Good Practice Review on Cash Assistance in Contexts of High Inflation and Depreciation

CASE STUDY SOUTH SUDAN
– July 2021

This case study accompanies the CaLP Network Good Practice Review on Cash Assistance in Contexts of High Inflation and Depreciation. It is intended to illustrate the process of situational analysis, response analysis and response option selection presented in the Good Practice Review. The learning from this case study has also actively contributed to the good practices documented in the review. It should be noted that the case study represents a snapshot in time of a continuously evolving situation. During the development of the case study, economic reform was initiated in South Sudan which will have direct impact on cash transfers. This case study has been written to derive lessons from both the pre-reform situation and the recent 2021 reform. It was authored by Maria Bernardez (DG ECHO), Stefan Bumbacher (SDC) and Raphael Tschirky (SDC), supported by Emma Holden-Maillard and Calum McLean (working for the FCDO-GIZ SPACE initiative).

1. CONTEXT

The humanitarian situation in South Sudan remains dire. More than **two-thirds of the South Sudanese population and some 300,000 refugees and asylum seekers in South Sudan are in need of some form of humanitarian assistance and protection** in 2021. The lack of durable peace and limited investment in basic services impeded many people's ability to move towards sustainable development. Since 2012 South Sudan had experienced internal shocks (conflict and extreme food insecurity including pockets of famine) and external shocks affecting the economy. The f**ragile context had led to the depreciation of the South Sudanese pound (SSP)**. This issue was exacerbated by: growing levels of debt (deepened by a lack of productive income-generating schemes), a shortage of foreign reserves with no credible short- and medium-term prospects of gaining access to additional reserves, and imports of goods and services against a limitation of dollar supply in the banking systems, including Bank of South Sudan (BSS). Weak fiscal discipline and management led to the situation worsening from 2015, and a floating exchange rate was adopted by the government-controlled BSS. The government soon ran out of foreign exchange to manage its official rate, which became de facto fixed. This led to the emergence of a parallel market and a de facto segmentation of the foreign exchange market into the official and parallel markets, hereafter referred to as market exchange rate. In the parallel market, supply and demand were brought into balance by market forces that steadily increased the gap between the official and parallel rates.[1]

In 2016 the combination of **violent conflict, disruption of cross-border trade, falling oil prices and oil production,**[2] **and drought** further worsened the already precarious macroeconomic situation, **contributing to rampant inflation**, further deterioration of balance of payments and capital flight.
The signing of the Revitalized Peace Agreement and formation of the Transitional Government of National Unity in 2020 had been a positive step forward in reducing armed conflict at the national level, providing opportunities for stabilization. However, the effects of COVID-19, floods and internal conflict in 2020 reduced the capacities for stabilizing the economy further.

In March 2021, the BSS released a circular on monetary and exchange rate reform, which aims to have a new market-based exchange rate (the 'reference rate') that in time is expected to be similar to the parallel market exchange rate. Banks and foreign exchange bureaus are required to use the reference exchange rate. In parallel, the official rate will be slowly devalued until it becomes redundant. This will have direct implications for cash transfer programmes.

The use of cash and voucher assistance (CVA) remains small in relation to the whole humanitarian response. For the last reported period **USD 52 million were reported as CVA in South Sudan, and 54% of that as cash.**[3] The main actor is the WFP, which delivered USD 25 million[4] of their relief responses using both cash and vouchers (with no distinction between the two modalities) in 2020 – approximately 12% of the total USD 385 million relief expenditure – while their plan for 2021 is to reach more than double that figure.

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[1]IGC (2015). Exchange Rate Reform in South Sudan. Policy Brief. https://www.theigc.org/wp-content/uploads/2015/12/Jefferis-2015-Policy-note.pdf
[2]Oil revenue is important for South Sudan as it accounts for over 90% of revenue. Ministry of Finance, Macroeconomic Division presentation at the 2020 Sector Budget Workshops.
[3]Cash Working Group Dashboard from Jan to September 2020
[4]WFP (2020). South Sudan Annual Country Report 2020 Country Strategic Plan 2018 – 2021. https://docs.wfp.org/api/documents/WFP-0000125432/download/

