

THE MACROECONOMICS OF COUNTERPART FUNDS: THE CASE OF FOOD FOR HUNGER PREVENTION IN ETHIOPIA

Deryke Belshaw

1 INTRODUCTION¹

This article explores the scope for monetising food aid to set up a special fund to finance famine-relief activities in Ethiopia. In so doing, it links two issues in the counterpart fund debate: first, the desirability of selling, or 'monetising', food aid to create a counterpart fund (Maxwell 1991 and in this Bulletin, Schulthes in this Bulletin); second, the calibration of commodity aid and counterpart funds to reflect good and bad years, one of the 'neglected issues' identified by Maxwell in this volume.

Ethiopia is an interesting case. In the second half of the 1980s, the country received more than 4 million tons of food aid, accounting for around 17 per cent of total cereal supply (Gutu et al 1990). More than 80 per cent of this was for emergency purposes, with the remainder destined mostly for food for work; only very small quantities of food aid were available for sale, almost all provided specifically to cover the costs of internal transport, storage and handling (Maxwell and Belshaw 1990:20).

Larger scale monetisation of both regular and programme food aid has been proposed, to provide balance of payments and budgetary support and to improve the efficiency of food aid use (ibid). In this connection, it is worth noting that the notional value of emergency aid (including non-food items) was equivalent in peak years to nearly 40 per cent of government revenue and as much as 95 per cent of development expenditure (ibid:viii).

In the 1990s, there has been a small amount of monetisation. Thus, in September 1990, the EC approved a structural food aid programme for Ethiopia of 50,000 tons of cereals. This was designed to be used for subsidized sale to vulnerable groups through the public distribution system, with local transport and other costs being met from the counterpart fund (Maxwell 1991:28).

As far as import support is concerned, Ethiopia has exhibited well known problems with the management

of counterpart funds. For example, two EC sectoral import programmes were agreed in the 1980s for a total of 30m ECU. There were no plans as to how counterpart funds were to be spent, with the result that there was a rapid accumulation of funds. By October 1989, accumulated counterpart funds had reached 40m Ethiopian Birr, equivalent to 2 per cent of government revenue (Maxwell 1991:27).

The remainder of the article explores the conceptual and practical issues surrounding the monetisation of emergency food aid. Section 2 develops the case for monetisation to create a wage fund. Section 3 explores the implications in Ethiopia; and Section 4 presents the conclusions. The main finding is that in a normal year, up to 300,000 tons of food aid can be monetised in Ethiopia. In emergency years, as much can be monetised as can be justified by cost savings on transport, storage and handling.

2 A CONCEPTUAL FRAMEWORK

In a recent paper, Roemer (1989) has identified two conditions if a counterpart fund is not to contribute to inflation. The second condition has three variants. These conditions are:

- i The instantaneous timing of the two transactions involved in counterpart fund creation and use, i.e. (a) the sale of gifts in kind, essentially food aid, on the recipient country's domestic market, and (b) the expenditure of these local currency funds on project inputs, e.g., wage labour, local materials and consumables (preferably with zero or very low foreign exchange content);
- ii Project expenditures must be included within the annual budget;² or project expenditures additional to the approved budget outlay must be balanced by additional transfers out of money supply (i.e., from the private sector to government by raising commercial bank deposits with the central bank or by increasing bank rate or by increasing sales of government securities); or project expenditures from existing counterpart funds are offset by

¹ The main text of this article was originally published in a report commissioned by the World Food Programme on 'Food for Development: New Roles for Food Aid in Ethiopia' (Maxwell and Belshaw 1990). Thanks are due to WFP for allowing it to be published in this Bulletin; and to Simon Maxwell for his contribution to the text. WFP are not, of course, responsible for the views

expressed.

² Either included in the budget's printed estimates or brought in via a later revision to make up for underexpenditure elsewhere in the budget.

additional food aid sales, i.e. counterpart balances are not reduced over time.

It should be noted that Roemer makes no reference to the possibility of domestic market imperfections and fragmentation occasioned, for example, by transport, marketing and information constraints. This analysis may be expected to apply, in a geographically large country with the pattern of non-price market constraints possessed by Ethiopia, more strongly to centrally controlled and executed projects located in the major urban areas and their surrounding regions, rather than to expenditures on decentralized projects in peripheral rural regions (where, as it happens, most food insecure Ethiopians live (Belshaw 1990)). Further, Roemer does not discuss the differences in the multiplier effects of counterpart fund disbursements in the form of wages spent on the primary wage good-food-in times of: first, good or normal local harvests; second, poor local harvests in the context of good national harvests; or, third, simultaneously poor harvests locally and nationally. The consequences of Roemer's simplifying space and time assumptions for the application of his analysis to Ethiopian circumstances are discussed in the conclusion of this note.

