chapter presents the use of auctions in the international gold markets and, in particular, bullion trading on organized commodity exchanges.

Johnson, R. D. "The Perfectly Competitive Auction Pricing Alternative for Agricultural Products." In *Bidding and Auctioning for Procurement and Allocation*, edited by Yakov Amihud. New York University Press, New York, 1976.

The author maintains that U.S. auction markets for agricultural commodities are noncompetitive due to pricing and physical inefficiencies. He also comments that Canada uses an auction system

424
117

for agricultural products that leads to physical and pricing efficiency.

Kagel, John H. and Levin, Dan. "The Winner's Curse and Public Information in Common Value Auctions." *The American Economic Review*, vol. 76, December 1986, pp. 894-920.

The authors examined the various outcomes of bidding with the presence and absence of the winner's curse. They found that multiple bidding provides more public information and reduces bidder uncertainty, which results in higher bids and revenues for the seller. With the presence of the winner's curse, however, a decrease in uncertainty due to multiple bidding leads to a reduction in seller's revenues. Therefore, public information has a varied impact on bidding revenue, subject to the presence or absence of the winner's curse.

Keir, P. M. "Remarks on Security Auctions." In *Bidding and Auctioning for Procurement and Allocation*, edited by Yakov Amihud. New York University Press, New York, 1976.

This chapter contains remarks made by a representative of the Federal Reserve about using auctions for selling securities and other uses in the management of its own open-market policy. The speaker provides a brief justification for using an auction scheme for the sale of securities.

Krum, Kathie. *Exchange Auctions: A Review of Experiences*. World Bank, Trade and Adjustment Policy Division, Country Policy Department Working Paper, July 1985.

The author compares and contrasts the auction of foreign exchange with other exchange rate regimes, and she discusses structural considerations for implementing exchange rate auctions. The experiences of Uganda, Sierra Leone, and Jamaica with exchange rate auctions are analyzed.

Labys, Walter. "Bidding and Auctioning on International Commodity Markets." In *Bidding and Auctioning for Procurement and Allocation*, edited by Yakov Amihud. New York University Press, New York, 1976.

The author provides a summary of the history of commodity auctions to trace the development of bidding and auctioning in physical and futures markets, and he provides an econometric approach for analyzing auctions. The development of futures auctions in terms of physical locations and contractual arrangements is followed by an explanation of the actual nature of the bidding process. Using spectral analysis, the author concludes

that there is little evidence of a systematic pattern of price fluctuations from futures and commodity auctions.

McAfee, R. Preston and McMillan, John. "Auctions and Bidding." *Journal of Economic Literature*, vol. 25, June 1987, pp. 699-738.

The authors survey recent developments in the theory of auction bidding mechanisms, and they discuss the relevance of the theoretical results for auctions in practice. The four major auction schemes are discussed: English, Dutch, first-price sealed-bid, and second-price sealed-bid. The authors examine various auction results under the assumption that monopoly or monopsony exists on one side of the market. Based on the benchmark model with the following assumptions (risk-neutral bidders, independent private values, bidders are symmetric, and payment is a function of bids alone), the authors conclude that auction revenue would be equal among all four auctions. The authors also discuss and examine optimal auction results under relaxed benchmark assumptions.

Mead, W. J. "Natural Resource Disposal Policy — Oral Auction Versus Sealed Bids." *Natural Resources Journal*, vol. 7, 1967, pp. 194-224.

The author compares two methods for auctioning mineral rights for Federal land containing natural resources — oral bidding (timber) and sealed bidding (gas and oil and oilshale) — in cases where oligopsony, rather than perfect competition, prevails. Using statistical analysis, the author concludes that oral bidding is the suboptimum method, since it facilitates collusion and often requires bidders to prequalify, thereby further reducing competition. Sealed bidding, therefore, would reduce collusion and increase seller revenue (particularly when there is only one bidder). Oral bidding, however, might be justified for industries faced with high fixed processing costs and dependency on raw materials having close proximity to the processing site (timber). In the case of oil and gas, while there are few buying firms, the raw materials might be transported over longer distances to processing facilities; therefore, sealed bidding is optimum.

Milgrom, Paul. "Auctions and Bidding: A Primer." *Journal of Economic Perspectives*, vol. 3, no. 3, summer 1989, pp. 3-21.

The author provides a review of auction theory used to analyze auction schemes with respect to maximizing the welfare of the bid-taker, ensuring efficient allocations, minimizing transaction costs, guarding against corruption by the bid-taker's agents, and reducing the effects of collusion among bidders. The paper also includes a discussion of auction theory used to predict auction

131

bids and profits, along with experimental evidence and empirical studies to test the theories' predictions.

________ and Robert Weber. "A Theory of Auctions and Competitive Bidding." *Econometrica*, vol. 50, September 1982, pp. 1089-1122.

The authors examine existing auction theory and develop their own model for analyzing auction behavior and results. The main results of the existing independent private values model, where a single indivisible object is sold to one of several risk-neutral bidders with independent values, indicate that the Dutch auction and the first-price sealed-bid auction yield the same revenue. While the English auction and the second-price sealed bid auctions are equivalent, they are weaker strategically than the Dutch and first-price auctions. All four auction schemes lead to Pareto Optimal allocations and identical expected revenue results for the seller. The authors conclude that this model cannot provide guidance as to the optimal auction form.

In an attempt to provide a theoretical framework to better predict auction results, the authors present their own model for risk-neutral bidders, relaxing the assumptions of the independent private values model concerning the independence of bidders' value estimates. This revised framework allows the auction methods to be ranked in terms of revenue generation as follows: the English auction generates the highest prices, followed by the second-price, Dutch, and first-price auctions.

Miller, E. M. "Oral and Sealed Bidding: Efficiency Versus Equity." *Natural Resources Journal*, vol. 12, 1972, pp. 330-53.

The author examines efficiency and equity issues surrounding oral versus sealed bidding for the auction of Federal Government-owned natural resource mineral rights. Examining auctions of mineral rights for timber, the author concludes that the optimal auction scheme employs a combination of oral and sealed bidding to maximize efficiency and equity. Such a system would ensure efficiency standards. It would also reduce the potential collusion characterized by oral bidding systems by requiring bidders to submit statements to the government indicating their maximum price prior to a simulated oral auction. The highest bidder in the simulated oral auction would pay the price bid by the second-place player.

Palfrey, Thomas R. "Multiple-Object, Discriminatory Auctions and Bidding Constraints: A Game Theoretic Analysis." *Management Science*, vol. 26, no. 9, September 1980, pp. 935-46.

The author examines properties of Nash equilibria solutions in multi-commodity simultaneous auctions where bidders are subject to exposure constraints (the sum of bids cannot exceed some level). The author concludes that pure Nash equilibria do not exist where (1) there are more than two bidders and two objects and/or a reservation bid requirement is present, and (2) two bidders and objects exist. Buyers have zero profits when there are more than two bidders and two objects since the Nash equilibrium exists. One important assumption states that buyer revenue in multi-object auctions is not simply the product of the expected net value of each item sold and the probabilities of winning each item, since the net value of an item is a function of the values of other items won.

———. "Bundling Decisions by a Multiproduct Monopolist with Incomplete Information." *Econometrica*, vol. 51, no. 2, March 1983, pp. 463-83.

