

Message to Inspector General USAID
Submitted 14 February 2012

I very much enjoyed and appreciated James Petersen's, of your office, article on waste in the USAID efforts in conflict areas as posted in Devex Newswire. I can also appreciate that there is some need for expedience in conflict areas that contributes to much of this waste as well as the need to minimize it whenever possible.

However, my concern is more far reaching which I hope you can investigate in detail. The concern is the use of the cooperative business model, including the emphasis of value chains as the current buzz word in rural development, for funneling assistance to smallholder producers that has become the backbone of rural poverty alleviation efforts worldwide, including all donor and all host countries. The use of cooperatives is now fully endorsed by the UN with 2012 being designated as the "Year of the Cooperative", although I would be more likely to refer to it as the year of the scandal. The effort to funnel assistance through cooperatives goes back over 20 years, perhaps to when McPhersons was the USAID administrator. While USAID probably initiated the effort, it was readily taken up by all donors working in agriculture, and has resulted in billions of dollars being squandered on projects the farmers/beneficiaries have little, if any, interest in. This could be a real major scandal and one that can be fairly easily demonstrated. It may also represent projects that could be more an encouragement for anti-American terrorism than enhance our national security. Nothing specific, just the pure logic of how often will individuals, participating in well-publicized clearly identified as a US funded projects involving credit clubs, allow their hard earned crops to be confiscated to pay a defaulting neighbor's loan, before developing an adverse opinion of the US and acting on it.

While I would agree the ideal of cooperatives is socially desirable. However, the question I have, in the overall financially suppressed business environment common to host countries in the developing world that effectively curtails private dealers profit margins, are development cooperatives competitive with the often vilified private traders or is the cooperative business model as modified for use in development projects too administratively cumbersome, too inconvenient, and too out of tune with well-established and reasonable rational financial management strategies, that the farmers wisely take the bulk (>70%) of their business elsewhere, usually to those vilified private traders, who actually offer a considerable better deal, both financially and certainly conveniently. The net result is the agriculture development projects attract the "**active**" participation of only a small percent of the potential beneficiaries, and even then the active participants will "side-sell" the bulk of their produce to outsiders. This is then covered up with what is basically some massive spin reporting aimed at appeasing the donors, USAID or otherwise, as needed to assure project extensions and future projects. The result is projects can only persist with continuous and extensive external facilitation and invariability shortly after external assistance ends.

Such reporting typically overlooks, what I like to refer to as the basic business parameters, that will determine if the project is attracting enough interest by the intended beneficiaries to be sustainable after donor assistance ends, as specified or at least implied in most RFPs. This would include overlooking the overhead costs to operate the cooperative or even worse allocating the overhead costs as a direct

financial benefit to the members. It also usually uses aggregate numbers that may sound impressive, but when prorated to individual members can be very trivial such as ACDI/VOCA's Ethiopian fair trade coffee project that boast 21,900 members and markets 181 tons of coffee. Assuming this is metric tons this averages only 8.3 kgs/member or only about 4% of the estimated crop of the members, and would provide a financial benefit of around \$5/member, based on the price difference between fair trade and open market coffee. I am sorry but I have difficulty seeing how \$5/member financial benefit will have any impact on poverty, and 4% market share can be considered a successful project. Apparently the idea of the article was to see how many people would sign up, but not how well they were served by the cooperative. This may wishfully sound as the exception, but I fear it is the general case for cooperatives as part of the development projects funded by USAID and most other donors.

What I would appreciate of your office is to fully investigate if the cooperative business model is attracting enough overall participation to justify its continued use, or should the rural development effort move on to consider other means of assisting smallholder producers. More specifically I would like to know why the M&E people are not insisting on the following, what I call basic business parameters be part of all routine progress reporting. My guess is the results are too embarrassing. In listing the basic business parameters I am including what laymen expectations are based on surveys to a class I taught as well as what I expect the reality is. The laymen would also be the taxpayer getting fleeced by ineffective program as well as jurors if class action litigation is initiated against individuals involved in misrepresenting the effectiveness of the cooperative system. If these are the perspective jurors perceptions of the effectiveness of development projects, any values substantially below these perceptions will need to be carefully justified.

