Helpdesk Report

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Donor agency macroeconomic support for food imports

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Question

What are the experiences of donors using macroeconomic tools to intervene in countries to support the commercial import of food staples such as wheat and rice? What has been done and what lessons have been learned? [This excludes humanitarian food aid.]

Contents

1. Executive summary

A functional financial sector, including foreign currency market is critical to enable effective private sector imports of essentials such as food. Donor funded technical assistance can support this, and is more likely to be effective where political will and security conditions are moving in a positive direction.

Where there is an operational parallel market, imports can get constrained by lack of access to foreign exchange. In cases where trading through the official rate is no longer credible for donors, **donor flows can help deepen parallel market operations** which can benefit domestic traders requiring foreign exchange for imports.

Monetised food aid can provide some relief to severe shortages in domestic markets, providing care is taken to not distort local markets or consumption preferences. The domestic funds raised through this process will require a use. It is an aid modality primarily used by the USA.

Concessional credit lines from bilateral sources exist where there is the political interest to underwrite the risk. However OECD bilateral donors are generally risk adverse in terms of export credit to fragile states. Most aid-related funding to support balance of payments, which in turn help support food imports in low income countries, is channelled through subsidised International Financial Institution (IFI) credit lines.

There are some cases where bilateral donors have worked to facilitate financial flows in crisis affected states to directly or indirectly support imports; in Somalia's case there was considerable effort to avoid *hawala*[1] remittance flows being constrained, which are critical for financing food imports into Somalia. In Zimbabwe, a donor fund that guarantees foreign exchange payment of maize imports against domestic payments has recently been set up to help ease an acute need for staple food imports.

Significant donor foreign-exchange inflows help ease foreign exchange constraints. These donor inflows can also directly benefit households through cash or agro-inputs for increased domestic food production. While investments such as agro-inputs are costly at scale, it is cost effective compared to anticipated food aid requirements in protracted crisis situations. In some cases, **voucher schemes can be designed to act as a de facto guarantee of payment of foreign exchange** required by importers.

2. Introduction

A macro-economic impact on essential food imports generally occur when there is a balance of payment (BoP) crisis, or other capacity constraints to imports as a result of conflict or political decisions. Macro-economic or other shocks such as climatic or conflict related can also be expected to significantly affect households' ability to produce and/or procure basic foods, and which can further deepen the crisis.

This note seeks to explore cases where donors have been able to have a macro-level impact on the causes and consequences of challenges to essential food imports. What this note does not explore are formal IMF-led interventions which are designed to overcome the balance of payment challenges which impact on capacity to import essential food, as well as humanitarian food responses. While it seeks to summarise lessons generally, it is written taking into consideration the challenges faced in Yemen in March 2017. It is also written to accompany the associated note *Responding to Central Bank collapse*.

3. Donor agency macroeconomic support for food imports

Helping ensure a functional financial system

Having an operational central bank to help enable an effective financial sector, as well as ensure sufficient availability of foreign exchange for imports, is an important part of facilitating essential

[1] A traditional system of transferring money used in Arab countries and South Asia, whereby the money is paid to an agent who then instructs an associate in the relevant country or area to pay the final recipient. (Oxford English Dictionary)

trade such as food imports.[2] This especially affects conflict states, and most donor interventions reflect post-conflict support. In most cases would have led to a fuller IMF-led programme of support.

In ***Rwanda***, the tragic 1994 genocide led to major challenges at the central bank including in human resource capacity. International support led to a streamlined role to reflect capacity constraints and enable greater focus (IMF 2007). This included a more flexible monetary and exchange rate policy, and a separate internal audit unit to ensure credibility. In ***Somalia***, donor support led by the World Bank, IMF and AfDB has helped to re-establish its central bank and gradually increase its role including supervision of a new formal banking system which had closed due to the conflict (World Bank 2015).

In the ***Democratic Republic of Congo***, the initial focus post 1998-2001 conflict was to focus on core central bank roles. This included the establishment of an effective Foreign Exchange Department to enable foreign exchange operations which were critical to support trade; here support was also brought in from other central banks eg: the National Bank of Belguim (IMF 2006). The shift to a free floating rate was already identified as a key step to ease the constraints on access to foreign exchange which previously had led to reduced ability to import food as well as fuel required for food distribution in-country (FAO 2000).

