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Cash Transfer vs Subsidy on Fuel and Electricity: A Case of South Sudan[1]

1. The purpose of this Policy Note is to contribute toward a political consensus on the idea of getting the exchange rate right in the Republic of South Sudan. Political leaders and governing elites must allow economic policymakers to formulate policies that would enable the country to consolidate peace, combat the COVID-19 pandemic, and create a vibrant economy. But governing and economic policy remain a "state-owned monopoly" over ideas, over economic activities, and over manipulation of loyalty to a single source of power. Those individuals living in rural areas are invisible and politically irrelevant. Yet, they should be at the heart of economic policy since 80 percent of the population of South Sudan lives in the rural areas. It was, therefore correct in our view, for the SPLM to have formulated two important strategies of taking towns to the people in the rural areas—and for making agriculture the engine of economic growth and fueling it through the instrumental use of oil revenues.

2. We would like to point out here that the triple objectives of consolidating peace, combating COVID-19, and creating a vibrant economy are not likely to be achieved without getting monetary policy and exchange rate management right in South Sudan. It is, however, imperative to insist that **the economy is a delicate machine** which requires creativity and innovation in the formulation of policies for the realization of its key functions. Production and distribution of goods and services are the foundation of the economy, and this requires a delicate balance between political and technical objectives. They (production and distribution of goods & services) also call for clear delineation of roles between the public (government) sector and the private sector.

3. The role of the public sector in the management of the delicate machine is largely one of guidance and nurturing. Central here is the provision of public goods—roads, schools, security, and so forth. This institutional framework is then elaborated by macroeconomic policy instruments that can—if smartly applied—guide the economy toward **economic growth, full employment, and price stability**. Stable prices promote economic growth and development by allowing the price mechanism to function and support the efficient allocation of resources. The most important price is the exchange rate. Problems with exchange rate regimes—and monetary policy—can cause substantial and diverse problems for different types of economies: from Greece during the Euro crisis, through to Zimbabwe and Venezuela's periods of hyperinflation. Getting the exchange rate right is a crucial pre-condition to placing the South Sudanese economy on the path to sustainable peace, economic growth, and poverty eradication. And more importantly, getting the exchange

[1] Prepared by the Ebony Center's VEST Team comprised of Lual A. Deng, Shanta Devarajan, Daniel W. Bromley. Meshack T. Tjirongo, and Alex Michie

right will enable the Revitalized Transitional Government of National Unity (RTGoNU) to consolidate peace, combat COVID-19 pandemic, and create a vibrant economy.

4. Though it is technically feasible and desirable, **getting the exchange rate right is politically difficult**. That is because a misaligned exchange rate amounts to a subsidy to those who are fortunate enough to receive foreign exchange at the official rate. Getting the exchange rate right amounts to a removal of these subsidies, e.g. on **bread and fuel** in the case of Sudan or **fuel and electricity** in the case of South Sudan (for the limited number of people who can access these goods at the 'official' exchange rate). Subsidizing essential goods (e.g. water, fuel, food) is best done, from our experience, via direct means—transparent for all to see and with clear ways for ordinary or low-income members of the public to access those goods. This is far superior to supporting a defective exchange rate which is indirect, poorly targeted, and provides strong incentives for abuse and corruption. With flawed exchange rates it becomes impossible to know if the implicit subsidies are helping or preventing essential goods from reaching the people of South Sudan. The implicit deviations from the optimal exchange rate imply that certain economic interests are capturing what we call "economic rent"—ill-gotten gains. This capture of rent can be thought of as "leakage." Moreover, recent international best practice tends to show that **direct cash transfers—when and where needed—are** superior means for **subsidizing goods** essential to the survival of vulnerable groups. This is because only a cash transfer can be targeted at the deserving households. A price subsidy, whether through a misaligned exchange rate or an explicit price subsidy, can benefit the rich and poor alike—since anyone who buys the subsidized good gets the benefit. Those segments of society least able to bear the costs suffer under a regime of flawed exchange rates. In South Sudan the poorest are the least likely to have access to the official exchange rate, and indeed it is the well-connected and the banks who are most likely to have access to the official rate. Therefore, any subsidy via the exchange rate is more likely to go to the relatively advantaged rather than to the poor or vulnerable.

