The Balance of Payments Impact of the Food and Fuel Price Shocks on Low-Income African Countries: A Country-by-Country Assessment

Prepared by the IMF African Department
June 30, 2008

This note discusses the implications of the price shocks for the balance of payments of low-income countries in sub-Saharan Africa. The response by bilateral donors and multilateral institutions will, in practice, need to be country-specific. To this end, the note identifies a list of 18 countries in the region that are especially hard-hit and that consequently face a pressing need for additional balance of payments and budget support. The list reflects country circumstances and underlying assumptions as of May, and is subject to change; it is not meant to be definitive.

The current crisis has many dimensions. Food price increases, in particular, tend to hit the poor the hardest and thus put at risk progress on poverty reduction, social cohesion, and the broader development agenda. Fuel price increases also have a variety of damaging impacts, including by raising the cost of agricultural production and thus, in turn, aggravating the food crisis. The scale of the shocks, and the central importance of the commodities involved, threaten to derail macroeconomic stability, growth, and efforts to achieve the MDGs. The Fund stands ready to cooperate closely with development partners to help countries deal with the crisis. This includes policy advice, technical assistance and financial support to promote appropriate macroeconomic policy responses.

High food and fuel prices are likely to persist. Pass-through to higher domestic prices, though not necessarily immediate, is therefore ultimately unavoidable. More broadly, monetary, fiscal and other policies will have to adjust. In some cases, the exchange rate can play an important role. Additional financing can play two critical roles in this context.

First, in the short term, additional external support to meet higher import bills can give countries time to phase in the necessary adjustments, thereby easing their economic impact and reducing social pressures. Such support may also make it feasible for some countries to run temporarily larger fiscal deficits to cover targeted budgetary assistance to the poorest segments of the population.

Second, looking to the longer term, additional budgetary expenditures may be called for to promote the development of domestic agriculture and to put in place sustainable social safety nets. While these expenditures may be met in part through higher domestic revenues or reductions in other spending, additional concessional financing will also have a role to play. The terms of such financing will need to take into account individual countries' debt situations; for most countries, it should be wholly or predominantly on grant terms.

This note seeks to identify those countries that may face the most pressing near-term need for additional concessional financing. The balance of payments impact of the food and fuel price shocks is large on average, but their incidence is highly country-specific, depending on the patterns of trade as well as initial conditions.

The list comprises countries for which the trade balance impact of the 2008 food and fuel price increases exceeds one of two thresholds (Figure 1 and Table 1):

- *Either,* 50 percent of initial international reserves: **Eritrea**, **Ethiopia**, **Guinea**, **Liberia**, **Madagascar**, **Malawi, the Democratic Republic of Congo, and Zimbabwe.**[1]

- *Or,* 2.5 percent of GDP: this threshold is applied to countries in the WAEMU and CEMAC currency zones (for which the reserves-based indicator is less meaningful): **Benin**, **Burkina Faso**, **Central African Republic**, **Guinea Bissau**, **Mali** and **Togo;** and to states with particularly weak initial institutional frameworks: **Burundi, Comoros**, **the Gambia, and Sierra Leone.**

The list excludes Senegal, which meets the second criterion, on account of other influences on the balance of payments.

The attached one-page country briefs provide context and background on the situation in each of the 18 included countries.

Although there is merit in focusing attention on the hardest hit, this list is not meant to be definitive. First, there is a degree of arbitrariness in the cutoffs used to place countries on the list. Countries below the cutoffs in many cases have substantial and urgent needs. Second, the list reflects price assumptions and country-specific circumstances in May 2008; as the outlook changes, so too will the impact on individual countries.

[1] For Madagascar, the cost of reconstruction due to natural disasters (cyclones) is also a factor. The estimates for Zimbabwe are highly uncertain, owing to data problems.

Sub-Saharan Africa (LICs): Impact of 2008 Food and Fuel Price Increases

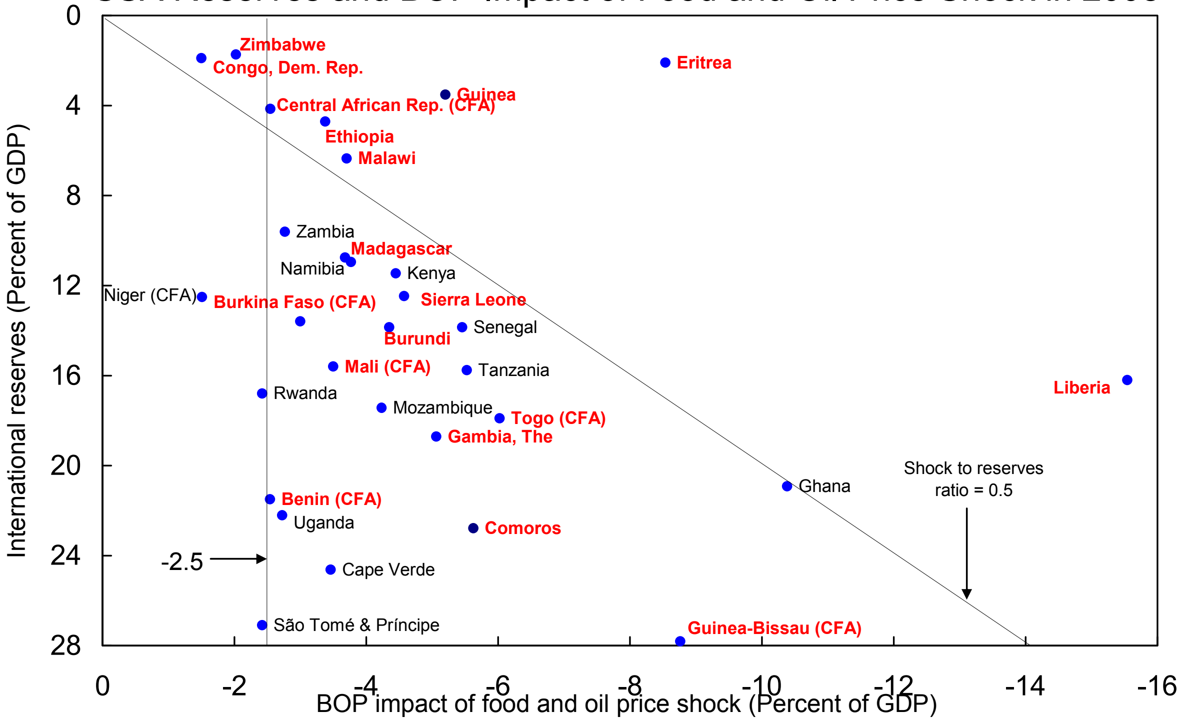
(Percent of 2007 GDP)