In ***Liberia***, a more interventionist approach was taken by the group of key international partners (UN, World Bank, IMF, EU, Ghana, Nigeria, USA, ECOWAS, AU). This included the placement of international experts, which in some cases had co-signature authority. This was to help ensure credibility of what were still very weak institutions; however it was also politically challenging given the perception of an affront to the sovereignty of a country. The role of regional powers and the UN were important in brokering this arrangement (Dwan 2006).

Evaluations of technical assistance provide variable pictures, which are often context specific. The IEO 2014 review notes IMF technical assistance[3] has improved in terms of better reflecting a balance between authority's needs and IMF priorities, albeit limited by the fact that demand for IMF provided technical assistance (TA) significantly outstrips supply. Reviews of regional IMF Technical Assistance Centres suggest technical assistance is generally effective, with the proviso of attribution being a challenge (Consulting Base 2013, ECORYS 2014). However technical assistance tended to be more effective in countries that were relatively stable/post-conflict (ECORYS 2014).

Where the official rate is no longer a credible option for donors, a shift to the parallel market can be a constructive move. Reasons can include value-for-money, or concerns over the poor use of the foreign exchange received by the government (effectively at an overvalued rate).

In the case of ***Zimbabwe*** in the mid-2000s, the official rate was significantly overvalued, and domestic prices shifted to be set by the parallel market making operating through the official rate very poor value for money. While illegal in-country, parallel market operations were legal outside Zimbabwe, with London and Johannesburg being two main bases for transactions – in part reflecting the large remittances from the UK and South Africa. All the major donors, and donor

[2] The associated note "Responding to central bank collapse" looks at this question in greater detail.

[3] There are limited cases of non-IMF managed technical assistance to central banks; with the exception of other central bank support. However evidence of impact of this type of intervention is limited.

funded agencies, were able to shift to off-shore operations deepening the market, and helped deepen the parallel foreign exchange market, which in turn provided a reference point for the more informal sector as well as eased access to foreign exchange for importers of essential food and fuel.

Similarly donor support has been in place to support remittance flows such as Somalia, for example the UK supported ***Somali-U.K. Safer Corridor Pilot*** to be mobilized in the event of a significant disruption in remittances (World Bank 2015).

Monetising food imports

Examples of food monetising are almost exclusively based on USA food aid, where this approach enables greater exports of USA grains and oils, and the domestic currency is then used to fund domestic spend of NGOs and in some cases, government (Schnepf 2016).

For example, ***Somalia*** has a relatively high dependence on imported staple foods (wheat and rice) to complement domestic production (maize and sorghum). In the 1980s, the Government of Somalia with support from donors would monetise food aid. This ensured a steady supply as well as a source of revenue for the government, contributing up to 10% of the Governments budget (Hossein Farzin, 1988).

Monetisation has its critics, including inefficiencies (cash transfers are generally cheaper) and market distortions (US food aid needs to have an approved Bellmon estimation[4] to avoid market distortions). However it does enable significant imports of essential foods that can then be sold at market rate and in some cases help support market structures, as well as then fund further spend in-country (Schnepf 2016).

For example in the 2011 famine hitting southern Somalia, Food for Peace working with IOM monetised sorghum to help supply the market and stabilise prices (Humanitarian Outcomes 2013). US funding similarly sold sorghum during shortfalls of food in Zimbabwe in the mid 2000s. In both cases, this has provided a familiar staple food option if often considered an “inferior good” to eg: wheat and maize. There is a significant time lag for this kind of programme, which makes it more suitable for a protracted crisis.

Foreign exchange credit lines to support importers

Extreme balance of payment crisis in low income countries can benefit from additional, more concessional, support from the IMF. In ***Liberia***, following the Ebola crisis, balance of payment support was provided to enable inter alia, core imports including staple foods. This was through the IMF Catastrophic Containment and Relief Trust (CCR) to temporarily service Liberia’s debts. In addition, and a Rapid Credit Facility (RCF) was agreed to cover the financing gap and provide

[4] The Bellmon Estimation is required before food aid can be shipped, and which must determine that adequate storage is available and that incoming food aid will not result in substantial disincentives for domestic production or marketing.

liquidity to the banking system (IMF, 2015). The CCR window however is limited to low income countries facing natural disasters or wide-spread health crisis.[5]

Bilateral finance tends to be through export credit agencies and banks, and while the underwriting of risk can reduce the financing terms, these would not generally count as aid. More specific (and subsidised) credit lines for essential imports are generally linked to wider political objectives. For example, there are reports of credit lines and grants to support food imports provided to Syria from Iran, and from Qatar to the opposition held areas of Syria.[6] Venezuela implemented a scheme of subsidised fuel exports backed by credit lines to the Caribbean region and key partner countries who were members of the ALBA group[7] (Economist 2014). Some traditional[8] bilateral donor countries do still provide concessional trade finance, however this type of finance is risk adverse in terms of covering fragile states. Support for broader balance of payments would generally be expected to be managed through donor-funded concessional funding via the IMF and other IFIs.