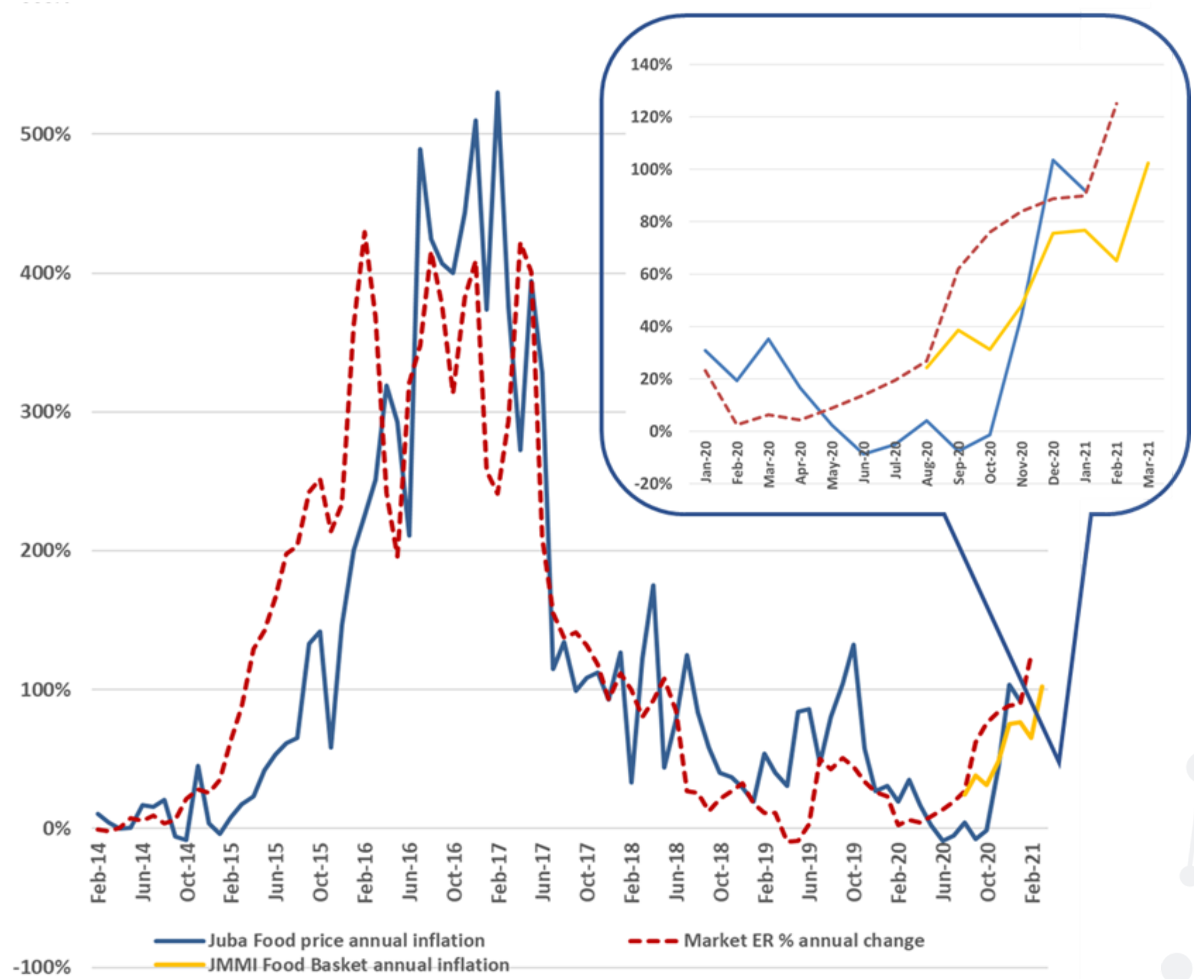
2. SITUATION ANALYSIS

a. What is happening to prices?

There has been significant ongoing inflation. The **year-on-year rate of inflation was 40.4% in March 2020,[5] a worsening trend that started in late 2019**.[6] Similarly, the cost of the median Multi-Sectoral Survival Minimum Expenditure Basket (MSSMEB) was calculated at SSP 63,987 in April 2021, as compared to SSP 37,847 in April 2020 – a 69% increase in one year.