	BOP Impact[1]					Memo:
	Food	Oil	Food and Oil Shocks	Other Commodities	Total Shock	Food and Oil BOP Impact/ Reserves (Percent)
Selected countries						
Liberia	-4.5	-11.1	-15.5	0.3	-15.3	-96.0
Guinea-Bissau	-1.1	-7.6	-8.8	0.0	-8.8	-31.5
Eritrea	-2.4	-6.1	-8.5	-0.1	-8.6	-407.7
Togo	-0.4	-5.6	-6.0	0.6	-5.5	-33.6
Comoros	-2.7	-2.9	-5.6	-0.9	-6.5	-24.7
Malawi	-0.8	-2.9	-3.7	-1.0	-4.7	-58.2
Guinea	-1.6	-3.6	-5.2	1.0	-4.2	-148.1
Gambia, The	-2.7	-2.3	-5.1	0.0	-5.1	-27.1
Sierra Leone	-0.9	-3.7	-4.6	0.1	-4.4	-36.7
Madagascar	-0.7	-3.1	-3.8	0.0	-3.7	-34.4
Burundi	-0.4	-3.9	-4.3	0.9	-3.4	-31.4
Ethiopia	-0.8	-2.6	-3.4	0.4	-3.0	-71.7
Burkina Faso	-0.3	-2.7	-3.0	0.5	-2.5	-22.1
Central African Rep.	-0.8	-1.8	-2.5	0.1	-2.4	-61.3
Benin	-0.6	-2.0	-2.5	0.3	-2.2	-11.8
Mali	-0.6	-2.9	-3.5	5.4	1.9	-22.4
Zimbabwe	-0.4	-1.7	-2.0	0.8	-1.3	-116.6
Congo, Dem. Rep.	-1.5	0.0	-1.5	0.0	-1.5	-79.4
Oil-exporting countries						
Cameroon	-0.7	5.3	4.7	0.5	5.1	35.4
Nigeria	-0.7	16.1	15.5	0.0	15.5	49.0
Chad	-0.3	22.8	22.5	0.5	23.0	179.9
Gabon	-0.3	26.1	25.8	0.1	26.0	258.8
Congo, Rep.	-0.6	33.1	32.5	0.1	32.6	126.5
Angola	-0.5	37.7	37.2	0.0	37.2	188.6
Equatorial Guinea	-0.3	51.8	51.5	0.1	51.5	157.2
Other low-income countries						
Ghana	-2.3	-8.1	-10.4	5.5	-4.9	-49.6
Kenya	-0.8	-3.6	-4.4	0.3	-4.2	-38.8
Tanzania	-0.9	-4.6	-5.5	1.7	-3.8	-35.1
Mozambique	-1.1	-3.1	-4.2	0.5	-3.8	-24.3
Zambia	-0.1	-2.7	-2.8	-0.1	-2.9	-28.8
Rwanda	-0.4	-2.0	-2.4	0.3	-2.2	-14.4
São Tomé & Príncipe	-0.4	-2.0	-2.4	0.3	-2.2	-8.9
Senegal	-1.5	-4.0	-5.5	0.0	-5.5	-39.4
Uganda	-0.7	-2.1	-2.7	0.8	-2.0	-12.3
Niger	-0.7	-0.8	-1.5	3.6	2.1	-12.1
Côte d'Ivoire	-1.1	2.0	0.9	2.1	3.0	9.3

Source: UN Comtrade; IMF, World Economic Outlook; and staff calculations.

[1] The BOP impact is calculated as the trade balance change resulting from changes in the terms of trade for each low-income country in SSA. It measures the effect of the expected increase in prices of exports and imports in 2008 compared to 2007, taken as given the 2007 volumes of trade, as a share of GDP. The oil prices used in the calculations are $71.1/barrel in 2007 and $112/barrel in 2008.

SSA Reserves and BOP Impact of Food and Oil Price Shock in 2008



Notes: Countries in the CFA Franc zone pool reserves, the group reserve holdings can be more informative than country reserve ratios.

BENIN

Macroeconomic impact: Because of rising food and fuel prices, Benin is expected to register a 5 percent deterioration in the terms of trade in 2008—following a cumulative 8 percent decline in 2006-07. As a result, the import bill is projected to increase by 2.3 percent of GDP in 2008, and the external current account deficit is projected to widen by about 1 percent of GDP. While domestic food availability has been broadly adequate, food prices increased by a cumulative 8 percent in the first quarter of 2008 (they fell 3.6 percent over the same period in 2007). Thus, year-on-year inflation is now projected to jump to 5.5 percent, from only 0.3 percent in 2007—well above the WAEMU ceiling of 3 percent. The budgetary cost of limited tax cuts and subsidies, in response to increased oil and food prices, is estimated at 1½ percent of GDP in 2008.

Macroeconomic context: Supported by prudent fiscal policies and external debt relief, Benin experienced a pickup in growth accompanied by low inflation in 2006-07. Growth is expected to firm further to above 5 percent this year. However, structural weaknesses and core economic vulnerabilities have not been addressed and growth has persistently fallen below program expectations, hindering progress toward the MDGs. A strengthening of the CFA franc is also adding to competitiveness concerns.

Policy response: On December 8, 2007, the government introduced fiscal measures to address the rising food prices. The measures consist of elimination of customs tariffs for pasta, tomato paste, and sweetened condensed milk; and reduction of customs fees—using below-market reference prices for taxation purposes—for refined sugar, rice, wheat and wheat powder, corn and maize, soybeans, and petroleum products. Traders are urged to downwardly adjust prices to reflect tax relief granted to them.