DFID has recently set up a facility for importers access to foreign exchange to pay suppliers in the context of a poor domestic harvest requiring significant staple food maize imports. The limited reserves and liquidity in Zimbabwe have meant importers face challenges using domestic payments to make international payments. Capped at USD20.9 million, the recently operational scheme which runs until 31 March 2017 is operated by the implementing agent competitively selecting importers of maize, who then make payments into a local account. The implementing agent then settles the international payment for the importer for the equivalent of the amount deposited. DFID then draws down the domestically held funds for its local payments. Suppliers are expected to target sales in districts receiving cash transfers (DFID 2016).

Direct support to populations through cash transfers or vouchers

In general terms, the donor community has shifted significantly towards cash transfers to replace food aid; however this has depended on the context and specific donor. Costs are generally significantly lower, and cash is consistently found to be more efficient that in-kind provision. When compared to vouchers, outcomes are more mixed, as it arguably depends on what the objective is. Cash will generally be most effective at increasing household welfare; however food voucher may be more effective at specifically improving food security and can also hedge against local inflation if the voucher is to cover a quantity rather than a value (Venton 2015).

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[5] http://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/49/Catastrophe-Containment-and-Relief-Trust

[6] http://www.syria-report.com/trending-content/Wheat?page=2

[7] The Bolivarian Alliance for the Peoples of Our America

[8] Using “traditional” as OECD DAC country members, though other non-OECD countries also have a history of providing bilateral aid.

The government of ***Pakistan*** with donor support, has delivered two of the largest cash transfers programmes in global terms. The humanitarian "WATAN card"[9] reached around 1.6 million families through cash payments, designed to help families hit by the 2010 floods and delivered jointly by the Government of Pakistan and range of donors. The foreign exchange inflow from the donor element worth USD500 million helped Pakistan's macro-economy manage the shock from the floods, as well as aided a more rapid recovery (in eg: higher subsequent harvest and lower than expected default rate to micro-financial sector) (OPM 2013). The BISP[10] is a longer term social cash transfer programme, set up initially to protect the poorest against the rise in commodity prices in 2008. As part of more recent international support to Pakistan when at risk of a balance of payment crisis, donor funds were increased to bolster BISP to reach more beneficiaries as well as increase the payment amount to each recipient. DFID additionally provided budget support to ease the fiscal impacts as well as BoP, with part of the funds directly earmarked to cash transfers and conditional on targets met (the other key disbursement-related targets were tax-related) (DFID 2014).

Despite very limited preparation time and ongoing conflict, large scale cash and food vouchers were effectively distributed in the 2011 famine in southern Somalia. This serves as an example of where cash and food vouchers can have a role despite a priori concerns of donors and implementing partners (Humanitarian Outcomes 2013).

Direct support to domestic producers through fertilizer and seeds (in-kind and vouchers)

Evaluations at the household level of large scale agro-inputs suggest that results are context specific. The provision of fertilizer (and sometimes also seeds) will have an output impact which increases food security of the household and community. Its impact on medium term recovery is more variable; chronically poor are unlikely to jump out of poverty. It is also an expensive option if done at scale, however very cost effective when food aid requirements are anticipated to be very significant in a following year. A computable general equilibrium analysis which also captures the indirect benefits of the national agro-input scheme in Malawi (government and donor funded) suggests a strong case for the programme in terms of macro-economic impact (Arndt 2016).

Commodity-based[11] vouchers can provide assurances for importers as this provides a guarantee of foreign exchange payment where donor funded. Given the protracted crisis in Zimbabwe, donor funding enabled early purchase of imported fertilizer (leading to competitive prices), with

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[9] Meaning "country" in Urdu, the WATAN card was a pre-loaded debit card working on the visa network. Each beneficiary was biometrically verified, and their card was then credited in two instalments to access as with any visa debit card.

[10] The Benazir Income Support Programme provides a regular unconditional payment primarily through a debit card to around 5 million women and their families who were below the poverty line, with an additional conditional cash transfer linked to child attendance at school.