Basic business Parameters

1. A detailed basic cost of business analysis to determine if you are offering the farmers a sustainably better deal than the competing private business. The jurors' expectation is 15 to 20% benefit; the reality is closer to a minus 10%. Overhead costs exceeding the financial "empowerment" financial benefits of bulk purchases and bulked sales.
2. What percent of the potential beneficiaries are "**actively**" participating in the program? Jurors' expectation is minimum 50%, reality closer to 10%, often less. Possible to higher percent registered but most maybe inactive while being retained on the books.
3. Sustainable overhead costs for operating a cooperative as percent of purchase price of inputs or sales of produce. Jurors' expectation 15% reality 30 to 35%. The 15% is probably unrealistic as most people greatly underestimate administrative costs. However, the 30% provides a lot of room for private traders to operate to the financial benefit of the smallholders. Sustainable overhead being that overhead costs excluding the facilitation costs, basically the host country hired employees and their operating costs, and excluding the expatriate advising effort needed to initiate the project.
4. What is the market share, either for inputs procured or goods marketed, members rely on the cooperative for? Jurors' expectations would be for this to be >70% but the reality is closer to 30% or less. Problems with consignment selling in cash oriented societies that prefers to retain

goods in kind as long as possible and dribbling goods onto the market to meet immediate cash needs. This can prolong the buying season driving up overhead costs.

5. On the converse what is the percent side-selling in which members deliberately divert their produce obligated to be marketed through the cooperative to the competing and vilified private traders. Jurors' expectation only 10 to 15%, but the reality is closer to 70% or more. This is a combination of avoiding the risk of confiscation to pay defaulting neighbors loans and desire for immediate cash settlement.
6. Percent loan repayments. This tends to be fairly high but the underlying question is how much of the loan repayments are through the confiscation of one farmers produce to cover the loan of a defaulting neighbor within the credit club. This results in astute honest farmers consigning only enough produce to the cooperative to cover their loans and side selling the rest. Then not worrying how the cooperative management allocates the accounting. The big issue here is for the donors to stop blaming the farmer for not complying with their legal obligations, and look at the horrendous business model being imposed. What would you do? Provide a business model that is worth complying with and the farmers will!!
7. Finally, what happened to the promised dividends promoted as an inducement to join the program? How long before the cooperative should be expected to pay these dividends? Jurors' expectations 2 or at most 3 years from the inception of the project. Reality never paid, at least according to the normal definition of dividends. However, you have to be careful of distorted definition of dividends that can be used to describe a second payment after an initial payment was not the full market value of the produce.

Unless there is something fundamentally wrong with these business parameters, I would like to know why M&E officers are not requiring they be included in all progress reports. I don't think it requires an excessive amount of effort to collect the information, but I think it would separate projects that are mostly nothing more than a publicity stunt of the donors' good intentions from those that offer a sustainable poverty alleviation effort. My guess the values for these business parameters are just too embarrassing. If the values for these or a similar set of parameters were supportive of the cooperatives, these parameters would be prominently mentioned in all reporting. Also, where possible all benefits need to be prorated to individual members that can be easily comprehended by laymen and not buried in aggregate reporting as was done with the Ethiopian fair trade coffee report mentioned above.

Now I realize I have put forth several major concerns without any solid data to support them, thus I would like to refer you to my website which contains additional details and links to the primary articles for the case studies mentioned, including the one of Fair Trade Coffee from Ethiopia.

Website: www.smallholderagriculture.com

Specific pages:

For background concepts

- Financially suppressed economy <http://lamar.colostate.edu/~rtinsley/FinancialSuppressed.htm> looks at the overall economic environment that can severely restrict the profit margins of most

small enterprises, making it difficult for cooperatives to financially compete unless being very aggressive in keeping overhead costs down.

- The development process <http://lamar.colostate.edu/~rtinsley/DevelopmentProcess.htm> that looks at how projects are developed and become a serious case circular reasoning that reinforces the established processes and reduces the prospects for innovation.
- The development hierarchy <http://lamar.colostate.edu/~rtinsley/Hierarchy.htm> looks at 4 levels of isolation between the donors such as USAID and the smallholder beneficiaries

Specific to the cooperatives

- Farmer Organization <http://lamar.colostate.edu/~rtinsley/Cooperatives.htm> starts looking at if they have a true competitive advantage
- Lose of competitive advantage <http://lamar.colostate.edu/~rtinsley/LossCompetitiveAdvantage.html> list 14 areas where the cooperative business model as used in rural development projects can easily lose the envisioned competitive advantage.
- Financial management strategy <http://lamar.colostate.edu/~rtinsley/FinancialStrategy.htm> looks at the possible financial management strategy used by smallholder that emphasizes retaining good in kind as long as possible, but goes completely against the idea of consignment selling to bulk the volume for more favorable prices.
- Perpetuating Cooperatives <http://lamar.colostate.edu/~rtinsley/DeceptiveReporting.html> looks at how the reporting of cooperatives is deceptive bordering on dishonest. It includes the case study on Fair Trade Coffee from Ethiopia mentioned above.
- Information Requested <http://lamar.colostate.edu/~rtinsley/InformationRequest-.htm> more details on the basic business parameters that appear to be completely overlooked by all reports on cooperatives but would indicate if programs were sustainable or most likely will collapse once external support ends.
- Banana Trader <http://lamar.colostate.edu/~rtinsley/BananaTrader.htm> as a case study of an impoverished private trader.