During the 1980s in Ethiopia, two major famines occurred, in the course of which food aid for famine relief was supplied in quantities either close to or above one million tonnes per annum. In the latter part of the decade, the question was raised whether a major part of such relief in the next famine period could not be directed towards productive purposes while providing food security for drought-stricken people at the same time. One way of doing this, attractive because of its cost-effectiveness at the micro-level, is to 'monetise' the food aid and institute with the proceeds a wage fund which induces food-deficit but able-bodied people to labour on public works projects.³ The latter must be either ongoing but capable of rapid enlargement or be taken off-the-shelf, i.e., they are pre-planned to be expanded or initiated as the impending famine becomes apparent and to absorb large quantities of unskilled labour over periods of a few months to a year or so. A large proportion of these projects would be designed and selected for their contribution to food security and future famine prevention.

By the early 1990s, the Ethiopian economy had become very fragile, with accelerating inflation, deepening balance of payment problems and rising unemployment. An attempt was being made to encourage private sector investment through participation in industrial joint ventures with the state and in private, large-scale

agricultural enterprises. It followed, therefore, that any conversion of part of Ethiopia's food aid into counterpart funds should contribute minimally, if at all, to inflation, to increased demand for foreign exchange, to the excision of approved development activities within the budget or to the reduction of incomes and employment elsewhere in the economy via disincentive and other possible substitution effects.

Several implications for monetised food aid follow from Roemer's analysis. Undesirable inflationary effects can be avoided only if, firstly, monetary expenditures from the fund generated by food aid sales are simultaneously balanced by additional food aid sales, i.e., a wage fund is created and either maintained or increased in size by periodic replenishment for as long as it is required. It follows that if the fund is to be deployed primarily in the major famine disaster years, a pre-disaster wage fund must have been created already. But food sales in the pre-disaster periods are more likely to generate disincentive effects because food will be relatively plentiful with prices tending to be at or below import parity price levels (Maxwell 1986; 1991). Disincentive effects can be avoided even then, however, if food aid is replacing normal commercial food imports — in the Ethiopia case, food aid substituting for imports of a preferred staple, wheat, which has a relatively high domestic resource cost at the margin, would appear to be justified on growth grounds. Is it desirable on other developmental grounds — macroeconomic stability and income distribution effects?

3 IMPLICATIONS IN ETHIOPIA

We consider first the use of monetised food aid to alleviate transitory food insecurity, defined as short-period lack of access to food intake, adequate for an active and healthy life, during the period of a major famine disaster. In Ethiopia, while avoiding disincentive effects one could probably import up to 300,000 tonnes of wheat food aid per annum. If this was monetised in say, the two preceding years, a wage fund with the value of 600,000 tonnes would be available for use in the famine disaster period.

There are two problems with this scenario, both concerned with undesirable effects on the inflation rate. Firstly, the time-gap between sales in the pre-drought year(s) and expenditure from the fund in the disaster year offends Roemer's first condition above. Although the money supply is not increased by the creation of a counterpart fund withheld by government against the future famine, nor is it reduced if the

³ The alternative approach is to combine the traditional delivery of food aid to the needy with payment in kind (i.e. food) related via a set of work norms to work done on public works projects.

⁴ S. Maxwell (1986), 'Food aid to Ethiopia: disincentive effects and commercial displacement', IDS, Sussex, *Discussion Paper No 226:69*; S. Maxwell 1991, *The Disincentive Effect of Food Aid: a pragmatic approach*.

Central Bank keeps to its original target rate for money supply growth. Spending the fund later increases the money supply, adding to inflationary pressure. The greater the time lapse between the two events, the less likely is it that the Central Bank will take countervailing action, i.e. reducing private credit by the amount of expenditure from the fund. Secondly, wages paid in a time of general famine to previously self-provisioning rural people will inject additional effective demand for food (assuming a unified market or absence of 'barriers' damping off the demand in question) at a time when this is already facing excess demand generally in both urban and most rural areas, i.e. inflationary pressure will be increased on an item counting for around 50 per cent of the urban consumer price index (CPI). This specific inflationary effect should be minimized even if the net inflation effect averaged over the year is zero.

This is because (a) poor people will die in a matter of a few weeks from nutrition-related disease when their access to food is sharply reduced by a corresponding inflation in food prices, and (b) the increase in money wage rates induced by a sharp rise in the modern sector's CPI will be 'sticky' downward and thus will contribute to a heightened rate of inflation in subsequent years via increased budget deficits and/or increased prices for the modern sector's goods and services.

Chronic food insecurity affects populations in overpopulated or low agricultural potential rural environments, the urban unemployed and the low income urban semi-employed. A wage fund could be utilized employing members of these target groups on a regular basis on development works up to the value of the sales of 300,000 tonnes of wheat for as long as the fund was topped up each year. These development works, therefore, would not be taken 'off-the-shelf' or be rapidly expanded.