5. It is essential to understand that we base our recommendations on accepted ***international best practices***. The political obligation to adhere to such practices seems obvious. In that regard, the economics literature on getting the exchange rate right—meaning unification of official and parallel market rates—provides four general options[2]. These are:

a) **Big bang** in which unification of the rates (official & parallel) is immediate;
b) **Sector-by-sector gradualism** in which the local currency is allowed to depreciate gradually (and by sector) against foreign currencies, such as the US dollar;
c) **Economy-wide gradualism** in which monetary authorities announce a timetable, say six months, for gradual movement of the official rate toward the market-determined rate; and
d) **Fiscally-cushioned big bang** in which unification of the rates (official & parallel) is immediate, e.g. Sudan announced on 21 February 2021 to float its currency and came into effect the same day. The subsidies are, however, replaced with targeted subsides (or direct cash transfers) to shield the reallocation pains on vulnerable families. In the case of Sudan, there is a donor-funded Sudan Family Support Program (SFSP) targeting 80% of the

[2] See **Exchange Rate Unification: The Cuban Case**, by Augusto de la Torre and Alain Ize, World Bank, 2013

Sudanese population and in which an individual within the vulnerable family is paid US$5.0/month for a period ranging from 6 to 18 months.

6. South Sudan has experienced, from the perspective of the political elites, a bitter experience with the "**raw big bang**" of December 2015. There was initially a political buy-in when the Presidency, the Cabinet, and the SPLM supported the recommendations of the Minister of Finance and Governor of the Bank of South Sudan (BoSS) on the understanding that there were sufficient financial and commodity buffers in place to back-up the immediate unification of the exchange rates. As it turned out, this was a mistaken presumption and the continued monetization of the government deficit through BoSS loans to GRSS/GoSS, due as a result of the collapse in both oil price and oil production, led to high levels of inflation and depreciation. There were clearly insufficient financial and commodity buffers in place to shield vulnerable families from the resulting pains. Moreover, this situation was compounded by the resumption of violent conflict on 8 July 2016.

7. In the light of the above paragraph, we recommend that South Sudan pursue the third option – **economy-wide gradualism**. If followed and adhered to thereafter, this approach should accomplish unification. This strategy would then allow policymakers the opportunity to design a successful ***transition strategy*** in which any economic pain associated with the gradual removal of any subsidies associated with the unification of the exchange rates can be properly addressed. We believe that a period of **6 - 9 months** should enable the Government to agree on a path for daily adjustment of the reference (official) rate toward the weekly foreign exchange (FX) auction-determined rate. South Sudan's international ***Development Partners*** (DPs) are likely to support such a move with technical and financial resources, which would in turn ensure sustainability of the reform. The FY2020/2021 budget contains subsidies on fuel (**US$1.0/month**) and electricity (**US$2.0/month**), which could be replaced with a system of direct cash transfers to those families that are likely to be negatively affected by the removal of these subsidies. Such a program should be designed in a manner that will strengthen the current social safety net project being funded by the World Bank and implemented through a third-party arrangement[3].

8. The World Bank funded South Sudan Safety Net Project (SSSNP) is targeting 430,000 people in 65,000 households in South Sudan's most vulnerable communities. According to the SSSNP document, the "**project objective is to provide access to income opportunities to the poor and vulnerable and strengthen safety net delivery systems. The proposed SSSNP would aim to contribute to strengthened household capacity to better withstand social and economic shocks and stresses, while also supporting increased community interaction and dialogue for enhanced local level social cohesion and unity**4." Economic stresses arising from unification of the exchange rate is, as mentioned above, a result of the removal of subsidies on fuel and electricity. We recommend that the savings from removal of these subsidies be transformed into a cash transfer, using the SSSNP as the vehicle for reaching those affected by the unification process.

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[3] "In the first phase, the SSSNP will scale-up direct income support in Juba County to provide rapid cash transfers to address emerging vulnerabilities amidst COVID-19 outbreak," said World Bank Country Manager for South Sudan Husam Abudagga in a statement after the approval of the project by the Bank Group's Board of Directors

[4] From **The World Bank** South Sudan Safety Net Project (SSSNP) (P169274), March 2020,

9. One approach might be to modify the SSSNP to include all the national public-sector employees (13,000 in the civil service and 120,000 in the security sector) so as to establish a ***permanent social safety*** net (SSN) system. Such a sustainable social protection system should be designed within the period determined for economy-wide gradualism with respect to the unification of the exchange rates. That system could have three key components: (1) direct cash transfer to be managed by community credit union (CCU) along the type of work-based credit union; (2) community-based cooperatives; and (3) public works. We highlight each component below.