The author examines the use of a bundling mechanism (tied sales) employed by multiple product monopolists working in an environment of imperfect information with regard to demand. Using a theoretical model, the author demonstrates that the monopolist's bundling decision is strongly influenced by the number of buyers in the market. In auctions with few buyers, the monopolist will bundle his output, leaving buyers worse off than had the seller auctioned his goods separately. With a larger number of buyers, the seller will untie output, with high-demand buyers being worse off and low-demand buyers being better off than had the seller auctioned bundled merchandise. Using a bundling mechanism leads to market inefficiencies both *ex ante* and *ex post*.

Reiber, M. "Collusion in the Auction Market for Treasury Bills." *Journal of Political Economy*, vol. 72, 1964, pp. 509-15.

The author critiques Milton Friedman's hypothesis that discriminatory pricing practices in weekly Treasury bill auctions limit the market to specialists who are forced to collude. Reiber argues that Friedman incorrectly used auction data and that auctions are not limited to dealers since sufficient information is available to all potential bidders.

Riley, John G. "Expected Revenue from Open and Sealed Bid Auctions." *Journal of Economic Perspectives*, vol. 3, no. 3, summer 1989, pp. 41-50.

The author examines why seller revenue is the same across different auction schemes by comparing the revenue from open versus sealed bidding. The study examines basic auction revenue

ranking theorems, the chief one being the revenue equivalence theorem. This theorem asserts that equal revenue will result from sealed bid and open auctions by competitive bidding by risk-neutral bidders. By relaxing two assumptions of this theorem, the risk aversion and independence of beliefs assumptions, the author states that a sealed bid auction would result in increased revenues for the seller.

________ and Samuelson, William. "Optimal Auctions." *American Economic Review*, vol. 71, June 1983, pp. 381-92.

The authors examine the various forms of auctions and discuss resource allocation resulting from using various auction schemes. A theoretical model is presented, demonstrating that different auctions yield revenue that is easily compared and that revenue is maximized if the seller announces the reserve price prior to the auction. Under different assumptions of buyer risk aversion, the authors find that the sealed high-price bid yields higher revenue for the seller than would the English auction in cases where the bidders are risk averse.

Roth, Alvin and Schoumaker, Francoise. "Expectations and Reputations in Bargaining: An Experimental Study." *American Economic Review*, vol. 73, June 1983, pp. 362-72.

This study examined the relationship between bidders' expectations and outcomes. The authors postulate that bidding outcome is determined not only by bidders' preferences and strategic options, but by their expectations. The study found that bidders formed differing expectations based on their previous experiences that influenced bidding outcome. The authors review three experiments to test their theories related to the expected utilities of bidders.

Schotter, A. "Auctions and Theory." In *Bidding and Auctioning for Procurement and Allocation*, edited by Yakov Amihud. New York University Press, New York, 1976.

This introductory chapter presents the hypothesis that auctions have not been the subject of extensive economic study because they defy conventional economic analysis. The author's definition of auctions is studied in terms of its departure from general equilibrium economics. The author defines auctions as exchange mechanisms without a recontracting provision in which the seller is relatively passive and goods are often indivisible. This brief analysis concludes that (1) the lack of a recontracting process results in sub-optimal allocations occurring in auctions, since sellers in auctions are passive and lack strategic opportunities available to them in other price-forming processes; (2) the optimality of the final auction allocation is influenced greatly by the sequence of the auction of separate goods; and (3) auctions are very low cost mechanisms of allocation.

Smith, Vernon L. "Experimental Studies of Discrimination Versus Competition in Sealed-Bid Auction Markets." *Journal of Business*, vol. 40, no. 1, January 1967, pp. 56-84.

The author examines bidding behavior and price determination under price discrimination and pure competition. Price discrimination exists when successful individual bids are filled at actual levels, and pure competition is characterized by successful bids filled at an average equilibrium price. Conclusions are drawn based on six sealed bid auction experiments using both market forms to assess auction results on the number and level of bids.

The results indicate that (1) competitive bid variance is consistently greater than is discriminatory bid variance, (2) competitive bids dominate discriminatory bids stochastically, (3) revenues for monopolist sellers are greater in a competitive auction when the proportion of rejected bids is low or moderate, (4) discriminatory auctions with a high proportion of rejected bids tend to dominate discriminatory auctions stochastically with a lower proportion of rejected bids, (5) total revenues of a monopolistic seller are greater the larger the proportion of rejected bids in a discriminatory auction, and (6) a very small proportion of bids demonstrate linear utility of money.

Stark, R. M. and Rothkopf, M. H. *Competitive Bidding: A Comprehensive Bibliography.* Technical Report 77/9, Department of Statistics and Computer Science, University of Delaware, Newmark, June 1977. Revised, Report ARG 78-1, Xerox Research Center, June 1978, pp. 364-90.

This bibliography contains almost 500 titles on quantitative models related to competitive bidding. It cites articles concerning models of single and multiple auctions and analysis of auctions for resource allocation and of historical data on bidding. While some of the articles deal with competitive bidding in theory, others discuss the application of auction theory for competitive bidding for construction contracts, oil exploration rights, and securities.

Thiel, Stuart E. "Some Evidence on the Winner's Curse." *American Economic Review*, vol. 78, December 1988, pp. 884-95.

The author uses statistical techniques to analyze the extent to which the winner's curse characterizes winning bids in the construction industry.

Vickrey, William. "Auctions, Markets and Optimal Allocation." In *Bidding and Auctioning for Procurement and Allocation*, edited by Yakov Amihud. New York University Press, New York, 1976.

The author discusses scenarios for ensuring optimal and sub-optimal allocation through auctions. The author compares allocation by means of auctions with the Pareto optimal allocation of resources through perfect competition, and he discusses applications for the bond market and airline industry.

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\126

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1 2 1

APPENDIX G

ORGANIZATION OF AN INVITATION FOR BIDS

TABLE OF CONTENTS

APPENDIX C:

ORGANIZATION OF AN INVITATION FOR BIDS

Choices and Decisions

A procedure for an invitation for bids (IFB) is generally selected as a sales mechanism for commodities when the government seeks to maintain its integrity and to remove the possibility of selective negotiations, favoritism, or the appearance of conflict of interest.

In general, IFBs are issued for the purchase or sale of commodities of more than a certain value. The value varies from country to country.

The requirements concerning the manner in which the IFB must be conducted are generally specified in regulations issued by the government or its agencies. It should be clearly understood that an IFB gives traders the possibility of purchasing from the government some commodities under certain conditions. If the trader makes an offer to buy such commodity at a set price and the government accepts that offer, the acceptance by the government should constitute an enforceable contract, subject to the conditions specified by the IFB.

Policies To Be Decided Before the Issuance of an IFB

The first phase of the IFB procedure concerns policy matters. The policies must be decided before an IFB is issued because they dictate the conditions and requirements for the IFB and eventually become part of the contract between the government and the bidder.

An Interministerial Commission, designated by the government to supervise government procurement regulations, is generally responsible for establishing the policies. The policies cover the following:

- Establishment of an appropriate reserve price. Under the P.L. 480 program, the minimum price acceptable for the sale of U.S. rice or other agricultural commodities is the f.a.s. price at the U.S. gulf port. This might or might not constitute an appropriate reserve price, but this should be decided before the IFB is issued.
- Definition of the criteria concerning the eligibility of bidders
- Establishment of procedures for the deposit of cash and opening of letters of credit
- Definition of the pricing mechanism
- Establishment of the size or tonnage of the lot to be sold. The size of the lots to be made available for sale and the maximum sold to each bidder, if any, will influence which traders participate and the degree of competition.

The implementation of these policies, the preparation and issuance of the IFB, the receipt and screening of bidders, the opening of the bids, and the choice of the successful bidders may be conducted by the Interministerial Commission or by a oversight committee designated by that commission.