Again following Roemer, if expenditures from the food aid fund were offset by under-expenditure in the annual budget, the general inflationary effects would be avoided. In this case, an unplanned shortfall in budgetary expenditure, probably reflecting a decline in fiscal revenue and/or foreign exchange earnings, could be made up late in the current financial year, or early in the next one, by expenditure from the food aid wage fund. This expenditure shortfall would most probably follow either general transitory food insecurity, with a time lag of around one year, or a significant decline in the world price of a major export commodity. In this case, projects would have to be taken from 'off-the-shelf'. Food aid used in this way could be additional to the quantity used in the permanent wage fund without adverse economic effects, **to the extent** that additional commercial food imports would have been incurred in the face of general transitory food insecurity. The

likelihood of this assumption can only be established by examination of the specific situation. If no increase in food imports would have occurred, the use of wage funds to implement off-the-shelf projects would have to entail the suspension of an equal volume of work on regular public works projects if inflationary effects are to be avoided. This option is obviously without merit.

4 CONCLUSION

In the current economic situation in Ethiopia, with an increasing debt-service ratio and foreign exchange scarcity, the Roemer model suggests that the most beneficial economic consequences would be obtained by monetising wheat food aid up to the quantity of regular food imports and maintaining an ongoing programme of public works using wage labour in any area and for any group suffering from chronic food insecurity, e.g. urban and urban-hinterland groups. The rest of the variable volumes of food aid should be consigned directly **as food** to centres of chronic and transitory food insecurity. Able-bodied persons would work on 'off-the-shelf' projects for physical quantities of food related to work norms. Adverse consequences would not be expected to result from such cashless improvements to real incomes; the money supply would not be augmented, nor would effective demand be directed away from domestic food supplies. The beneficiaries of the outputs of appropriate productivity-raising investment projects (for a discussion of which, see Belshaw 1989) would be (a) the peasants themselves and their dependents, in the form of reduced vulnerability to future famines and (b) Government and international donors in the form of reduced costs of future famine relief outlays. External costs to other non-assisted (wealthier or less vulnerable) groups, in the form of disincentive effects on other producers or general inflationary effects, could be expected to be slight at worst, if not zero or non-negative. Even for transitory food insecurity, however, payment in cash could be justified if equivalent sales of food aid were made at the same time (Roemer's first condition).

The situation becomes more complex when we take into account the effects of (a) market imperfections facing food markets in peripheral rural regions and (b) the possibility that food surpluses with high marketed supply elasticities are available locally or within profitable trading distance (see para 2 above). The restriction on the quantity of monetised food can then be relaxed further. If the transitory food insecurity is (a) relatively localized, and adequate grain surpluses are available locally or elsewhere in the country, and (b) the distribution costs of grain from the cheapest domestic food (either food security reserve or a swapped commercial surplus) are less than those from the trans-border point of entry, there would be an efficiency gain from utilizing a food aid fund to

generate wage employment in the food-deficit area rather than providing food aid directly. Probably many areas of chronic food insecurity in Ethiopia would have a cost advantage of this type, e.g. areas lying south, west and north-west of Addis Ababa.

A limit to the extent of monetisation is required, however:

- a when the food demand of transitionally food insecure buyers cannot be met from domestic supply (including releases from the food security reserve) without price inflation occurring; direct food aid is required in these conditions;
- b when the transport costs of delivering food aid to

specific beneficiaries is sufficiently below the transport costs of moving the quantity concerned to a major urban centre to monetise it, as to exceed any added logistical costs incurred in transferring and distributing food rather than cash. Given locations of transport routes, major cities and famine-prone areas, quite large numbers of people in northern and eastern Ethiopia may fall into this category.

To summarize, the specifics of the Ethiopian situation suggest that there may be considerable scope for monetisation of food aid in Ethiopia: up to 300,000t in a normal year and as much food aid in emergency years as can be justified by cost savings on transport, storage and handling.

REFERENCES

- Belshaw, D., 1989, 'Food production and food processing in Ethiopia: priorities for action within the frameworks of the national food and nutrition strategy and the Five Year Plan 1989-94', mimeo, Addis Ababa
- 1990, 'Food strategy formulation and development planning in Ethiopia' *IDS Bulletin*, Vol 21 No 3, IDS, Sussex, July
- Gutu, S., et al., 1990, 'Cereal, pulse and oilseed balance sheet analysis for Ethiopia: 1979-1989', *Commissioned Study* No 8, IDS, Sussex, September
- Maxwell, S., 1986, 'Food aid to Ethiopia: disincentive effects and commercial displacement', *Discussion Paper* No 226, IDS, Sussex
- 1991, 'The disincentive effect of food aid: a pragmatic approach' in Clay, E. and Stokke, O. (eds.), 1991, *Food Aid Reconsidered: Assessing the Impact on Third World Countries*, Frank Cass, London
- with Owens, T., 1991, 'The developmental uses of counterpart funds', *Discussion Paper* No 289, IDS, Sussex, June
- and Belshaw, D., 1990, 'Food for development: new roles for food aid in Ethiopia', Report of the World Food Programme Food for Development Mission, mimeo, Rome, July
- Roemer, M., 1989, 'The macro-economics of counterpart funds — revisited', *World Development*, Vol 17 No 6