Staff advice: Faced with such a large shock, staff believes that it is best to smooth adjustment to higher food and fuel prices by allowing a temporary increase in the fiscal deficit. At the same time, staff is urging that the authorities better tailor their initial measures aimed at softening the impact on the poor by moving toward well-targeted safety net measures and away from distortionary price restraints. Medium-term adjustment will require full pass-through of food and fuel price increases to consumers. This will help to foster a positive agricultural supply response.

Next steps and Fund role: To address the higher import bill, the current PRGF-supported arrangement was augmented by 15 percent of quota on June 16, 2008. Staff intends to closely monitor the cost of the fiscal measures and to assess any further macroeconomic adjustment needs.

BURKINA FASO

Macroeconomic impact: At current prices, the oil and food price shocks are expected to lead to a widening of the current account deficit by, respectively 2.7 percent of GDP and 0.3 percent of GDP in 2008. Incomplete pass-through of rising petroleum prices leads to losses of the national oil company, SONABHY, of about 1 percent of GDP. These quasi-fiscal losses will need to be monitored carefully and resulting subsidies reflected in the budget. The estimated loss in fiscal revenues from temporary tax and customs exemptions for some basic products is about 0.3 percent of GDP.

Macroeconomic context: Adverse terms of trade shocks and weather conditions in 2007 slowed GDP growth. The near-term outlook is mixed. While growth should be supported by a rebound in cotton production and the opening of several gold mines, continued high food and oil prices dampen growth prospects. Inflation is rising (7.7 percent year-on-year in April), partly tracking food prices (16.8 percent y-o-y). If international food and oil prices stabilize (at a high level), inflation is expected to abate.

Policy response: The authorities (i) eliminated custom fees for some food imports (for 6 months) including for rice, pasta, salt, powder milk, condensed milk, and derivatives for powder milk for children, and (ii) announced indicative prices for these food products in early March, which they plan to monitor and support through a strengthened dialogue with wholesalers and retailers. The authorities increased petroleum pump prices in January 2008. However, pump prices remain below the price suggested by the price adjustment mechanism.

Staff advice: Staff's policy advice has aimed at striking a balance between macro stability considerations, ensuring incentives to consumers and producers to adjust, and supporting the most vulnerable. In terms of macroeconomic policies, the fiscal policy stance (in terms of the overall deficit as a share of GDP) agreed in the context of the Fund-supported program remains appropriate. However, a further increase in food and oil prices could require some fiscal tightening to counter inflation expectations. To minimize budgetary risks and improve incentives to adjust, staff has advised the authorities to close the gap between pump prices and prices mandated by the price adjustment mechanism. Due to the lack of well-developed social programs, staff encouraged the authorities to assess the scope for indirect measures, such as school feeding programs. Staff advised against distortionary price controls, which would have undesirable effects on supply. For the longer term, Burkina Faso should raise agricultural productivity, improve diversification, and strengthen social safety nets.

Next steps and Fund role: The authorities already requested an augmentation (15 percent of quota) of the PRGF arrangement at the time of the first review in January 2008. If price pressures increase, Fund staff could discuss the need for another augmentation during the mission for the third review, scheduled for September. The World Bank is discussing additional financial support for targeted measures (e.g. school feeding programs, vaccines). Additional donor aid for targeted support would be desirable, particularly if the food situation worsens.

BURUNDI

Macroeconomic impact: Burundi's 2008 BOP has been affected by oil and food price increases, with the former of a much larger magnitude (-3.9 percent of GDP and -0.4 percent of GDP, respectively, in percent of 2007 GDP). Burundi's terms of trade have also worsened significantly. The 2008 budget is under increasing strain, mostly reflecting the fiscal impact of higher food and fuel prices. The budgetary impact of higher fuel and food prices will reach about 1.5 percent of GDP in 2008; the budget does not include spending on social safety nets (0.8 percent of GDP) because of lack of funding.

Macroeconomic context: Burundi is a net importer of food and oil products, and its position as a landlocked country raises import costs. Together, food and oil imports comprise one fourth of total imports. Maize, sugar, and wheat were Burundi's largest food imports in 2007. Food prices have increased sharply in Burundi lately, mostly reflecting a pass-through of oil import prices. Because of rising food prices, inflation has risen sharply since mid-2007, reaching 27.2 percent year-on-year in April. From December 2007 to April 2008, prices of basic staples rose on average by 23 percent.

Policy response: Tariffs on diesel imports (mostly consumed by the poor) have been reduced from 12 percent to 9 percent. At the same time, tariffs on gasoline imports were raised from 12 percent to 16 percent to preserve overall tax collection levels. The authorities have also sought to mitigate the impact of higher food and oil prices on the poor by enhancing social safety nets (e.g., food security programs and school feeding programs).

Staff advice: Bank and Fund staffs have been supportive of targeted tax measures taken by the authorities. Staff are working with the authorities to (i) improve the targeting of social safety nets and temporary tax cuts; (ii) strengthen monetary and exchange rate policies; and (iii) design supply side measures to increase agricultural production.

Next steps and Fund role: On May 30, a mission concluded discussions, ad referendum, on a three-year program to be supported by a successor PRGF arrangement. The level of access under the arrangement has not yet been finalized but will take account of the increase in food and oil prices Given the country's debt situation, a concerted effort to increase donors' support would be needed to address the fiscal impact of higher food and fuel prices. It is expected that the World Bank's Relief Fund would be made available to Burundi. A fiscal gap of around 0.7 percent of GDP will be financed by additional support from African Development Bank.

CENTRAL AFRICAN REPUBLIC

The macroeconomic impact: A recovery in the agricultural sector, following an improvement in the security situation, had moderated food price pressures until recently. But prices are now rising, prompting the media, the national assembly and trade unions to call for government action.

Fuel price increases are estimated to have a significant negative impact on the current account balance in 2008 (over 1½ percent of GDP). Petroleum products are subsidized, and a sizable fiscal gap would emerge without fuel price adjustment. Prices increased on June 1 (see below) and are expected to raise end-period CPI inflation by 3 percentage points.

