SUMMARY PAPER

ADAPTING CVA TO CONTEXTS OF HIGH INFLATION AND DEPRECIATION: SCENARIOS AND MEASURES FOR CVA ACTORS

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CALP NETWORK
CHOICE & DIGNITY FOR PEOPLE IN CRISIS

This summary paper discusses the key issues and proposed approaches that emerged from consultations with a variety of stakeholders across Africa and beyond, on the actions needed for effective implementation of cash assistance to contexts of high inflation and depreciation. Our gratitude goes to all who contributed their views through key informant interviews and workshops carried out with Zimbabwe, South Sudan, Malawi, Nigeria and Burkina Faso cash working groups, as well as at the global level.

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Cover image – Hasiya Sani shows some rice she bought with the cash assistance she received from WFP in her home in Anka, Zamfara State, Nigeria. She says, 'The assistance from WFP came at the right time because I have taken so much debt to feed my family. I paid my debts, bought more food and some soya beans to continue my small business'. ©Damilola Onafuwa/WFP. February 2022

Both inflation and depreciation can have a variety of effects, and understanding the different scenarios in which they can occur is crucial for cash and voucher assistance (CVA) actors. This synopsis highlights the various factors that can contribute to inflation and depreciation, as well as the different scenarios in which they may manifest, and provides brief adaptation measures. Rarely do the consequences of these scenarios manifest in isolation. Most of the situations in which CVA is implemented experience two or more scenarios and therefore the solutions from multiple scenarios need to be applied.

SCENARIO 1 – IMPORTED INFLATION

Countries with integrated economies and stable economic outlooks are currently experiencing inflation rates of between 5 and 10% because of supply chain disruptions, global inflationary pressures, and the effects of the monetary policy implemented during the COVID-19 pandemic. Every aspect of the global economy, including CVA, is impacted by this scenario. Due to its dependence on global food prices and supply networks, in-kind assistance is being particularly impacted. In this baseline scenario, cash assistance offers a comparatively better value for money and is more resilient. Actors using in-kind assistance should shift to cash assistance where feasible.

SCENARIO 2 – ALIGNED HIGH INFLATION AND CURRENCY DEPRECIATION

This scenario involves high inflation rates and currency depreciation, with prices in hard currency[1] – remaining constant while prices in local currency continue to increase. It is caused by a lack of confidence in the local currency and high inflation, which are typically the result of monetary policy and a lack of faith in the country's institutions.

From the perspective of CVA actors, this scenario is neutral at the programme level, as the need to continually increase transfer values to maintain purchasing power is offset by the exchange rate gains generated by a continuously depreciating local currency[2]. However, the recipient's purchasing power is constantly eroded if transfer values are not periodically raised. In this case, the foreign exchange rate savings over the course of the programme cycle must be used to raise transfer value prices to preserve purchasing power. In this scenario, the CWG must have the procedures necessary for a seamless transfer value revision process. Organisations should advocate for coordinated minimum expenditure basket and transfer value revisions rather than unilaterally increasing transfer values.

SCENARIO 3 – RUNAWAY INFLATION

In this scenario, runaway inflation refers to high inflation rates that translate into higher commodity prices both in local and hard currency. Unless transfer values are constantly increased, recipients' purchasing power is continuously eroded. Without additional resources, implementing organisations will be unable to compensate for inflation and depreciation while continuing to assist the same

[1] Hard currency refers to money issued by a nation seen as politically and economically stable. Hard currencies usually represent a large part of a country's/central bank's foreign reserves and serve for backing a local currency. They can sometimes be accepted as a form of payment for goods and services and even be preferred over domestic currency. The typical example is US dollars (USD). See CALP's Glossary of terms https://www.calpnetwork.org/publication/glossary-of-terminology-for-cash-and-voucher-assistance/

[2] Local currency devaluation versus the currency of the program (generally USD or EUR).

number of beneficiaries. In this situation, implementing organisations should collectively advocate for more resources from donors. A pragmatic approach may be required to determine the best course of actions for the populations in need. Conducting a depth versus breadth analysis[3] including the pros and cons of each approach may help to determine whether to maintain the purchasing power of fewer recipients or to assist the same number of recipients who will be able to cover a smaller proportion of their basic needs. It is important to keep in mind the lowest proportion of needs that are worth covering per household.

SCENARIO 4 – HIGH EXCHANGE RATE DIFFERENCES

Parallel exchange rates, also known as black market exchange rates, appear when there is a difference between the official exchange rate set by a government or central bank and the exchange rate that is effectively used in the local economy. In situations where the central bank is willing to set a fixed or managed exchange rate but is unable to manage it, typically because of a lack of foreign currency reserves, parallel exchange rates emerge.

Large differences in exchange rates could consume a substantial portion of the funds designated for the recipients. Depending on when the conversion from foreign currency to local currency occurs, either the central bank or the FSPs will profit from the exchange rate difference.

In this situation, CVA actors should convert their foreign currency to the local currency at the most advantageous exchange rate. CVA actors should request preferential exchange rates from central banks or FSPs and utilise collective negotiation to their benefit. In general, this exchange rate difference impacts all CVA delivery mechanisms and modalities, including vouchers and mobile money. If preferential exchange rates cannot be obtained and the difference between the two rates is substantial, a temporary switch to in-kind aid could be considered.

SCENARIO 5 – LIQUIDITY CRISES

In a liquidity crisis scenario, program recipients either do not have access to physical cash or access to certain denominations. In some cases, due to lack of market integration, certain denominations do not reach all geographic areas. This scenario has often generated policies that try to limit the use of physical cash. The situation is common in contexts with high inflation and currency depreciation or as side effects of anti-runaway inflation policies. This scenario is particularly severe in those areas where physical cash is still the main medium of exchange for most economic transactions.

In this scenario, CVA actors should explore delivery modalities that do not require the use of physical cash. Use of mobile money if the recipients do not need to cash out their entitlements or value vouchers could be good solutions for liquidity crisis.

[3] Within humanitarian assistance, *depth* refers to the amount of assistance delivered to each programme recipient and *breadth* refers to the number of individuals assisted. In the context of the CVA sector, this means applying a higher transfer value that will cover a greater proportion of the MEB to fewer recipients as opposed to maintaining the transfer value for a higher number of recipients that will be able to cover less of their basic needs with the assistance provided.

SCENARIO 6 – MONETARY POLICY SIDE EFFECTS

Monetary policies to combat runaway inflation and currency depreciation could have important side effects that affect CVA. In some cases, monetary authorities establish capital controls that distort foreign exchange rates. In other instances, price controls generate scarcity and spiralling inflation. Foreign exchange traders are often blamed for parallel exchange rates and controls on FSPs may be established in such cases. Monetary authorities could also impose taxes or limits on transactions or withdrawals, ban bulk transactions or limit the use of a certain delivery mechanism like e-money or remittances platforms. In countries with a de-facto multi-currency system, they could limit the use of hard currency for transactions or ban humanitarian organisations from using hard currency. All these measures could have important consequences on CVA.

In these cases, advocacy with the central or local governments must be explored. In certain contexts, exceptions for humanitarian actors have been made when collectively requested. The involvement of Humanitarian Country Teams, Resident Coordinators or donors through bilateral cooperation level could help with such advocacy. Humanitarian actors could also collectively increase the Government's knowledge of CVA and the challenges experienced, by generating briefings and inviting government officers to CWG meetings.