Implementation of the IFB Under the Supervision of the Commission

After the policies have been settled, an oversight committee is responsible for their implementation. The tasks of the committtee are as follows:

- Issue the announcement that there will be an IFB and have it publicized through the radio and the press
- Prepare and issue the IFB and the "Cahier des Charges"
- Receive the bids, open and record publically the bids at the time and place indicated in the IFB, and establish an alternate or waiting list of bidders
- Decide on the technical aspects of the bids:

- Determine the eligibility of the trader using the criteria mentioned in the IFB or announcement
- Check the deposit of cash and/or bid bonds and the opening of the letter of credit, if any
- If the bidder first chosen cannot qualify financially, designate the next bidder on the waiting list
- Cancel the IFB if there are not enough bids or for other appropriate reasons

If this procedure is not strictly followed, there might be a lack of credibility in the decisions made by the commission.

Eligibility of Bidders

Before the issuance of an IFB, one or more of the following requirements should be adopted:

- The bidder must be registered as a businessman and have experience in the field of purchase, sales, import, or export of agricultural commodities.
- The bidder must have a financial credit that will allow him to pay for the amount written in his bid, as shown by a bank letter of recommendation, for example.
- The bidder must have the technical capacity to handle the transaction and have warehousing or storage facilities commensurate to his bid, if this requirement can be met by most established traders.
- The bidder must have paid his taxes and commercial dues.
- The bidder must not have been condemned judicially.

USDA, for example, requires that bidders interested in commodities under P.L. 480, Title I must submit the following information to determine their eligibility:

144
132

- A current financial statement of the person or firm wishing to become eligible as evidence of financial responsibility

- A statement containing general background information about the firm, with particular reference to the firm's experience as buyer and seller of agricultural commodities, and any other information available relating to whether the person or firm is a responsible party and able to perform under the P.L. 480 purchase authorization

- A statement to be maintained on a current basis listing the name, address, and chief executive officers for all branches, affiliates, subsidiaries, and associated companies, both foreign and domestic, in which the supplier has a controlling interest. This statement must also furnish the same information for any companies that have a controlling interest in the supplier, either directly or through subsidiaries.

There must also be a statement that the potential buyer has not used the services of persons or agencies with influence or contacts in the government and whose remunerations on commission will be based on the final purchase.

The following certificate could be required from bidders. The bidder certifies whether:

- He has or has not employed a person or a corporation or any other entity than his own employees to obtain the contract

- He has or has not paid or promised to any person (other than one of his employees or ordinary representatives) a commission, percentage, brokerage or benefit to be given only in case the contract is awarded to him

- He accepts to supply under his signature the information relating to his agents or representatives if it is asked by the seller

- He has an agent in an office located in . . . , upon which service of process may be made, and further warrants that he will comply with all requirements of the announcement.

145
133

There are generally three steps required for an IFB.

Step 1 — Announcement of an Invitation for Bids

Approximately 20 days but no less than 10 days before the opening of the bids, an announcement concerning the IFB should be made in the press and over the radio, and also to the Chamber of Commerce, cooperative associations, and other professional associations. The announcement should state the following:

- The nature and approximate amount of commodities
- The location, day and time set up for the opening of the bids as well as the conditions for the expedition and submission of the bids or tenders
- The authority responsible for the award of the contracts
- The location where the interested parties may obtain or review the clauses and provisions that will apply to an eventual contract. This includes the IFB itself plus whatever regulations might have been approved by the government
- The details of contract implementation
- The document that will have to be presented with the bids by bidders, the justifications that they must produce concerning their reputation and financial capacity as indicated above, and the criteria that will be used to decide their eligibility
- The conditions under which bids will be received; non compliance will result in the bids being returned prior to their opening

Step 2 — Content of the Invitation for Bids

A check list of contents for IFBs is as follows:

- Invitation for bid number
- Name and address of the office issuing the IFB

- Date of issuance
- Number of pages
- Date, time, and location for the bid or tenders opening
- Information on the source of financing
- Quantity of commodities to be sold; tonnage of each lot, if to be sold by lots; maximum number of lots that can be bought by any bidder
- Specifications of grade of commodities to be sold; availability of samples and where
- Documentation on elegibility to be supplied by the bidder: offer, certificates, tax, bank, credit, guarantee or security, bid bond, or certificate of deposit
- Current location of commodities or estimated arrival time and place
- Authorization, if necessary, to submit bids by telegram
- List of members that compose the commission responsible for opening the bids
- Packing and marks if any
- Location and conditions of inspection
- Insurance, security, execution, or compliance guarantees to be deposited
- Penalties
- Payment terms acceptable and consideration of terms in evaluation of bids
- Duration or time during which tender or bids can be made
- Reserve price if any
- Notification terms — length of time bidder is required to keep offer open method and timing of notification of winner

147

- Disclaimer clause, i.e., reserving the right to allocate any quantity up to the maximum or to cancel the sale

Other clauses might have to be prepared and approved. They should be included in the IFB or a separate document made available at the same time that the IFB is issued to the public.

The IFB should have very precise specifications of the product to be sold. Specifications that are not prepared with care almost variably result in errors and misunderstandings on the part of the bidder. Poorly conceived IFBs also often result in numerous complaints and protests by bidders or in the cancellation of one IFB and the issuance of another. All of this evidently brings about delays in awarding the commodity and completing the final sale. In the case of cereals, extensive delays might cause losses in cereal stocks and diminish the quantity or quality of cereal available for sale.

Step 3 — Acceptance of Offers

The most important points concerning acceptance of offers are as follows:

- The acceptance of offer will be made by telegram or letter or telex no later than the time specified in the applicable invitation.
- The highest bidder will be awarded the contract.
- The government may consider any other factors in evaluating offers and awarding contracts.

It is understood that a sale at the price specified in the tender and the written acceptances agreed to will become a binding contract including the conditions and clauses enumerated below, if they were made known in advance to the contractor, either by reference in the IFB or because they were made part of regulations issued by the government.

Financial Arrangements

Within 10 business days after the date of the contract, payment must be received in the government office. If the payment has not been made within 10 business days, interest at the annual rate in effect at the time the offer is accepted by the government shall be paid by the contractor to the government from the date of the contract to the date payment is received by the government.

Notwithstanding the above paragraph, at the election of the government, if the contractor fails to make arrangements for payment to the government within 10 days after the date of the contract by (1) wiring transfer of funds or (2) depositing certified check payable to the government, all of the contractor's rights under the contract may be terminated by the government and the government may proceed against the contractor to recover any damages the government might have sustained.

No commodity should be delivered until paid for in full. Partial delivery and payment may be permitted, if full payment is expected within days.

Transfer of Title and Risk of Loss

Transfer of title and risk of loss shall pass from the government to the contractor on the date specified in the loading order. In specifying the date for transfer of title, the government will consider the probable date the loading order will reach the warehouseman in the normal course of business. Any difference with respect to the quantity and quality or any other factor shown on the warehouse receipts surrendered by the government and the quantity and quality or any other factor of the grain actually delivered to the contractor by the warehouse shall be settled between the contractor and the storing warehouseman.

Warehouse Charges

The government will pay storage through the date of transfer of title, but no later than 10 business days after the date of the contract. Storage after that date will be charged to the account of the contractor. The government will pay normal loadout charges to the storing warehouse at uniform grain storage charges.