The macroeconomic context: Growth in 2008 is expected to increase moderately. Inflation has picked up in early 2008, but is expected to remain under control. In a fragile socio-economic environment, the authorities' policy priorities are to preserve the fiscal framework by raising domestic revenues and better controlling expenditures. In the past, acute budgetary constraints have led to accumulation of domestic expenditure arrears and high-cost commercial bank borrowing. Spending in priority areas is curtailed by the low availability of domestic and external resources.

Policy response: The VAT on several key food items has been reduced. The ministry of commerce has also set up a strengthened framework to monitor the prices of 30 basic necessities, with the participation of consumers and the business community.

Petroleum product prices were adjusted on June 1—as part of the revenue measures under the PRGF-supported program—by 16 percent on average. Although politically difficult, the measure (amounting to 1/2 percent of GDP) is needed to fill the fiscal gap.

Staff advice: The staff advised the authorities to: urgently develop implementable safety net measures to mitigate the social impact of petroleum (and possibly food) price increases; and formulate a transparent and credible plan to clear domestic expenditure (especially wage) arrears, to address social tensions. The staff also advised the authorities to seek greater donor assistance to help adjust to these shocks in an already tight fiscal environment. Areas meriting increased support are agriculture and education. Emergency support for agriculture could alleviate the food crisis while dealing with long-term structural issues (inputs, training for producers, extension services). CAR imports food from neighboring countries and the weight of food in the CPI is quite high; thus boosting yields has the potential to reduce imports quickly. Education could benefit from school feeding program using the World Food Program's existing mechanisms to alleviate the impact of food prices on the poor; this is further justified by the high malnutrition rate among schoolchildren.

Next steps and Fund role: Augmentation of access under the PRGF arrangement by 15 percent of quota was approved in late June. Board consideration is scheduled for late June.

THE COMOROS

The macroeconomic impact: The oil and food price shocks are expected to worsen the current account balance by 5.6 percent of GDP in 2008. There are no explicit subsidies on food and fuel, but price controls (see below) have created losses in various parastatals, notably the state hydrocarbon monopoly and the public electricity company, with knock-on effects on tax revenues.

The macroeconomic context: By end-2007, inflation rose to 4 percent, reflecting food price increases and disruptions to supply caused by a sustained political crisis. For end-2008, the authorities are projecting a further rise in inflation to about 6 percent, mainly due to rising food and fuel prices. The political crisis, combined with continuing problems in the vanilla sector, a shortage of credit, and a decline in imports and tourism, contributed to a contraction in real GDP growth and much lower fiscal revenues in 2007 (4.0 percent of GDP). The economy's very narrow export base, large import dependence and exchange rate peg make it vulnerable to international price swings. In addition, long periods of political and economic instability have undermined institutional capacity.

Policy response: The authorities intervened in 2007 by temporarily freezing the price of selected food items and petroleum products prices. The Union government is considering introducing a number of budgetary measures, including the temporary removal of customs duties on imported ordinary rice, which would cause a revenue loss of about 0.7 percent of GDP.

Staff advice: Staff has advised the authorities against price freezes, particularly with respect to petroleum prices, which will be costly to the public finances, while recognizing that temporary price caps on selected food items may be politically necessary. Relatedly, staff has urged the authorities to resolve the triangular arrears relationship between the state hydrocarbon monopoly, the public electricity utility, and the Ministry of Finance.

Next steps and Fund role: Following a recent visit by the Fund's resident representative in Madagascar, the Fund is planning a mission, to take place after the June elections, which may initiate discussions on possible Emergency Post Conflict Assistance (EPCA). The authorities are also considering asking the Bank for technical assistance to examine the price transmission mechanism for petroleum products, as a basis for taking policy decisions on the passthrough mechanism.

THE DEMOCRATIC REPUBLIC OF THE CONGO

Macroeconomic impact: The rapid rise in food and oil prices has contributed to an increase in inflation and imports. Annualized 12-month inflation rose from 10 percent at end-2007 to 24 percent in May 2007, with food and oil price inflation at 24 percent and 34 percent, respectively. In 2008, the import bill is projected to increase by 1½ percentage points of GDP, largely on account of higher food prices; net oil imports are negligible. However, the DRC's balance of payment is also likely to benefit from robust prices for copper and cobalt exports. Buoyant fuel prices would modestly improve the fiscal position, reflecting increased royalties from exports. But absent fiscal compensatory measures, the distributional impact of the food price increases would be large, with disproportionate effects on the urban poor.

Macroeconomic context: The DRC economy continues to recover at a robust pace, albeit from extremely depressed levels. In 2007, Real GDP grew by 6.3 percent. Prospects for stronger growth in the near to medium term have also improved in view of the anticipated large investment in mining encouraged by the commodity price boom. Macroeconomic policies are highly constrained by very low international reserves (about 2 weeks of imports) and a small monetary base requiring the government to essentially run a cash-balanced fiscal policy. Some fiscal slippage late in 2007 rekindled macroeconomic pressures but corrective measures were implemented in early 2008 under the current staff monitored program (SMP).

Policy response: The DRC government is considering reducing duties on food and related items. Products that could be affected include cereals, meat, milk, cooking oil, fertilizers, and agriculture equipment. The government is also considering creating a commission to regulate food prices.

Staff advice: The strong performance in commodity exports and associated higher government revenue should help minimize the need for macroeconomic adjustment to sustain the balance of payments—although the very thin reserves cover means there is little room for maneuver, and reserves accumulation to reduce vulnerability remains a paramount objective. At the same time, the authorities have limited fiscal resources to help alleviate the impact on the poor of higher food and fuel prices. In this context, staff is advising that any lowering of tariffs on food imports would probably need to be temporary. It is also urging the authorities to avoid price controls in view of their adverse effect on incentives for domestic production and imports.

Next steps and Fund role: Fund staff is continuing to advise the authorities in the context of ongoing discussions on a new PRGF arrangement.