The **prices in South Sudan have been continuously rising amid seasonal fluctuations**. Prices tended to dip in the dry season when harvest became available and rose again in the wet season. This was also a result of accessibility issues and compounded conflict and security issues. However, these fluctuations were minimal compared to the overall trend. Populations reported increasing difficulty in purchasing basic items in many areas, and the exchange rate (see section 2b below) and impacts of COVID-19 were often cited as key drivers for these. Most actors anticipated that prices would continue to rise. Nevertheless, there was also the hope of a decrease in prices if the current peace process persisted, with the new economic reforms in place.

Figure 1: South Sudan inflation rate 2014–2021



[5]National Bureau of Statistics (2020). Consumer Price Index for South Sudan March 2020. https://ssnbs.org/sites/default/files/2020-12/CPI-March_2020_Press_Release.pdf

[6]UN COVID Response Plan https://ss.one.un.org/wp-content/uploads/2020/11/United-Nations-Social-Economic-Response-Plan.pdf

No source is entirely reliable on the subject of market prices in South Sudan and the best sources are the Crop and Livestock Market Information System (CLIMIS) and the South Sudan Joint Market Monitoring Initiative (JMMI). Moreover, price changes are very localised, owing to weak market integration and poor transport links, the latter of which are often disrupted by insecurity and/or weather conditions. **Prices of essential goods and services correlated to the daily market exchange rate, though less so with official inflation data**. There was the typical lag time between market realities and official data reporting, coupled with the anticipated disconnect between official and non-official market realities. Price changes were localised in the short-term given poorly connected markets, particularly in the rainy season. However, over the course of a year, they were likely to move in roughly the same direction given the country's high dependence on imports.

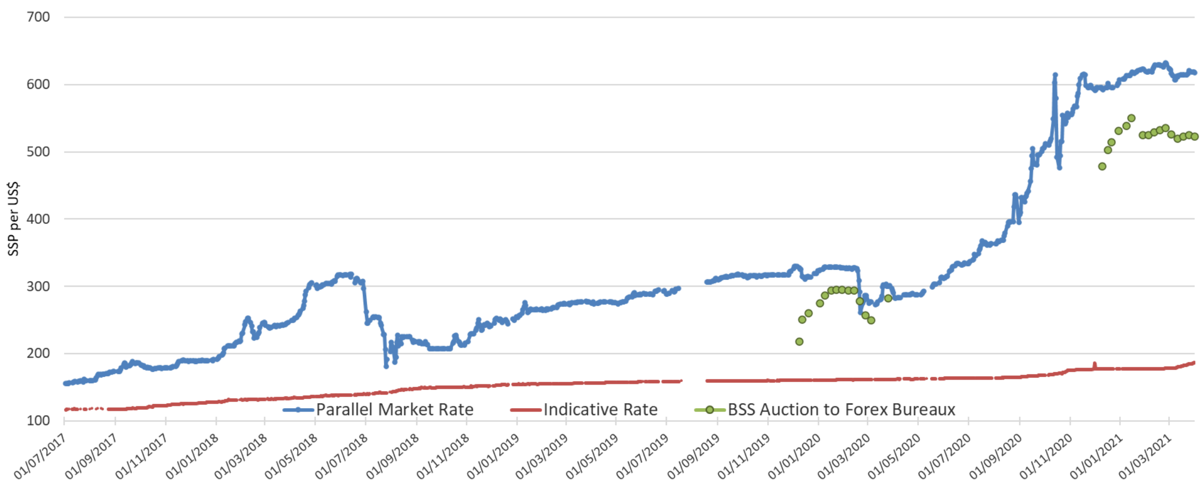
South Sudan's economy is import-driven, and consequently, imported goods are more affected by exchange changes. Food and medicine have been most affected by the rising prices and market fluctuations. This is due to scarcity based on insecurity, hoarding, climate impacts (rains/flooding) and challenges accessing foreign exchange for the importation of goods. Transport and housing were also impacted due to a lack of supply and cost of inputs for operations (electricity/gasoline). Furthermore, remittances to South Sudan, which in 2019 constituted around 34% of GDP,[7] had significantly decreased since the pandemic.