10. **Community-based credit union (CCU) model**: This is a modification of the idea of community development foundation we have described in our Policy Note 2021-2. Direct income support to poor and vulnerable families/households will be channeled through CCU, which will in turn encourage individual beneficiaries to save a small percentage of their income and thereby develop a culture of thrift and savings for a "rainy day". In this regard, we recommend that the amount of US$3.0 million/month, which is currently allocated to Trinity Energy (US$1.0) for the importation of fuel and JEDCO (US$2.0) to provide cheaper electricity, be paid into the CCU. We recommend that if the idea is accepted by the political leadership, a full design of the CCU, including its governance structure be undertaken by BoSS with technical assistance from DPs.

11. **Community-Based Cooperatives (CBCs):** Removal of subsidies will impose additional costs on those who can currently access the subsidized goods — but the poorest recipients will be most seriously harmed. These transition costs could be moderated by the establishment of community-based consumer cooperatives. Villagers would establish CBCs, thereby pooling their purchasing power to obtain fuel—and perhaps limited staple goods—in large quantities from suppliers in major market towns or regional growth nodes. Through bulk purchases, the CBCs would have the ability to negotiate slightly lower prices for some necessities, with the savings being passed on to their members. This institutional innovation would also provide excellent opportunities for villagers to acquire skills in business management and local collective action. Success with CBCs could also provide a valuable introduction to the creation of ***Community Development Foundations*** described in Ebony Policy Note 2021-2.

12. **Community-based Public Works (CBPW)**: The SSSNP has allocated **US$22.8 million** to this component, which demonstrates the importance of CBPW in providing social protection during the unification of the exchange rates. It will be one of the critical pillars of the ***Regional Growth Nodes***, which we discussed in our EPN 2021-2. According to the SSSNP document, "**this component will finance: (a) cash transfers, including transfer fees, for beneficiary households participating in labor-intensive public works to meet immediate needs and sustain household assets; (b) equipment, materials, and skilled labor to ensure public works of reasonable quality; and (c) complementary support to strengthen household capacity to more consciously use the cash received for the family's well-being.**"

13. We end this Policy Note with an illustrative diagram from India, which is used as a tool for "**identifying the key design elements and challenges that would need to be addressed while**

planning a nationwide cash transfer scheme for kerosene and LPG[5]." It could help in the case of South Sudan.

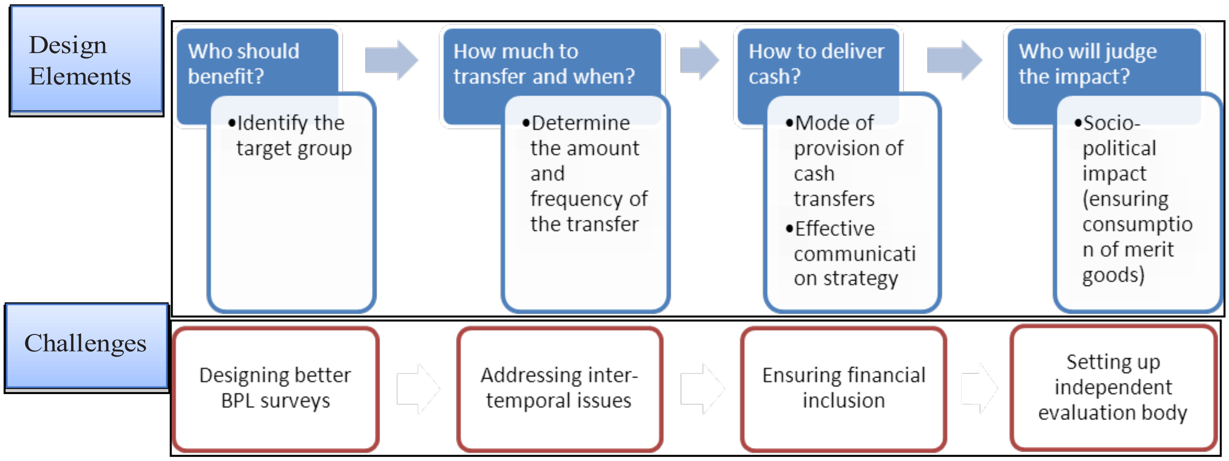

Figure 1: Design Elements and Challenges for Implementing Cash Transfers

[5] RESEARCH REPORT AUGUST 2012: Fossil-Fuel Subsidy Reform in India: Cash transfers for PDS kerosene and domestic LPG