ERITREA

Macroeconomic impact: Fund staff estimate that the impact of higher oil and food prices on the balance of payments is considerable and should amount to around 8.5 percent of GDP (2.4 percent from higher food prices, 6.1 percent of GDP from higher oil prices).[1] As Eritrea does not export oil and exports very limited amounts of food products, there are basically no offsetting terms-of-trade gains. The impact on the fiscal balance is unclear, as policies that may affect domestic food and fuel prices are largely off-budget. Notably, profits of several state-controlled enterprises (an important source of budget revenues) could contract. The end-of-period inflation rate rose to 12.3 percent in 2007 (from 9.0 percent in 2006), owing largely to higher food prices (rising by 13.8 percent in 2007, up from 7.0 percent in 2006).

Background: Eritrea has one of the lowest levels of GDP per capita in Africa. The economy continues to stagnate and inflation remains high. After a decline in 2006, real GDP growth is estimated at about 1 percent in 2007, driven by an improved agricultural harvest and a rebound in construction activity. The fiscal position improved markedly in 2007, but the fiscal deficit remained high at 10 percent. Economic prospects are dominated by the security situation, because the border conflict with Ethiopia has not been fully resolved and tensions persist.

Policy response: The authorities try to mitigate food shortages through public procurement of food through a state-controlled enterprise, without a direct fiscal cost. However, as the importer benefits from priority foreign exchange allocations, there is an implicit cost as foreign exchange is rationed and the priority allocations crowd out other sectors. Progress has been made in expanding agricultural production, and the government estimates that cereal production in 2006 met 80 percent of the country's needs. However, the country is drought-prone and remains vulnerable to periodic and widespread crop failure

Staff advice: Staff advice has focused on existing macroeconomic imbalances, notably the large fiscal deficit, which is the main source of the imbalances in the balance of payments. With food and oil prices adding to the pressures on the balance of payments in the foreseeable future, the case for a fiscal adjustment becomes even more urgent.

Next steps and Fund role: The authorities have not asked for Fund advice regarding the impact of higher food prices, but have made specific requests for TA in other areas. Eritrea could potentially benefit from debt relief under HIPC/MDRI; the authorities are not pursuing a Fund arrangement at present but do not rule out doing so in the future.

---

[1] As the Eritrean state-controlled importer contracts larger quantities at a fixed price in advance, the changes in the spot price of oil may overstate the immediate impact of increasing oil prices on the balance of payments.

ETHIOPIA

Macroeconomic impact: Ethiopia is particularly vulnerable to the rise in world oil prices because oil imports in 2007/08 are equivalent to 5.5 percent of GDP and foreign exchange reserves are low. Because oil price increases have not been fully passed on to consumers, sizable implicit subsidies (about 1 percent of GDP for 2007/08) are being provided through the Oil Stabilization Fund. The BOP impact of high world food prices is more limited because a large portion of food imports reflect food aid; however, to the extent that food aid is limited in value terms, high food prices could lead to significant reductions in food aid volumes. Food prices rises are in any case adding to domestic inflationary pressures, in part because Ethiopian food prices are catching up to world levels. This is having a significant adverse impact on the urban poor. Disappointing early rains in some regions of the country could exacerbate food supply problems.

Macroeconomic context: High economic growth has been registered in recent years, though macroeconomic risks are intensifying. The 12-month inflation rate jumped to nearly 30 percent in March–April 2008 (food price inflation was around 40 percent) and international reserves have fallen to just 1.5 months of imports.

Policy response: To address the broader problem of inflation and excess demand, monetary policy has been tightened through a tripling of reserve requirements, the money growth target has been lowered, and the authorities are seeking to contain public capital spending with high import content (including by public enterprises). To protect domestic food supply, the government has banned exports of main cereals and suspended the WFP's local purchases for emergency interventions. In the meantime, targeted food subsidies are being provided with an estimated cost of 0.1 percent of GDP for 2007/08. The VAT and turnover tax on grain and flour was lifted in March 2008 with minimal revenue loss. Fuel prices were increased in January 2008, although by less than required for a full pass-through of world price increases.

Staff advice: Staff is encouraging the authorities to support the money policy tightening through a reduction in the public sector domestic borrowing (including public enterprises) and through greater exchange rate flexibility in order to help ease the pressures on international reserves due to the higher oil and food bill. Additional external support would limit the anticipated slowdown in growth and would help maintain progress toward the MDGs. Staff is also advising full pass-through of oil price rises to consumers. In the longer term, investments in hydroelectric power would help reduce dependency on energy imports.

Next steps and Fund role: In the context of the May Article IV mission, staff prepared medium-term scenarios to illustrate the costs to the Ethiopian economy of adjusting to high fuel and food prices and the role that additional donor support could play in alleviating the short-term impact on poverty reduction. The Fund stands ready to continue providing advice on and assessment of the authorities' adjustment strategy.

THE GAMBIA

The macroeconomic impact: Increases in food and fuel prices in 2008 are projected to cause a deterioration in The Gambia's balance of payments equivalent to 2.7 and 2.3 percent, respectively, of 2007 GDP. The fiscal impact has so far been limited as the authorities have avoided subsidizing petroleum products, and have offset tax reductions on rice imports with increased taxes on other products.

The macroeconomic context: The rising cost of food imports pushed the annual rate of inflation from less than 1 percent in December 2006 to 6-7 percent during most of 2007. However, tight monetary policy and significant dalasi appreciation against all the major currencies in the last year and a half have helped contain inflation. Year-on-year inflation fell to 1.4 percent in April 2008. International reserves stand at a fairly comfortable five months of imports.

Policy response: The authorities reduced the sales tax on rice imports from 15 percent to 5 percent in July 2007 and eliminated it altogether in May 2008. At the same time, they increased other taxes (on car parts and used vehicles) to compensate for the revenue loss. The authorities also raised the price of petroleum products in May by 10-24 percent. Although there is no budget subsidy for petroleum products in aggregate, the price of kerosene is cross-subsidized by the prices of other petroleum products (diesel and gasoline).

Staff advice: Staff have advised the authorities to continue to pass through fuel price increases to consumers in order to safeguard the government budget. Staff have also discussed with the authorities options to mitigate the impact of food price increases on the poor through targeted subsidies, pro-poor spending, and tariff reductions on a limited number of food items.