[7]Migration Data Portal. Remittances. https://migrationdataportal.org/themes/remittances; World Bank (2020). How is the pandemic affecting remittances to fragile and conflict-affected settings? Blog. https://blogs.worldbank.org/dev4peace/how-pandemic-affecting-remittances-fragile-and-conflict-affected-settings

b. What is happening to the currency and what are the implications for programming?

There was a wide gap between the exchange rates i.e., the official BSS rate, the UN rate (which followed the indicative rate) and the market rate. The official exchange rate had remained stable, but the market rate had continued to rise significantly, with minor interventions by the government to stabilise. The average exchange rate of USD 1 was SSP 300 in 2018, which stood at SSP 640 in March 2021 – a more than 100% increase. Contractions in the availability of foreign exchange affected the prices in a broad context, thereby creating more challenges in accessing currency nationally.

Figure 2: Evolution of the South Sudan exchange rate



Over the last three years, the local currency experienced significant gains in value against the dollar, but this did not trickle down to prices, as the gains were politically driven. Table 1 shows the official versus market exchange rates from 2019 to March 2021.

Table 1: Official vs market exchange rates 2019–2021

Year	USD	Official rate SSP	(Unofficial) market rate SSP
Early 2019	1	155	250
Late 2019	1	160	300
Early 2020	1	162	400
Late 2020	1	175	680
Early 2021	1	177	650
March 2021	1	187	640

The depreciation of the SSP could be attributed to a multitude of factors (*see section 1 above*). Frequent recourse by the government to utilize central bank credit to finance the deficits, i.e. excessively printing local currency, exacerbated the issue. The response to the depreciation from the government had been to tap into the foreign currency reserves and to rely on future oil production and monetary and exchange rate reforms. There were also established market tools to absorb excess SSP from the market but there was limited capacity to respond and sustain the demand for USD. This response had only a limited impact on liquidity because much of the liquidity was outside the banking system. However, since late 2020, the government seemed to have halted the excess printing of SSP.

As the prices of goods and services were pegged to the unofficial daily parallel market exchange rate, the market was to a large extent informally and indirectly dollarized. However, the government categorically rejected the dollarization and recognized SSP as sole legal currency.[8] Technically, the only legal tender is the SSP, and transactions in USD are discouraged. Despite this, USD is still used in the capital, Juba, although it was significantly less common elsewhere for day-to-day purchases by South Sudanese.

The use of USD is simply not practical for most transactions. Banks can pay any foreign currency amount in a large denomination, but there are challenges of paying small denominations, as the cost of importing dollars is based on weight and not the value of the consignments. As such, the commercial banks only import big denominations. To import foreign currency, approval from the BSS is required. This is what the commercial banks have been doing, as their Nostro accounts[9] are outside South Sudan.

Until April 2021 commercial banks had only limited scope to set their own exchange rates. Banks were offering up to 10% above the (grossly overvalued) official rate, on the basis of verbal communication on this indicative rate from the BSS. However, there have been no circulars or guidelines to limit the commercial banks in setting their exchange rate since the special accounts regulation was removed at the end of 2020.

These rates from the commercial banks differed for banks and other financial service providers (FSPs). The latter were free to use and have access to foreign currency, but the exchange rates were controlled by the central bank and all financial institutions were mandated to adhere to the regulation. **Some organizations had been using the indicative rate of BSS while others had negotiated for a better exchange rate**, with the aim of limiting the decrease in purchasing power of the beneficiaries. International organizations were governed by BSS Circular BSS/3/2015[10] on the use of the SSP as legal tender.

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[8] https://docs.southsudanngoforum.org/circulars/ssp-legal-currency

[9]A Nostro account refers to an account that a bank holds in a foreign currency in another bank.