Legal Recourse

In general, suits have not been raised by governments against bidders for non-payment. However, all IFBs should contain a clause for legal recourse for both the government and the bidder. The clause should state that disputes will be solved through arbitration or through the appropriate court system.

Opening of the Bids and the Choice of the Successful Bidder

The bids must be forwarded to the committee under double sealed envelopes. The external envelope should indicate clearly the name or number of the IFB, and it should contain all documents required from the bidder by the IFB. These would include the following:

- Description of physical means available or rented for the storage of the cereals
- Description of staff or personnel, if any
- An indication of financial resources, financial viability and/or rate of return
- References
- A sworn declaration or certificate that no attempt has been made to influence in any way the commission or its members in the choice of successful bidder
- A bid bond

These documents allow the oversight committee to determine the financial and technical capacity of the bidder and his general standing within the business community.

The inside sealed envelope, on which the name of the trader appears, should contain the bid itself.

All envelopes must arrive at the deadline for their receipt and at the location indicated in the announcement and IFB, either by registered mail or by hand but against a receipt. All envelopes containing sealed bids must be registered as they are received. The envelopes must remain sealed until the date and hour fixed for their public opening.

The sealed envelopes are opened by the committee designated by the local regulation or specified in the transfer authorization with USAID if such a provision exists in the authorization.

At the time set for the opening of the bids, external envelopes are open publicly and a list of the documents enclosed is made by the committee.

The committee may ask bidders to explain further their submissions. Eligible bidders are those that submit documents in conformity with the prevailing IFB regulations. Discussions on the qualifications of the bidders may be made without the presence of the bidders. The reason for not accepting a bid must be given in the minutes of the meeting.

If the committee decides that the bidder is not eligible, his bid must be returned to him without the inside sealed envelope being opened. He is given the reasons for the rejection of his bid.

When the eligible bidders have been screened, their bids contained in the inside sealed envelope are opened in public and read aloud.

Registration of the Bids

The steps for registering bid submissions and notifying winners is as follows:

- The name of each bidders and the price offered are included in a written statement certified by the members of the committee.
- A list of responsible bids is made by price, beginning with the hignest bidder. All of the bids are registered.
- The president of the committee opens the envelope containing the reserve price if it has not been made public before. The highest bids are then chosen until the number of lots or the tonnage is exhausted.
- A list of winners, showing the quantity awarded to eacn and at what price, is established.
- The possibility of changes due to inquiries or to the fact that some successful bidders cannot fulfill their obligations might make it necessary to delay the final selection of bidders for awards.
- The winners, if present, sign a paper stating that they have been notified of the results. If not present, they must be notified by registered mail.
- If successful bidders default, the bidders on the alternate list (ranked in descending order by bid price) are notified that they have been chosen to replace the defaulting bidder. To allow this, it should be put in the IFB that the

offers of the bidders are considered binding until a date that is later than the date of opening.

- In the case of bid bonds, the money is to be returned to the unsuccessful bidders only after the date set in the IFB.

APPENDIX H

IMPLICATIONS OF FOOD AID PROGRAMMING AND PROCUREMENT PROCEDURES FOR AUCTIONS

TABLE OF CONTENTS

APPENDIX H

IMPLICATIONS OF FOOD AID PROGRAMMING AND PROCUREMENT PROCEDURES FOR AUCTIONS

To understand the differences that can exist in the timing of the invitation for bids (IFB) within the framework of Title I or Title II of P.L. 480, it is necessary to understand the procedure used under both titles.

Four tables and a figure are attached to this appendix. They concern Title I and Title II operations.

- Table H-1 shows the procedure as it exists for Title I.
- Table H-2 shows how the procedure might be changed to provide more action to private business for Title I.
- Figure H-1, reproduced from the USDA, depicts the operations as they are implemented now.
- Table H-3 shows the procedures for Title II Private Voluntary Organizations (PVOs).
- Table H-4 shows the procedures for Title II government-to-government programs or projects.
- Table H-5 is a list of 71 steps describing the way P.L. 480 works. It was prepared by a private business representative.

To identify when the private importers can be given authority to purchase and sell the agricultural commodities under P.L. 480, it seems important to separate Title I procedures from Title II procedures. Under P.L. 480 Title I, food aid is sold through sales agreements. Under Titles II and III, food aid is granted for humanitarian purposes through PVOs and to governments for projects and programs.

Under Title I, the recipient government receives a loan in dollars repayable within a certain period of time, preceded by a grace period, and at a low interest rate. With this loan, the recipient government purchases agricultural commodities in the United States and it imports them for sale locally (with a provision in the sales agreement that these commodities cannot be re-exported). The U.S. government requires that the local currency that the recipient government obtains from the sale of the commodities be itself considered as a loan and be used for "self-help projects or programs designed to increase the agricultural productivity of the recipient country and for the benefit of the poorest members of that country."

Under Title II, Title III, and Section 416(b), a grant is made by the United States either to the recipient government through a transfer agreement or to a PVO or cooperative through a multi-year operational plan/annual estimate of requirements (MYOP/AER), or a Section 416(b) plan of operation. Those grants can be either for humanitarian purposes or for economic development.

Under the grant procedure, the government, the PVO, or the cooperative does not purchase the agricultural commodities in the United States. The commodities are supplied and shipped by the Commodity Credit Corporation (CCC). As a consequence, there is no private business involved in the purchase of agricultural commodities in the United States, as it is the CCC who is in charge of that operation. The PVO, cooperative, or government agency is involved only in the sale in the recipient country of those commodities when there is a project or program involving monetization. In some cases, they are also involved in the ocean transportation of the commodities. Although, under current procedures, only Title I programs permit private sector traders to purchase the commodity directly in the United States, all Title II and Section 416(b) programs require that the local governments be involved.

Title I

Under Title I, the loan in dollars made by the U.S. government is used only for the purchase of agricultural commodities by the foreign government. The title to those agricultural commodities passes to the foreign government when they are loaded on a ship at a U.S. port. The USDA supervises the implementation of the sales agreement, and, as required by U.S. regulations, it verifies that the commodities are purchased by IFB and that the lowest bidder gets the contract.

Title I of P.L. 480 also directs the President to "take appropriate steps to assure . . . that small business has adequate and fair opportunity to participate in sales made under the authority of the Act." To ensure that small business firms have an equal opportunity to participate, the Title I

156

financing regulations issued under the Act prohibit buyers from establishing minimum quantities to be offered. All offers, regardless of size, must be considered (Section 17.6(b)(3)(v)). In addition, the IFBs issued by importing countries cannot limit the right to submit offers to any specified group or class of suppliers; IFBs must permit submission of offers by any supplier who meets the requirements of the regulations (Section 17.6(b)(3)(iii)).

It is the foreign government that is responsible for preparing the IFB, and generally the embassy of that government in the United States prepares the IFB or hires a procurement agent to prepare and follow up on the IFB. The IFB is issued after the purchase authorization (PA), which contains specifications for the quality of the commodity to be purchased. The USDA must approve the IFB for the purchase of commodities, as well as the IFB for the freight and the contracts for both operations.

Administratively, the foreign government can separate the purchase of the commodity in the United States and the sale of that commodity in the foreign country from the implementation of programs funded by the monies raised through the sale. It can, therefore, decide to designate private importers rather than a parastatal agency or a government agency to purchase the commodities directly in the United States and sell them in country. In Guatemala, for instance, there are two groups of importers that have been designated by the government for the importation of wheat under P.L. 480.