Next steps and Fund role: A mission in May 2008 concluded discussions on the third review of The Gambia's PRGF arrangement. The authorities indicated that if the increases in world oil and food prices persist, they may request an augmentation of access under the program. Staff will assist the authorities to monitor the situation in the coming months and revisit the issue of augmentation of access during the next review mission (currently scheduled for October/November 2008).

GUINEA

Macroeconomic impact: Based on the revised WEO oil price projections, staff estimates the adverse impact on the external current account to be about $170 million (3.8 percentage points of GDP) in 2008. This implies a current account deterioration of about 2.9 percent of GDP from 2007. The negative impact of fuel price increases on government revenue has been neutralized by the government's recent decision to increase domestic prices by 63 percent. The CPI inflation is projected to increase by an additional 5 percent by year-end compared to earlier projections.

Macroeconomic context: In 2007, social conflict early in the year slowed down real GDP growth to 1.8 percent, while the subsequent tightening of fiscal and monetary policies brought end-of-year inflation down by almost 30 percent to 13 percent. However, real GDP growth is projected to rebound to 4.5 percent in 2008 because of the expected implementation of large mining projects. Guinea's external position remains precarious, with official reserves still at less than one month of import cover at end-March 2008.

Policy response: The government's short term response to higher food and fuel prices envisages increased support for the transportation of public civil servants and students. The expected fiscal cost of these measures would amount to 0.4 percent of GDP. The authorities are also exploring ways to increase domestic food production and to build up an emergency stock of food products. The authorities have also called for emergency food assistance to finance programs that would target the most vulnerable segments of the population. They have so far resisted social pressure to re-introduce the ban on exports of agricultural and fish products that was lifted at end-2007.

Staff advice: Staff has advocated full pass-through on domestic petroleum prices and time-bound well targeted measures to limit the impact on the poor. The fiscal targets of the PRGF-supported program have been eased in 2008 by 0.2 percent of GDP in an attempt to accommodate these measures without jeopardizing return to fiscal sustainability. In a recent joint letter, Fund and Bank staffs have urged the authorities not to resort to food export restrictions, because, inter alia, it would set an undesirable precedent for the region. The letter indicated also that the introduction of measures to limit possible disruptions in the domestic supply of rice (a key staple good in Guinea) such as a modest export tax on rice could be considered on a temporary basis.

Next steps and Fund role: Fund staff is finalizing discussions on the first PRGF review. At the time of completion of the first review, the Board may consider an increase in access to PRGF resources.

GUINEA-BISSAU

Macroeconomic impact: The 12-month inflation rate rose to 9.3 percent at end-December 2007, from 3.2 percent at end-2006. Annual inflation came down somewhat in early 2008, to 8.1 percent at end-April, but remains well above historical levels. The rise in headline inflation has been driven mainly by the recent surge in international prices for food, given the large weight of food in the CPI basket. Excluding food items, the annual inflation rate was just 1.0 percent at end-April 2008. For 2008, annual average inflation is now estimated at about 6–7 percent, compared to the initial projection of 3.3 percent. There are already pressures from labor unions to raise wages, as nominal wages have remained unchanged for more than 3 years.

Higher-than-expected import prices for food and fuel will impact the country's external position. The external current account deficit (excluding official transfers) is now expected to widen to more than 15 percent of GDP in 2008, slightly worse than the deficit of 12 percent of GDP initially projected for the year. The contribution to the larger current account deficit comes equally from food and fuel imports.

Policy response: The authorities have responded so far by reducing taxes on rice and fuel imports. Since March, taxes on rice imports are fully exempted[2], while the reference price used to calculate import duties for rice and diesel imports is much lower than the actual import price[3]. The loss in terms of potential tax revenues from rice and fuel imports for 2008 is estimated between CFAF 2-3 billion (1-1.5 percent of GDP or some 10 percent of tax revenues for the year).[4]

Staff advice: As a fragile, post-conflict country, there is limited scope for short-term fiscal adjustments; spending is already minimal and capacity to raise revenues in the short term is limited. Nonetheless, the authorities have agreed, in the context of the EPCA-supported program, to take a number of revenue and expenditure measures to offset any revenue losses, as well as other fiscal pressures, and keep the fiscal program on-track for 2008. Additional external concessional assistance will be also critical for macroeconomic stability.

Next steps and Fund role: The staff is considering ways to augment Fund financing for the country. Access under the current EPCA-supported program will have reached its annual ceiling with the second purchase, which is expected for Board consideration in July. If EPCA performance remains satisfactory, staff could initiate discussions for a new PRGF arrangement later this year, and the proposed access would take into account the impact of food and fuel shocks.

---

[2] Rice imports now pay only WAEMU-related taxes (a rate of about 2.5 percent). The reference price for calculating rice import duties has remained unchanged from 2007 and is well below actual import prices.

[3] Currently, the reference price for import duties on diesel products, the main oil product imported by the country, is just 77 percent of the estimated CIF price.

[4] The estimated revenue loss for 2008 assumes full taxation of rice and fuel imports as well as reference prices used for calculating rice and fuel duties that reflect actual import costs in 2008.

LIBERIA

Macroeconomic impact: Liberia is a highly dollarized economy, with U.S. dollars estimated to account for about 95 percent of effective money supply. The government is committed to a balanced cash-based budget, with no borrowing. Inflation accelerated sharply in the first quarter of 2008, mainly on account of higher imported food prices. The projection for end-year inflation has been raised to 13.4 percent. Current estimates are that, with unchanged volumes, the trade balance would deteriorate in 2008 by around 16 percent of GDP on account of higher fuel and rice prices.[5] This is likely to be financed in part by higher official and private transfers.

Policy response: The government's strategy has been to inform the public about the origin and causes of the high world fuel and food prices, as well as its limited ability to sustainably protect the domestic economy from such movements. Increases in fuel prices have been allowed to pass through to domestic prices. The government suspended, with effect from March 1, 2008, the rice import duty. In addition, the government adopted a three-pronged approach to: (i) increase domestic food production; (ii) mitigate the impact of rising food prices, and ensure consistent supplies; and (iii) maintain access to food among vulnerable households. The total annual cost of the suspension of the rice import duty is estimated at US$8 million (0.9 percent of GDP). An export ban on food, announced in mid-May, was withdrawn by the end of the month. On May 30, the World Bank announced it would provide US$10 million to assist implementing the government's strategy.