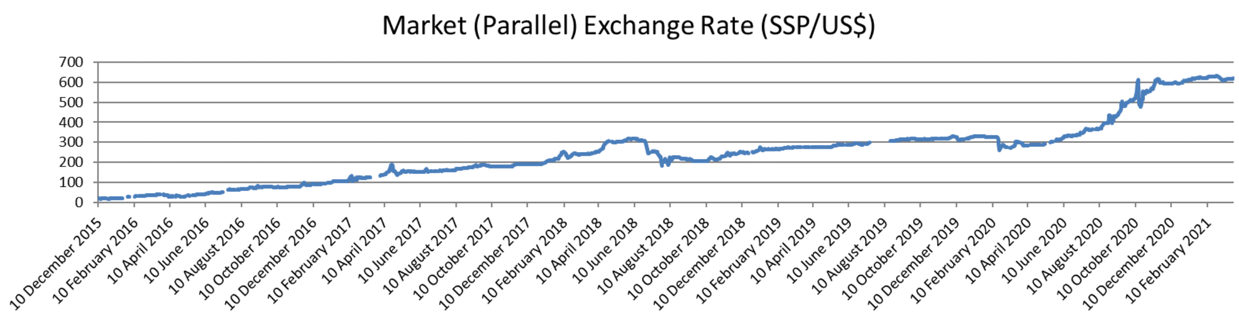
[[10] See https://docs.southsudanngoforum.org/sites/default/files/2016-07/01.A.2.5.8.c%20Circ%2012-2015%20BoSS%20SSP%20as%20Legal%20Tender_0.pdf

There was **continuous advocacy from the South Sudan Cash Working Group (CWG) and its partners to have access to better rates**. The UN had developed a joint paper through its Joint Policy Analysis Team (JPAT) to understand rapid currency depreciation. UN agencies had also been lobbying with government to narrow the gap between the market rate and the official exchange rate, and the International Monetary Fund (IMF) and World Bank raised concerns about the distorted value of the local currency. The South Sudan Bankers Association also engaged with the BSS to intervene in the market through auctions and strengthening settlement of the foreign currency clearing market.

Since the 2021 reforms, commercial banks are expected to trade at the market exchange rate. The reference market exchange rate is published every day by the BSS, based on commercial banks' daily reports on exchange rate. The official exchange rate is published separately by the BSS for transactions between the government, government ministries and agencies, and the BSS. [11]

From late 2021, the depreciation against the USD is expected to be less volatile, provided there is political stability in the Transition Government and there is progress on institutional reforms such as the BSS, National Revenue Authority, oil sector and other primary institutions. Increases in global oil prices are also likely to stabilize the currency at around SSP 600–700 against the USD. The government is also acquiring credit from the IMF (through BSS) and auctioning USD to forex bureaus, which is stabilizing the parallel market rate.

Figure 3: Parallel market exchange rate



[11] See https://boss.gov.ss/pr/PressStatementbyHon.GovernoronPolicysandt.pdf

3. Implications for CVA Programmes

a. Implications for recipients

Du**e to depreciation and differences in exchange rates, the amounts received provided less purchasing power than the originally designed transfer value.** As cash transfers were provided in SSP and based on official exchange rates, whereas prices were established on market rates, this contributed to the erosion of the value of received support to the beneficiaries for their basic needs. It limited their ability to acquire assets and ability to travel due to increased transport costs. This could cause beneficiaries to consider cash no longer preferable in terms of value for money. There was also inconsistency in the amount beneficiaries received from different organizations as the latter negotiated different rates. There was a risk this factor could lead to conflict.

b. Implications for humanitarian agencies and donors

Given the exchange rate limitations, cash transfers were cost-inefficient for humanitarian agencies, as for every dollar transferred to the beneficiary population, two-thirds were lost in the difference between the official and the market exchange rates, and gained by the FSPs. The fluctuations in value meant agencies and donors monitored prices from month to month and adjusted the values based on market prices (not possible for all actors, but the JMMI is a good reference tool), leading to additional operational costs. The inefficiencies reduced capacities of partners to either cover more people, increase the amount per beneficiary, or to cover people for a longer period of time.