Under the current system, the PA is issued by the USDA Foreign Agriculture Service at the request of the foreign government. This PA includes such details as the particular grade or type of commodity to be purchased, the approximate quantity of the commodity, and the maximum dollar amount authorized. It includes the period during which contracts may be entered into and the period during which deliveries must be made.

Those details are included in the PA after receipt by USDA of the operational reporting cable from the U.S. embassy in the recipient country, containing specifications of commodities, quantities, purchasing and shipping dates, and the names of the banking institutions to be used in the United States and the foreign country.

The importer in some countries might still be an agency of the recipient government and it is that agency who decides the date of purchase, quality of grain, delivery period, etc. Unfortunately, very often those choices might appear in the PA, but the date of issuance of the PA makes them inoperative.

If the foreign government authorizes private importers to purchase agricultural commodities under P.L. 480 and to ship and sell those commodities in the recipient country before the purchase authorization is issued, two questions must be asked:

131

- Are the importers chosen in a way that avoids accusations of favoritism or conflict of interest?

- How will the sale proceeds be calculated?

It should be possible for the recipient government to choose the importers by a first IFB in the recipient government country, but what exactly would be expected from the bidder? Would he have to bid on the basis of tonnage or money or both?

If the private importer proposes to make a purchase in U.S. dollars, he will have to know the market price of commodities in both countries, the world market price, the freight and transport costs, and the timing of the delivery. If the importer has to pay the equivalent of the price in local currency before the IFB is issued in the United States, he will take some risks on all those prices. Even if he has the authority to choose the time at which the IFB will be issued, he will encounter some of the same delays that the government encounters. This is because the IFB can be issued only after the sales agreement has been signed and the commodities must be shipped before the end of September, the end of the fiscal year, which often coincide with the harvest season of the recipient country.

Few developing countries have traders sophisticated enough to handle those transactions, especially when the 75-percent clause concerning the shipping of commodities on U.S. flag vessels is added to other timing and payment constraints. The problems can be partially solved by using a procurement agent.

It is difficult, however, for the importers to control the delivery time when it is the government who controls the signature of the sale agreement. As the fiscal year terminates on September 30 in the United States, USAID has to process all remaining operations before that date. In general, sale agreements have been signed late in the fiscal year, and there is a lot of available food to be obligated at that time. If the agreement is signed late in the fiscal year, the time for deliveries is very short.

The question of quality is also important for private businessmen. For instance, red sorghum does not sell easily in Chad and yellow corn is not well received in Zaire. Nevertheless, CCC has shipped those commodities to those countries either because the specifications had not been clearly stated by the USAID Mission or because they did not have the right commodity in stock at the time shipment was requested.

It would help, therefore, if the importers could be involved in preparing the specifications to be included in the PA and if the USAID Mission would consult with local traders or agencies on the grade and quality of commodities to be purchased in the United States. It is assumed that most Missions do this. It is less evident that this precaution is taken when commodities are imported for monetization under Title II, Section 206. In case of a grant, it seems that the market study is not pursued as well as it should be for commercial sales.

Title II

Under the Title II program, the possibility of involving private business in the purchase and sale of P.L. 480 commodities is limited to transactions taking place in the recipient country. This is because the purchase of the commodities in the United States is done by the CCC (or the commodity is drawn from CCC stocks) and the contract for freight is also the responsibility of the CCC.

Under the government-to-government grant programs, the recipient government is the consignee of the commodities shipped by the CCC, and it receives title to the commodities. These commodities may then be sold to private traders.

The experience in Guinea shows that if the government has no warehouses or if it chooses to make private businesses responsible for unloading, receipt, storage, and sale of the commodities, the following steps must be taken:

- The date that the ship is loaded and the date it is to arrive in the recipient country must be known sufficiently in advance for the government to issue an IFB 30 days before the opening of the bids. (The 30 days is required by the United States.)

- The traders or importers should be involved in the choice of the forwarder and the stevedores, and a plan for unloading and distributing the commodity to the importers and traders should be prepared in advance of the arrival of the ship. The manner in which the importers and traders would share losses and expenses incurred during the transport and unloading should also be decided.

The recipient government should choose either to receive and store the commodities and then sell them through an IFB or to imitate the Guinean government and issue an IFB to choose the traders or importers before the arrival of the ship. In the latter case, the government avoids the responsibility and the expense of unloading and storing the commodities.

In general, if there are any losses during the ocean transportation, it is the shipping company who is responsible to the U.S. government and the "out turn report" will specify those losses. If there are losses during the unloading, it is the responsibility of the stevedoring company and the importers. As a consequence, when the government is the importer and has to pay for the losses, these should be deducted from the sales proceeds or from the money received from the bidders. Since the amount to be deposited in the counterpart fund should be no less than the f.a.s. price U.S. gulf port, the government must establish a minimum price that reflects the f.a.s. U.S. gulf port price plus the losses and other costs incurred by the government in transporting, storing, and selling the commodities. This implies that the monies raised through the IFB cannot always be directly deposited in the counterpart fund. Expenses must be deducted first, leaving at least the required minimum for deposit.

Given the confusion and misunderstandings surround these issues, they should be discussed between USAID and the government before the issuance of an IFB.

How to Read the Tables and Figure

To find out how private importers can be increasingly involved in food aid sales under Title I, consult Tables H-1 and H-2. Table H-1 shows the procedure as it exists now. Table H-2 shows how that procedure could be modified to involve more private importers at an earlier stage in the process. Figure H-1, reproduced from a USDA publication, depicts the operations as they are implemented now.

The left column in Table H-1 enumerates the documents issued and the steps taken for purchasing the commodities in the United States, shipping them, and paying for them. The headings show the entities that are involved in the process. An X indicates that the entity must take action on the document or step. An O indicates that an entity is merely to be informed but that it has no direct action to take at that time.

If one looks at the second-last column of Table H-1, one can see that the private importer is involved only at the last step in the process, when an IFB is issued locally by the foreign government. The foreign government or its agent is directly involved in the purchase of commodities in the United States and their shipment overseas. Table H-2 shows increased involvement by the private importer, beginning with the choice of supplier and shipper. The private importer thus has title to the commodities when they are delivered to the ship in the U.S. port.

Is the scenario depicted in Table H-2 valid within the framework of P.L. 480, especially given the nature of the sales agreement between the U.S.

government and the recipient country? As already noted, the loan provided by the United States to the recipient government and the special provisions contained in that agreement are between the two governments. They do not necessarily concern the private importers, except to the extent that commodities cannot be re-exported.

The control of the USDA over the purchase in the United States and the payment to the U.S. exporter is a separate operation in the sense that it covers only the approval by USDA of the IFB and the contract of sale. Therefore, the IFB or the contract of sale may be made by agents of the recipient government in the United States. This agent is generally that country's embassy in Washington, but that embassy — as in the case of Guatemala — can designate a procurement agent to prepare the IFB and contract on behalf of the importers. Theoretically it is possible to have a foreign government choose a private importer by means of an IFB that is organized just after a sale agreement is signed but before a PA is issued.

When those importers have been chosen, there is another obstacle that has to be overcome if they are to be allowed to purchase directly from U.S. exporters. This is the manner of the USDA's control over purchases in the United States. At the present time, the USDA's control consists in approving the IFB for both commodities and freight and approving the contract. This means that if private importers want to buy directly in the United States, they must do so through an IFB approved by the USDA. As indicated above, the quality of the commodities and the timing of their arrival in the recipient country is very important. Thus, both the time of arrival and specifications should be decided by the importers or buyers.

How could this be done under the present system?

1. The specifications and quality of commodities can be given to the USAID Mission by the chosen importers and sent to Washington for inclusion in the PA.