Fund policy advice: Staff's advice is broadly consistent with the authorities' views. The staff has emphasized the importance of avoiding measures that could create distortions, maintaining incentives to increase domestic rice production, as well as approaching international partners for assistance. Given limited capacity to target assistance and widespread poverty (64 percent of the population is estimated to be living below the poverty line), staff agreed with the authorities' decision to suspend the rice import duty.

Next steps: Rice is a politically sensitive commodity in Liberia. This underscores the importance for a positive response from Liberia's international partners to the government's appeal for additional support, and to fast-track its PRS programs for agriculture and food production. Staff commented on the Government's food security strategy, formulated in collaboration with key partners, to ensure it is consistent with the objective of broad macroeconomic stability.

---

[5] GDP figures are likely underestimated.

MADAGASCAR

Macroeconomic impact: The oil and food price shocks are expected to lead to a deterioration of the trade account of the balance of payments of, respectively, 3.1 and 0.7 percent of GDP in 2008. Oil price increases are expected to reduce GDP growth by about 0.3 percent in 2008. Presently, there are no explicit subsidies on food and fuel, so the budget has been exposed only via direct operational costs and to additional transfers to the state-owned electricity company (0.1 percent of GDP).

Macroeconomic context: Economic growth (projected at 7.0 percent in 2008) continues to have a strong impetus coming from the construction of two large mining projects, despite the disruptions resulting from two cyclones early in 2008. Overall inflation has declined (to about 7 percent at end-March 2008), owing to a deceleration of food prices (notably rice, due to the base effect of a price spike from an earlier cyclone); however, direct and indirect prices pressures stemming from fuel and food costs could intensify. The current account deficit has temporarily widened (to about 23 percent of GDP) mainly because of imports linked to mining construction.

Policy response: The authorities have negotiated rice imports from India at below market prices, and have recently announced a ban on their (already small-scale) exports of rice.[6] Over the medium term, the intention is to increase domestic rice production in order to become a net rice exporter. There has been some moral suasion on oil distributors and taxi operators to limit the pass-through of international oil prices in domestic prices. The authorities have proposed a package of measures for 2008H2 that would have an overall effect on the fiscal budget of about 0.4 percent of GDP, comprising: (i) a temporary reduction of the VAT on rice, on lighting/cooking fuel, and possibly other primary necessity goods; (ii) a fuel subsidy for certain categories of urban transport; (iii) a school feeding program; (iv) a cash for work program; and (v) support for a countercyclical (off-season) rice crop. Given the anticipated increase in energy costs, the authorities have postponed a planned rise in the electricity tariff in April 2008, which will require an increase in the budgetary transfer to the state utility company this year.

Staff advice: Fund staff has advised the authorities to allow a full pass-through of international oil prices to domestic prices, to emphasize targeting of food subsidies, seek donor support, and to lift expeditiously the ban on rice exportation. It has also recommended lower electricity price increases for lifeline use (i.e., the first units of consumption) to alleviate the impact on the poor. Fund staff, in close cooperation with World Bank staff, has agreed to the temporary VAT reductions on rice and on lighting fuel, as well as to the other programs noted above.

Next steps and Fund role: The Executive Board is expected to discuss an augmentation of access to help cover the balance of payments impact (in 2008 and 2009) of the rise in food and fuel costs as well as cyclone reconstruction, in the context of a PRGF review in early July 2008.

---

[6] Exports are limited to specialty rice and amounted to less than 1 percent of production in 2007.

Malawi

Macro economic impact: Rapid increases in fuel and fertilizer import prices are putting pressure on international reserves. The direct effect of the terms of trade change in 2008 would be to increase the external trade deficit by more than $160 million in 2008, equivalent to almost three-fourths of the $217 million end-2007 gross international reserves. The fiscal impact of the rise in fuel prices has been small—there are no fuel subsidies—but increased fertilizer prices, caused by the rising world fuel prices, may add 0.5 percent of GDP to expenditures in 2008/09. Malawi has been relatively insulated from the current worldwide increases in food prices. The fertilizer subsidy scheme and good weather have, in recent years, made Malawi self-sufficient—in 2007 even a net exporter—of the staple food maize, although there remains substantial uncertainty about whether these favorable developments surrounding domestic food security will persist. Food inflation has remained steady at a level below overall inflation, indicating that the long downward trend caused by large domestic maize surpluses is countering by imported food inflation. The budgetary and balance-of-payment impact of the 2007 world market food price increase was positive.

Macroeconomic context: Real GDP growth is expected to remain strong in 2008 at 7½ percent, following growth of 7 percent in 2007, on the strength of several years of macroeconomic stabilization, falling public debt and rising private sector credit, and good harvests. Inflation fell to 7½ percent in 2007 before rising above 8 percent this spring with higher fuel prices. Reserves remain low at about 1 month of imports.

Policy response: There has largely been a continuation of past policies. There are no fuel subsidies and no change to the fertilizer subsidies program (itself implying a higher budgetary cost given higher world prices). An Inputs-for-Assets program for irrigation equipment is in place, and the government plans to increase its strategic maize reserve by 67 percent. The government also reasserted an export licensing requirement on maize exports, except to Zimbabwe, in response to the recent increase in world food prices.

Staff advice: Staff has focused on the needed macroeconomic adjustment in the short term to avoid an excessive loss of foreign reserves, and to re-build reserves over the medium term. Staff have been generally supportive of the agricultural input subsidy program, but stressed the need to contain its fiscal costs and improve its efficiency.

Next steps and Fund role: Additional balance of payment support is needed to provide time for an orderly macroeconomic adjustment. Maize surpluses mitigate the need for additional safety net measures. Additional support is needed to further increase agriculture productivity and the efficiency of the fertilizer subsidy program. The PRGF program has one more review, scheduled for June; discussions are ongoing on a follow-on program.