A lack of financial/banking/mobile phone infrastructure stifles the implementation of cash initiatives across the country. The limited presence of FSPs outside urban areas and access constraints (security, roads) create difficulties to deliver cash. The depreciation of the SSP forced agencies to transport excessive quantities of banknotes to be able to cover the transfer value. This in turn increased security risks for beneficiaries. The actual cost of transport and security was not really known, as FSPs wouldn't charge it visibly (this could change now that cash implementers can get competitive exchange rates from FSPs). Intense negotiations between partners and FSPs were required in order to secure better rates. Difficulties also extended to contracting service providers, who preferred to be paid in USD. If they were paid in SSP, this could lead to inflated operation costs as they anticipated losses caused by the rapid depreciation of the currency.**One solution was to work with traders in the locations where cash transfers were to be made**, given they had the reverse problem: traders in many low-denomination SSP locations outside of Juba needed to return to Juba to convert SSP into USD to bring in the next shipment of imports.

4. Response Analysis

Beneficiaries and local market actors prefer local currency, particularly in rural areas, as it is more practical to buy or pay for small services or cheaper items. In rural areas, SSP is the main currency as transactions are done in SSP at market/service level and there is no access to small denominations of USD. In main cities, foreign currency could be more accepted by both beneficiaries and market actors. However, it is also constrained by the lack of access to small denominations. A significant additional risk to consider is that traders might take advantage and convert at lower exchange rates for the beneficiaries.

In order to adapt and better respond with cash assistance in the context of inflation and depreciation, **humanitarian actors strengthened the response analysis as follows:**

- CWG engagement on broader analysis around multi-modality (cash, voucher, in-kind, or a combination of modalities) options for the response.
- **Increased use of market information** to understand the impact of depreciation and discrepancy between rates to inform response designs (particularly to inform the amount of cash to beneficiaries). Actors like the WFP, FCDO, UNDP and others had conducted analyses and some had **reinforced market price monitoring and reporting**, increasing to weekly the frequency of follow-ups, including forecasting analysis, and conducting post-distribution monitoring to explore the effectiveness of the cash activities.
- **Increased dialogue** on the topic within the CWG, inviting participation by banks and other economy/financial experts.
- **Advocacy by CWG, UN, NGO forum etc. to the government and BSS for access to exchange rates closer to market rates**, as well as advocating for harmonized service charges and harmonized exchange rates for cash actors.
- **Negotiations with banks or other FSPs to have a preferential exchange rate** to provide better value to beneficiaries. The World Bank was implementing a monthly top-up to cover the difference between the official and market exchange rate, but this was not sustainable as the gap continued to widen. The WB successfully negotiated with the government to use an exchange rate closer to market rate.
- **Negotiations with suppliers for payments in USD**. (In some instances, due to the exchange rate disparity, service providers are unwilling to accept payment for services in SSP.)
- **Flexibility of humanitarian organizations to respond** to basic needs in different areas of the country **with different aid modalities** – cash, vouchers or in-kind – depending on market factors, beneficiary preference and accessibility.

5. Response Options

a. Policy solutions

Underlying policy solutions: Liberalised exchange rate regimes; institutional reforms for better economic management and consistency; political stability; improved security. All the underlying policy solutions were being addressed through different advocacy messages, including exchange rate reform, control over money supply growth; pressing central bank for a 'temporary solution' to the exchange rate problem; and seeking to negotiate more commercial rates with banks and other FSPs.

The JPAT analysis proposed several policy options for discussion with government:

1. **Floating exchange rate so that the official and parallel market rates converge** (this has already been adopted as the main element of the reform process – see below).
2. **Government to allow the payment of cash transfers in USD by UN agencies on a temporary basis**, for example for six months, and discontinue the practice as the economy recovers, SSP stabilizes and inflation drops.
3. **Government to agree on a negotiated SSP conversion rate for commercial bank**s to make payments to beneficiaries of humanitarian assistance where cash payment is the agreed mode of support. This rate can be pegged between the official and parallel market rate but determined based on prevailing market price of goods.

While ongoing advocacy between the UNCT and the government continues, in March 2021 the BSS released **Circular DSR/01/2021**[12] **on monetary and exchange rate reform.** The modalities of implementation remain to be seen but will have direct implications for cash transfer programmes:

- The reform will aim to have a **new market-based exchange rate** (the 'reference rate') which in time is expected to be similar to the parallel market exchange rate.
- **Banks and foreign exchange bureaus from now on are required to use the reference exchange rate** defined by the central bank on a daily basis as a result of currency auctions. In parallel, the official rate (which is now restricted to intra-government transactions) will be slowly devalued until it aligns with the reference rate and becomes redundant.
- This reform is linked to availability of foreign exchange, including from other sources than the IMF loan, such as oil incomes, etc.