2. There is very little that can be done with respect to the timing of the issuance of the PA because this depends on the date of the signing of the agreement, which in turn depends on the negotiations between the governments. But the delivery period that is written in the PA can be extended as long as possible.

3. There might be more than one invitation to bid approved by USDA if there more than one private importer designated and if they are certified to the USDA as agents of the foreign government. There does not seem to be any prohibition of this in P.L. 480. But, in practice, it will be difficult to find private importers in the recipient country that could have a representative in the United States to handle all the operations.

161

149

This is the reason why, even with importers as sophisticated as those of Guatemala, the embassy of that country chose a procurement agent to coordinate with the USDA and the importer all the issuance of IFBs, the reduction of contracts for commodities and freight, and their approval by the USDA.

In that system, the procurement agent also coordinates the opening of letters of credit and the timing of shipments, but this does not resolve the questions of specifications, timing of delivery, payments for 75-percent U.S. flag shipment, and the necessity of having separate IFBs for freight and commodities instead of CIF contracts. Some of those inconveniences are due to the lobbying of other private business interests, such as the commercial shipping industry, or the control over taxpayer money that is the responsibility of the administration.

There are also differences of opinion between advocates of liberalization and free enterprise. For instance, some advocates of private business liberalization want more traders involved in the sale of agricultural commodities, but other representatives of private industry prefer "not to lose" the important benefits that accrue from long-established commercial relationships and joint ventures with established importers. These representatives complain that P.L. 480 encourages sellers to have a short-term and sometimes adversarial attitude toward importers.

Table H-1. Flow of Documents for P.L. 480 Title I

	U.S. Embassy and/or USAID	Foreign government importing agency	U.S.D.A. F.A.S.	CCC	Foreign government or its embassy in Washington	U.S. Bank	Importing country bank	U.S. Supplier		Private importers in importing country	Special account in foreign country
								Commodity	Freight		
Agreement Title I	X	X	O	O	X						
Purchase authorization	X	X	X	O	X						
Letter of commitment	O	X	O	X	X	X					
IFB & Commodity purchase in U.S.		X			X			X			
Opening of bids		X		O	X			O			
Choice of supplier			X	O	X			O			
Contract with U.S. supplier			X		X			X			
Commodity Letter of credit opening		X		O	X	X	X	X			
Payment against B/L & documents		X (c)		X	O	X (d)		X (e)			X (f)
IFB & Choice of ship	O	X	X	O	X	O	O	O	X		
Freight L of credit opening		X	O	O	X	X	X		X		
Payment against B/L	O	X	X		X	X	X		X		
IFB & commodity sales in country	X	X								X	X (g)
Choice of successful bidder	X	X								X	X (g)

(a) X signifies that action must be taken by that agency or institution
(b) O signifies that the agency or institution is to be notified
(c) Payment in local currency to special account
(d) Payment in dollars
(e) Receives payment in dollars
(f) Receives payment in local currency
(g) Deposit of difference between amount of payment by foreign government agency and amount of local currency received by foreign government agency for the local sale to local trader

Table H-2. Flow of Documents for P.L. 480 if a Private Importer Issues the IFB

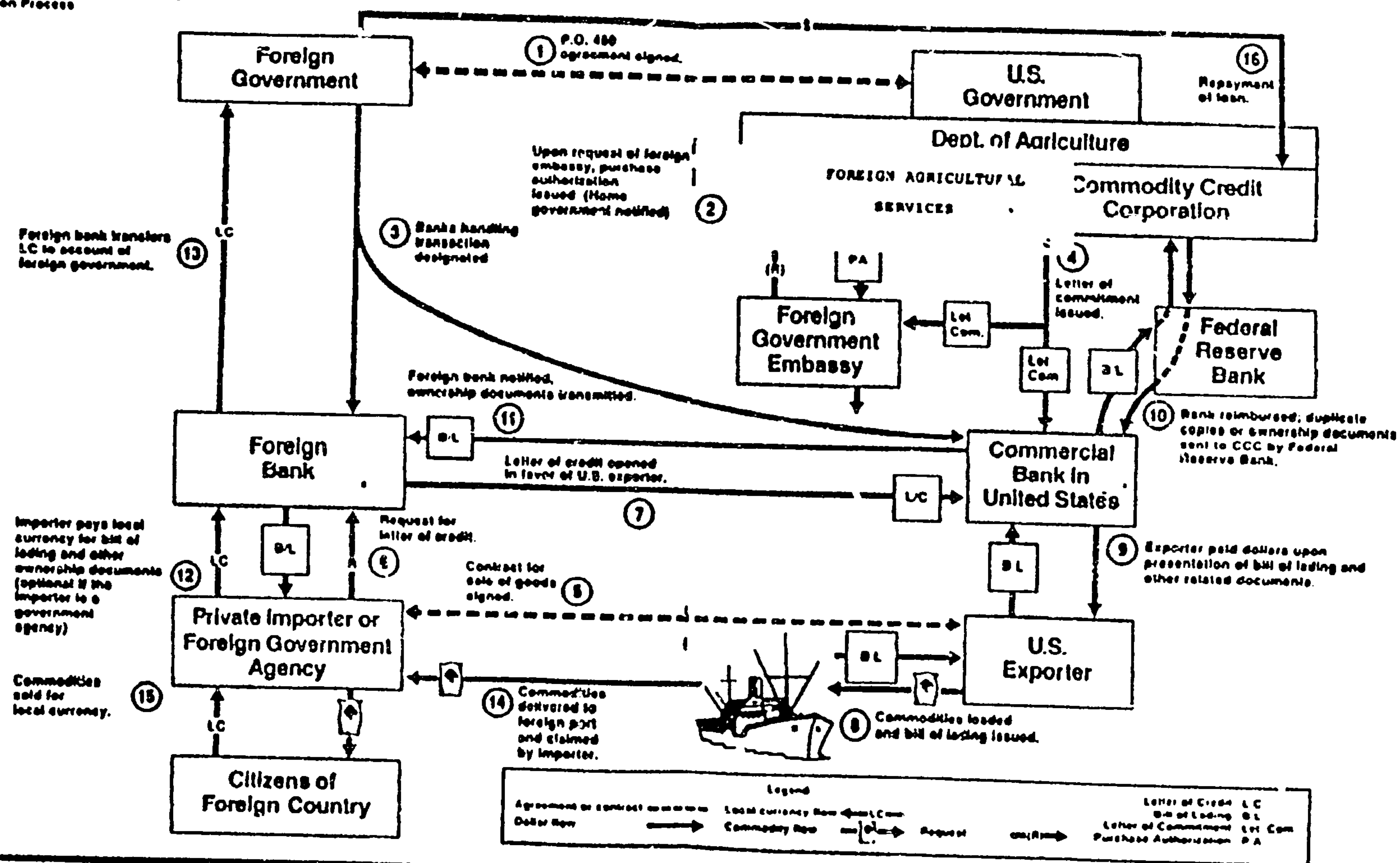
	U.S. Embassy and/or USAID	U.S.D.A. F.A.S.	CCC	Foreign government or its embassy in Washington	U.S. Bank	Importing country bank	U.S. Supplier Commodity	U.S. Supplier Freight	Private importers in importing country	Special account in foreign country	Procurement Agent
Invitation for bid issued by foreign gov't to choose private importer issued by foreign government				X					X		O
Choice of procurement agent				X					X		
Agreement Title I	X	O	O	X							O
Purchase authorization	X	X	O	X							X
Letter of commitment	O	O	X	X	X						O
Invitation for bid				X			X		X		X
Opening of bids		O	O	X			O		X		X
Choice of supplier		X	O	X			O		X		X
Contract with U.S. supplier		X		O			X		X		X
Commodity Letter of credit opening				X	X	X	X		X		X
Payment against B/L & documents			O	O	X (d)		X (e)		X	X (f)	X (c)
IFB & Choice of ship	O	X	O	X	O	O	O	O	X		X
Freight L of credit opening		O	O	X	X	X		X	X		X
Payment against B/L	O	O		O	X	X		X	X		X