[11] Commodity based vouchers provide X amount of a specific commodity such as a bag of fertilizer. They protect the beneficiary against price fluctuations, but are not flexible in terms of their use and less effective in terms of crowding in the market at the local level. Value-based vouchers have a cash equivalent, which can be relatively "closed" and so eligible for use for a specific or range of specific agro-inputs, or more "open" so can be redeemed for any product sold by the accredited outlet (usually an agro-input store). Open vouchers are generally preferred for their flexibility/reduced likelihood of beneficiaries selling them at a discount for cash. However they do also mean it is harder to pre-determine the end use and therefore pre-plan suppliers to meet the demand.

the suppliers knowing "demand" is guaranteed and payment against re-deemed vouchers would be in foreign exchange (so potentially a "bankable" for credit purposes). In some cases, there was a co-payment, which covered domestic costs (as well as reduced perception of a "hand-out") with donor funds covering the actual fertiliser input costs.

4. Commentary and conclusion

These are reflection by the author, which may or may not apply to the actual realities faced by Yemen.

Periods of major political crisis, especially with associated conflict, will tend to have protracted negative impacts on the population and the wider economy. For donors, getting the balance right between responding to often an urgent humanitarian crisis and medium term needs can be technically challenging. However in practise, it is often more difficult in political terms, for both donor countries and in-country, given the many risks and unknowns.

However the impacts on the private sector, including the micro-enterprise and household economy will be somewhat easier to anticipate if still challenging to respond to. Ensuring appropriate and effective support is important at both an ethical level in terms of supporting those most in need, and also working to maintain capacity for a more rapid economic recovery. Prices are likely to rise against incomes, affecting food security as well as wider purchasing power, and productive inputs from fuel to fertilizer will be harder to access as well as afford.

To help limit this challenges, an important priority is likely to ensure a functioning currency, probably also a hard currency operating alongside it which ideally is something accessed by low income households to protect their limited assets as well as the better off. The fiscal impact on government can be a real challenge with inflation-related risks associated with a growing fiscal deficit[12], though a non-functional central bank may limit this possibility though impact directly on the ability of government to provide basis services. Similarly a functioning and relatively deep exchange rate market is needed that provides flexibility to the economy to respond to shocks. This can be a parallel rate or an official rate that mostly mirrors the parallel rate. Working to support key institutions, including the essential functions of a central bank, will be important for the recovery period even if "returns to investment" are very limited while political and actual conflict remains a reality.

To help ensure food security through the market, the economically optimal way is likely to be through direct cash transfers, and the removal of subsidies including through an overvalued official exchange rate (which a non-fiscal tax to exporters/official rate purchases of domestic currency)[13]. The savings from generalised subsidies and loses from an overvalued currency are

[12] This assumes a loss of revenue, as well as a shift in international credit and donor-funded grants to be off budget and primarily focussed on humanitarian challenges. In protracted crisis cases, donor funded parallel support to state functions can be built up, such as donor funded essential drugs and even "top-ups" for staff in the health sector (as an example) which reduce the fiscal impact of donor including IFI withdrawal while not undermining state functions.

[13] While a parallel rate can have a risk premium (especially where illegal and fragmented), it will be closer to a market rate than an official rate that no longer is set by the market. Where there is a significant difference with the official rate, a subsidy is effectively in place, with exporters/those selling foreign exchange are "subsidizing" imports/those purchasing foreign exchange.

likely to be more than sufficient to cover the cost of cash transfers, and cash will help underpin the secondary market for food aid (which is often sold at a loss for households requiring cash). It is of course recognised that there are short to medium run technical challenges to wide coverage of a cash payment, however also examples where this has been possible in very challenging environments.

Similarly facilitating key agriculture inputs (fertiliser, potentially seed) offer a way of reducing future food aid requirements as well as boost the household economy and wider economy, ideally accompanied by some extension support as well as through a gender sensitive design. Facilitating trade financing would then be the priority, and potential currency swaps backed by donor needs for domestic currency (as in the DFID example being implemented in Zimbabwe) may be an effective short term measure.

Along with what domestic production is possible, remittances are likely to be the main engine of consumption and economic activity. Helping reduce their transaction costs, including making electronic transfers easier, is likely to have a valued impact. A shift to e-banking may also help the market (ie: parallel) rate deepen and so facilitate the foreign exchange transactions required for essential imports.

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