Impacts of these reforms for cash programmes include:

- The availability to cash transfer programmes of this new exchange rate will increase the amount of SSP paid to beneficiaries per USD and improve their purchasing power with the cash transferred.

[12]See https://www.boss.gov.ss/fin/exchane.pdf

- Making explicit transfer fees for humanitarian actors to FSPs (which until now were hiding costs and profits in the exchange rate difference), implying new negotiations needed with FSPs.
- Stabilization of the depreciation is likely to lead to reduced inflation.
- Value for money should improve for cash programmes and will need to be monitored as the reforms are expected to take time to have an impact.

b. Programming solutions

Using USD. Another potential solution would be conducting cash programming in USD instead of SSP, perhaps in the acute phase of emergencies. Paying recipients in USD is a viable solution as they can exchange on the parallel market. However, this is currently not allowed by the SSD government and could arguably be counterproductive, since, depending on how much money is distributed, it could further negatively affect local currency rates. However, for voucher assistance, there is flexibility to pay vendors in USD. This would give organizations better purchasing power and increase the number of beneficiaries that would benefit.

Using mobile money for cash transfers to recipients might be an option, but it needs to be further explored as the mobile phone network is still very limited and phone ownership is likely to be low, particularly in more remote field locations, though there is little data to be conclusive. Further, the regulatory framework has not been developed, raising questions on many aspects of delivery. However, according to the Bankers Association, improving access to moving cash through the adoption of mobile money solutions is essential, suggesting that mobile banking may be introduced. There are currently two platforms available in South Sudan, and one pilot is being carried out by Save the Children International, with results to be shared at the CWG. However, it is clear that mobile money requires an investment in the physical infrastructure of ensuring mobile network coverage throughout the country in a stable manner for it to be a viable option countrywide.

The high cost of **moving large volumes of low-value SSP banknotes has been an issue**, as it hampers everyone's ability to deliver effective and timely solutions. One solution has been to work with traders in the locations where cash transfers are to be made, given they had the reverse problem: traders in many low-denomination SSP locations outside of Juba needed to return to Juba to convert SSP into USD to bring in the next shipment of imports.

It is likely that variations on this will continue despite the exchange rate reform.

6. Conclusions and Lessons Learned

The South Sudan economic situation is particularly complex, the result of insecurity, lack of infrastructure, reliance on financial service providers and climate shocks. Inflation and volatile exchange rates have considerably reduced in value the package that is normally provided, resulting in purchasing power loss for beneficiaries and associated loss in efficiency of the cash interventions. Consequently, there are vested interests to benefit from the discrepancy between the official rate and the parallel market rate, which has made it difficult to incentivise the Central Bank and government to change the official rate.

Donors should be flexible, take into account the impact of fluctuation in project design and planning versus implementation period, and work with partners to ensure optimal value for money and continuity of assistance.

Monitoring. The improvement in the quality and regularity of collecting market and price information and regular sharing was very timely and appreciated. This needs to continue to allow for programmatic adjustments and to understand the impact of the recent reform process on the key parameters of depreciation and inflation. Forecast analysis of inflation and price trends is needed, and budget planning should take into account economic analysis.

Advocacy. Work done by the CWG to bring in key actors (economists, banks) to explain and discuss the issues with humanitarian partners was very much appreciated by actors to better understand the challenges and options available. Efforts to advocate on a harmonized exchange rate and service charges for cash actors are important to ensure targeted populations receive the same support. Collective advocacy and joint efforts among actors are key for effective negotiations with banks, FSPs and other suppliers.

Guidance and preparedness. There is a need to create further guidance for partners, including operating standards in the context of volatile currency depreciation and inflation, noting that despite the positive reforms, similar issues may re-emerge. Timely measures to prevent the loss of purchasing power are essential.

Infrastructure and investment. The new economic reforms are welcome, but there is still the need for investment in the infrastructure, political stability, and improved security. Infrastructure needs to be developed to improve access to FSPs, particularly the use of mobile money, and regulations developed for humanitarian support.