(a) Action X] See Table H-1
(b) Information O]
(c) Payment in local currency to special account
(d) Payment in dollars
(e) Receives payment in dollars
(f) Receives payment in local currency
(g) Deposit of difference between amount of payment by foreign government agency and amount of local currency received by foreign government agency for the local sale to local trader

Figure H-1

Figure 3

Stages of the P.L. 480 Program Planning and Implementation Process



The Flow of Documents for P.L. 480

Agreement Title I

This is agreement between the U.S. government and a recipient government that concerns the loan that is made to the recipient government to purchase cereals in the U.S. within the framework of P.L. 480 Title I and that includes the terms of the loan and the self-help measures or projects that the recipient government will undertake.

Purchase Authorization

This document is issued by the general sales manager of the USDA under regulations governing the financing of commercial sales of agricultural commodities. It is an authorization to purchase agricultural commodities, and it is issued to a participant under the regulations. "Participant" means the importing country or private trade entity with which an agreement has been negotiated under this Act. This purchase authorization (PA) authorizes the participant to (1) purchase agricultural commodities and (2) procure ocean transportation.

Letter of Commitment

On application of the recipient country, the controller of the CCC will issue letters of commitment to banking institutions designated by the participant and acceptable by the CCC. Under the letter of commitment method of financing, the U.S. supplier of agricultural commodities will receive payment as provided in the USDA regulations, under irrevocable letters of credit, issued confirmed or advised by a banking institution for the commodity and (when authorized in the PA and included as a part of the commodity cost) for the ocean freight or the ocean freight differential and marine insurance. The bank will be reimbursed by the CCC. If provided in the PA, there is available a reimbursement method under which payments to suppliers will be made by the participant, and the CCC will reimburse the participant directly.

Invitation for Bids

Under paragraph 17.6(b)(2), the importer shall purchase food commodities on the basis of an IFB. The terms of the IFB must be approved by the USDA general sales manager before it is issued by the importer. The importer is the recipient government embassy or the procurement agent hired by that embassy.

166
154

Opening of Bids

The importer shall issue the IFB in the United States and he shall open all offers in public in the United States at the time and place specified in the IFB.

Choice of Supplier

Commodity suppliers must be approved by the USDA as eligible under P.L. 480, Title I program, in order for their contracts to be eligible for CCC financing.

Contract with U.S. Supplier

The contract for the purchase of food commodities under P.L. 480 must be approved by the USDA and that approval is conditioned by the approval of the supplier. The selling agent, if any, the contract price. The sale must conform to the provisions of the purchase authorizations and respondto the terms of the IFB.

Letter of Credit Opening

The letter of credit is opened in favor of the suppliers of commodities, and it states that payment will be made for the commodities against presentation of documents that will show or bring evidence that there is a contract approved by USDA and that a delivery or shipment of commodities has been made. All USDA regulations must have been complied with.

Bill of Lading

A Bill of Lading (B/L) is generally required. It is a document that is signed by the transporter or captain of a ship that accepts responsibility for the commodities delivered to the transporter or shipper. Any losses or damages to those commodities becomes the responsibility of the entity who has signed the B/L.

The ocean B/L is the document that is sent to the importer and USAID Mission. It shows the tonnage and quality of commodity to be delivered. An outturn report, which is signed by all parties concerned, shipping agent, importer representative, and the USAID representative, is designed to show the losses or damages for which the shipping company is responsible and must compensate the U.S. government.

The B/L is one of the most important documents required under the letter of credit issued by a banking institution. It will be presented to the CCC for reimbursement under the terms of the letter of commitment.

IFB and Choice of Ship

A separate IFB is issued to choose the freight transporter and a letter of credit similar to that for commodities is opened in favor of the successful bidder. However, some special conditions concerning freight differential between U.S. and foreign flag vessels are taken into consideration. The time at which the IFB for freight is issued depends on the importer's decision and may be made at the same time as the IFB for the commodities.

IFB for Sale

This concerns the IFB that may be issued by the participant for the choice of the importers or traders that will purchase the commodities. It should be done under the same conditions as the choice of the seller, except that the successful bidders will be those who offer the lowest price in case of sale in the United States and the highest price for the purchase of the commodities in the participant country.

165
156

Entities Mentioned in the Headings

Foreign Government Importing Agency

This may be a state organization or a committee designated by the government or by a ministry. Sometimes ministry of plan, sometimes ministry of finance or economy.

USDA/FA

This is the United States Department of Agriculture/Foreign Agricultural Service

Foreign Embassy or Government

This is the embassy representing the foreign government or a procurement agent designated by the embassy and approved by USDA.

U.S. Bank

This is a bank designated by the foreign government and approved by USDA, where the letter of commitment is domiciled by the CCC.

Importing Country Bank

This is a bank designated by the foreign recipient government. It opens the letter of credit for (ocean) freight.

U.S. Suppliers

There are two, one for commodity and one for freight.

Private Importers in Importing Country

These are the importers or traders that have been chosen by the foreign government to purchase from the government the P.L. 480 commodities and resell them through private traders or retailers.

Special Account in Foreign Country

This is an account opened in a bank of the foreign country in which the sales proceeds are deposited. Money deposited cannot be taken without joint signature of the representatives of the foreign government and the United States.

Table H-3. P.L. 480 Title II. Flow of Documents for P.V.O Program

Documents	A.I.D. Mission	PVO Field mission	Shipping agent	DCC	Traders in recipient country	PVO		
						A.I.D./W FVA/FFP	USDA CCC	PVO U.S./HQ
MYOP. AER	X	X		X		X		X
Monetization proposal	X	X		X		X	O	X
Approval	X	O		X		X	X	X
Call forward	X	X	X			X	X	O
Shipment			X			O	X	X
IFB	O	X				O		O
Bid opening	X	X						O
Choice of buyers	X	O						O

Documents Listed in the Left Column of Table H-3

MYOP	Multi-year operational plan
AER	Annual estimates of requirements
Monetization of proposal	Proposal submitted as part of MYOP updated in AER
Call forward	Request by USAID Mission for the shipment of commodities
IFB	Invitation for bid

Entities in the Headings of Table H-3

A.I.D. Mission	A.I.D. office in recipient country
PVO field mission	Private voluntary organization office in recipient country
Shipping agent	Agent of PVO responsible for shipment
DCC	Development Coordination Committee, a working group that reviews each proposal
Traders	Traders in recipient country invited to bid
A.I.D./W	U.S. Agency for International Development
FVA	Bureau for Food for Peace and Voluntary Assistance
FFP	Office of Food for Peace, Washington
USDA	U.S. Department of Agriculture
CCC	Commodity Credit Corporation
PVO U.S./HQ	Central office of headquarters of Private Voluntary Agency in the United States