I hope this will be sufficient for you to thoroughly investigate the use of cooperatives in funneling assistance to smallholder producers. Are they attracting enough participation by the intended beneficiaries to justify their continued use, or is the accompanying business model just too cumbersome and too inconvenient so the smallholder beneficiaries wisely take their business elsewhere so they can receive a better financial return, less hassle and more convenient?

In so investigating be careful of some distorted definitions such as:

- The term **cooperative** could be considerably distorted away from good business practice as use in the successful US cooperatives such as Land o' Lakes, Florida Natural, and Ocean Spray
- The term **empowerment** which according to most definitions implies a political empowerment and representation, but here is mostly limited to a limited financial empowerment in terms of

getting better prices. This is really a nearly obscure definition empowerment in most dictionaries.

- The term **dividend** which normally means a sharing of profit, but in this case it is used for a second and delayed payment, when the first payment was below the fair market value of the crop.

I am not a lawyer, nor have I had detailed discussion with any lawyers, but as I alluded to above I think there could be some substantial class action liabilities here. Certainly, vilifying private traders without any clear accounting data or business model comparisons is slander. It would not take much effort to organize some private traders, particularly the multitude of those operating below the poverty line, to participate in class action litigation against those individual legal responsible for any slanderous comments in any project documentation, including RFPs, proposals developed from RFPs, periodic progress reports, and periodicals. In the case of those private traders whose market volume is so low they are living below the poverty, vilifying them and attempting to deprive them of their livelihood could imply promoting their starvation, and that would come close to meeting the definition of genocide. Could such class action litigation be filed in Washington? I seriously doubt if USAID or the US Government has a policy of wantonly slandering anyone particularly impoverished people. Thus the liabilities would fall on individuals rather than USAID as an institution, just like it did with the Iraq prison scandal.

Litigating against those individuals misrepresenting the effectiveness of the cooperative system might be more of a challenge, but there needs to be some accountability somewhere in the system. I believe the first responsibility of public servants is to be a good stewards of the funds entrusted to their care. Aren't the M&E officers mandated to make certain the reporting criteria are relevant to assuring that projects will be sustainable beyond the donor assistance as normally implied in the RFPs, and not just what can be easily publicized? Likewise aren't project officer and contract officers expected to see through any spin reporting to assure projects are sustainable beyond donor assistance and effectively using the funds committed? Again I seriously doubt if USAID or the US Government has a policy of promoting spin reporting. Although the pressure to report only success stories can come very close to demanding spin reporting.

It would indeed be unfortunate if people, who devoted their entire professional careers intent on assisting a deserving impoverished group of people, but with a far greater commitment to a socially ideal mechanism for assisting them, than to the beneficiaries would end up courtroom and lose everything because they engaged or encourage deceptive reporting. Please assist in bringing the commitment to the smallholder beneficiaries instead of some social ideal mechanism that is just too cumbersome to attract wide spread involvement of the beneficiaries.

Meanwhile, I will continue my quiet search for Watchdog Organizations with sufficient financial resource to litigate individuals who are vilifying private traders without solid supporting evidence, or who are involved in either deceptive reporting or promoting and accepting deceptive reporting. Hopefully you can fully investigate these issues and bring about the needed changes, before I can succeed in getting

the support for the litigation. We really need stop toying with a fragile group of people and provide the assistance they need in a manner they appreciate and are willing to fully participate in.

If you are able to investigate this a couple starting points might be:

- Look at projects for which funding has ended for two or more year to see if there is anything left and has there really been any lasting impact.
- If you do any field investigation of existing project, concentrate your interviews on the senior host country personnel instead of the expatriate advisors. They may be more candid in providing answers to the business parameters I mentioned.
- Get assistance from consultants that are fully independent of USAID, host governments, and implementing NGOs.

With that I think I should close and hope you will be able to conduct a complete investigation so both the US taxpayers get a better return on the development dollars invested and the smallholder producers get more effective projects that will provide them sustainable economic benefits.

Thank you,

Respectively submitted

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