159

Table H-4. P.L. 480 Title II. Flow of Documents, Government to Government

	USAID Mission	FVAFFP Washington	Africa Bureau Washington	DCC	Traders in Recipient Country	U.S.D.A. CCC	Recipient Government Agency	Counterpartfund in Bank in Recipient Country
Project or program agreement	X	X	X	X		O	X	
Transfer authorization	X	X	O			X	X	
Call forward	X	X				X	X	
Shipment	O	O				X	O	
I.F.B.	X	O			X		X	
Opening of Bids	X				X		X	X
Sales Proceeds	X				X		X	X

Documents Listed in the Left Column of Table H-4

Project or program agreement	Document prepared by USAID mission to request monetization of Title II food for a project or program
Transfer authorization	Document signed by USAID Representative and U.S. Ambassador and the representative of the recipient government. It includes the tonnage of commodities to be shipped and their value and the program objectives concerning the use of commodities, and conditions for transfer.
Call forward	Request by USAID Mission for the shipment of commodities

- 1B
161

TABLE H-5. STEP-by-STEP ACCOUNT OF P.L. 480 PROGRAM

1. CP to Congress by A.I.D. etc.

2. U.S. government sends U.S. Embassy instructions to negotiate a P.L. 480 agreement with the foreign government.

3. Foreign government selects an official to act as P.L. 480 liaison officer.

4. Foreign government announces the signing of a bilateral P.L. 480 agreement in the foreign country and the USDA simultaneously announces the agreement in Washington.

   This often takes many months and sometimes it requires a full vote by the local legislative assembly.

5. Foreign government instructs its embassy in Washington to implement the P.L. 480 program, and it notifies them of shipment quantities, quality, and delivery details.

6. Foreign government selects a U.S. company to act as its P.L. 480 procurement agent. The importer is not a party to this decision.

7. Foreign embassy officially notifies USDA of procurement agent's appointment and provides copy of the agency contract.

8. U.S. Embassy sends USDA an Operational Reporting Cable advising the specifications of commodities, quantities, purchasing and shipping dates, and names of the banks to be used in the U.S. and foreign country.

9. Foreign embassy requests USDA to issue a Purchase Authorization (PA)

10. USDA uses Operational Reporting Cable as the basis to issue PA and approve Invitations For Bid (IFBs) for commodity and freight. This normally takes 3 to 5 days.

11. USDA announces in Washington that PAs have been signed by the foreign embassy.

12. Importer notifies procurement agent by telex of the quantity, quality, delivery periods, and any special terms and conditions for the IFBs.

13. Procurement agent submits to USDA for approval the draft IFBs for commodity and freight.

14. Commodity Credit Corporation (CCC) issues a Letter of Commitment to a U.S. bank for 100 percent of the commodity letters of credit (L/Cs).

15. CCC issues a Letter of Commitment to the U.S. bank for the Ocean Freight Differential (OFD) amount of the U.S. Flag freight L/Cs.

16. U.S. bank accepts CCC's Letter of Commitment for commodity and U.S. flag OFD.

17. Procurement agent releases the commodity and freight IFBs by computerized telex directly to suppliers and news wire services.

18. USDA requires a minimum 6-day lapse between the release of the PA and tender date.

19. USDA requires a minimum 10-day lapse between tender date and first shipment date.

20. Purchasing delegation, if any, arrives in Washington for commodity and freight tenders.

21. Freight tender is held at 12:00 noon at procurement agent offices, with representatives from foreign embassy and purchasing delegation if any. USDA receives copies of all offers.

22. Procurement agent reviews and sorts freight offers in order of flag, loading range, position, and freight rate.

23. Wheat tender is held at 3:30 P.M. at procurement agent offices, with a representative of the foreign embassy and importer. USDA receives copies of all offers.

24. Wheat offers are reviewed and sorted by procurement agent in order of type, specifications, delivery periods, and price. Due cargo preference, commodity offers give separate prices for U.S. bulk carriers, multi-deckers, tankers, and LASH vessels.

25. Non-responsive offers and commodity offers for which there are no corresponding freight offers are discarded.

26. Procurement agent establishes a purchasing and shipping program based on lowest landed cost (C&F), using a minimum 75 percent U.S. flag vessels.

27. USDA checks and approves shipping schedule and proposed awards for commodity contracts.

28. Procurement agent, on behalf of importer, and subject to USDA approval, telephonically awards the commodity contracts prior to 10:00 A.M. expiration of offers on the morning after the tender.

29. Procurement agent telexes "Notice of Award" to the successful suppliers, recapping the commodity purchase details.

30. Suppliers register their sales with the USDA, requesting price approval.

31. Procurement agent prepares the commodity sales contracts for signature by the sellers.

32. Procurement agent, on behalf of importer, and subject to USDA approval, negotiates U.S. and non-U.S. flag vessels.

33. Procurement agent telexes final negotiated ship charter to ship owners or their brokers.

34. Procurement agent submits all ship charters to USDA for approval.

35. USDA ensures that a minimum of 75 percent has been chartered on U.S. flag ships, in conformity with P.L. 664 cargo preference law.

36. USDA notifies procurement agent of its approval of all commodity sales and ship charters. The contracts with the wheat suppliers and ship owners are now finalized.

37. Procurement agent prepares ship charter parties for signature.

38. Procurement agent telexes to importer instructions for opening commodity & freight L/Cs.

39. Importer gives L/C instructions to the foreign bank.

40. Foreign bank opens L/C on the U.S. bank.

41. Foreign bank does <u>not</u> transfer any U.S. dollars to open the commodity L/C.

42. Foreign bank does transfer U.S. dollars to U.S. bank to open L/Cs for the foreign flag freight and the non-subsidized part of the U.S. flag freight.

43. Procurement agent nominates to commodity suppliers the ships transporting the commodity.

44. Procurement agent, upon receipt of the load port nomination from the commodity suppliers, declares load ports to the ship owners.

45. Procurement agent coordinates the logistics and loading of all the ships.

46. Procurement agent notifies importer of any changes in the shipping program.

47. Procurement agent monitors the receipt of L/Cs by the commodity suppliers & ship owners.

48. Procurement agent requests importer to make any amendments to L/Cs requested by the commodity supplier or ship owner.

49. Suppliers have been warned by USDA not to load commodities without an operable L/C.

50. Procurement agent's outport agents and suppliers confirm the time the ship completed loading, the tonnage loaded, and specifications of the commodity loaded.

51. Procurement agent telexes importer the full commodity and tonnage details and the Ships ETA at the discharge ports.

52. Procurement agent's outport agents and suppliers sign the Statement of Fact at loading port.

53. Supplier of commodity presents original Bills of Lading to the U.S. bank for payment of 100 percent cash against first presentation.

54. U.S. bank advises the foreign bank that the commodity L/Cs have been cashed.

55. Foreign bank transfers the value of the commodity in local currency to the P.L. 480 special account and advises the U.S. embassy.

56. Importer telexes procurement agent "Notice of Safe Arrival" when ship arrives at discharge port.

57. Importer discharges the ship and imports commodity into foreign country in the usual manner.

58. Ship owner presents documents to the U.S. bank for payment of 90 percent freight against first presentation of documents.

59. Procurement agent, on behalf of importer, negotiates with the commodity suppliers to finalize the load rate guarantee clause of the contract.

60. Procurement agent, on behalf of importer, negotiates with ship owners to finalize Laytime Statement at load and discharge ports.

61. Procurement agent, on behalf of importer, collects any load rate guarantee demurrage from the suppliers.

62. Procurement agent requests the transfer of funds from foreign country to pay the ship owners, in case demurrage was incurred.

63. Foreign government and A.I.D. use the foreign currency for selected agricultural projects.