MALI

Macroeconomic impact: Assuming $500/MT for rice and $112/bbl. crude oil to project petroleum product prices, higher fuel and food prices raise Mali's import bill by 2.9 percent and 0.6 percent of GDP, respectively, in 2008. Tax exemptions on these products are expected to lower fiscal revenue by about 1.5 percent of GDP for petroleum products and 0.3 percent of GDP for rice.[7]

Macroeconomic context: Inflation rose sharply in recent months, driven by food prices that were 16 percent higher in April than a year earlier; there has been only a partial pass-through of higher fuel prices. With the 2008 budget calling for taxes on oil products to provide 3.6 percent of GDP in tax revenue (almost ¼ of the total), reductions in oil taxation could put macroeconomic stability at risk if offsetting expenditure cuts are not carried out.

Policy response: The authorities have granted tariff and VAT exemptions on rice imports, lifted administrative hurdles to rice imports, and promoted importation of lower cost rice varieties. A major program to boost production by 2009 has been launched, at a cost of about 1 percent of GDP. Fuel taxes have been trending down for the past year, absorbing much of the increase in world prices, but taxation is set to stabilize under the new PRGF.

Staff advice: The staff has advised the authorities to limit customs exemptions on fuel imports; provide temporary customs exemptions on cereal imports, taking care not to undermine price incentives for higher production; improve investment and institutional arrangements for irrigation (part of the PRGF); and avoid export restrictions and work through ECOWAS to remove barriers to food trade.

Next steps and Fund role: In approving the new PRGF arrangement on May 29, the Executive Board approved high and front-loaded access under the to help cover higher import costs for the first year of the program. Disbursements in 2008 would amount to 0.4 percent of GDP. Fuel price hikes are expected to follow cost increases under a performance criterion on taxation in the new PRGF-supported program; the authorities mobilized substantial financial support ($7 billion for 2008-12), including new funding commitments for food production, at a donor roundtable in mid-June.

[7] Staff have assumed the impact on the current account is somewhat less, reflecting reduced purchasing power for other imports as a result of higher fuel prices. Efforts to boost domestic rice production, which normally covers ¾ of consumption, could also reduce import needs.

SIERRA LEONE

Macroeconomic impact: food price inflation (accounting for over half of the CPI) has been volatile as a result of supply shocks (weather, transport conditions, and a ban on export of agricultural products by a neighboring country). However, domestic fuel prices have been kept stable through end-April 2008, despite the increase in world oil prices. As a result, average inflation is expected to reach 14.1 percent in 2008 (against a previous target of 12.4 percent and 11.7 percent in 2007). Higher energy prices are expected to somewhat dampen economic activity (particularly in the manufacturing and services sectors) leading to a reduction in real GDP growth rate of about 0.5 percent in 2008. Based on the most recent WEO world oil price projection, it is estimated that food and fuel imports will add about US$77 million (4.6 percent of GDP) to the 2008 total import bill, compared to 2007, assuming unchanged volume of imports.

Macroeconomic context: Sierra Leone has made good progress in its post-conflict recovery, but poverty remains pervasive and the country ranked last (177) on the 2007 UN Human Development Index. Output growth has been strong and broad-based over the last 3 years and international reserves have increased significantly. Inflation, however, remains in double digits, driven by the sharp rise in global food and oil prices. Real GDP growth is expected to remain strong, helped by increased public and private investment.

Policy response: For the short term, the authorities have taken a number of administrative measures and are strengthening dialogue with all stakeholders on the appropriate way to address the food crisis. They have: (i) reduced the import duty on imported rice and flour to 10 percent from 15 and 20 percent, respectively; (ii) changed in December 2007 the import duty on petroleum products from an ad-valorem rate of 5 percent to a specific rate of US$20 per metric ton (roughly equivalent to an ad-valorem rate of 2.5 percent); and (iii) imposed a ban on export of rice and palm oil. Also, rice and flour importers have been asked not to adjust domestic prices above the increase in international prices. For the long term, the authorities have committed to creating the conditions for achieving food self-sufficiency and security. In this context, they are: (i) expanding land available for agriculture; (ii) increasing smallholder farmers' access to improved inputs; and (iii) strengthening extension services.

Staff advice: The staff's policy advice seeks to sustain macroeconomic stability, encourage increased agricultural production, and help the poor to cope with the significant price increases. To that end, the staff is monitoring closely the balance of payments implications of the food and fuel price developments. On promoting increased supply, the staff has advised against the export ban because it hinders expansion of agricultural production and encourages smuggling. Staff has also advised a pass-through of world oil prices to domestic petroleum prices.

Next steps and Fund role: While the additional balance of payments need could be financed by a drawdown of reserves, higher access under the PRGF could also be envisaged during the third program review (scheduled to be completed by November 2008) if more concessional financing cannot be secured from donors. The Fund will work with donors, including the World Bank, to assist the authorities cope with the macroeconomic impact and design well targeted programs for the poor.

TOGO

Macroeconomic impact: Togo is among the hardest hit economies in the world, with a projected *balance of payments impact* of the oil price shock of 6 percent of GDP in 2008. This reflects Togo's heavy reliance on oil imports (18 percent of GDP in 2007) resulting from its role as a regional transport hub and extensive diesel-based electricity generation. The balance of payments impact of the food price surge is only about ½ percent of GDP, as Togo is nearly self-sufficient in food production, with imports of only about 3 percent of GDP. Higher world food prices may even have some benefits for agriculture, but the recent price surge has created significant social problems, especially in some urban areas. The *fiscal impact* will depend on the specific policy measures, which are estimated at ½ percent of GDP for food, and uncertain for oil. *Inflation* has risen to nearly 5 percent by March 2008 and is expected to climb further, to between 6 and 9 percent this year.

Macroeconomic context: After 20 years of economic stagnation, a nascent economic recovery has been underway since 2006, but constrained by widespread electricity shortages. The 2008 growth projection was revised down to 2.7 percent, partly reflecting the impact of the price shocks, but also delays in rehabilitating the phosphate mine. Togo's current account deficit is expected to rise to 9 percent of GDP this year on account of higher oil prices.

Policy response: The authorities have initiated a social dialogue, distributed some grain reserves, and repaid arrears. They intend to support subsistence agriculture by distributing fertilizer to farmers at last year's market prices. They also intend to appeal for donor assistance in raising productivity in agriculture. The authorities have resisted the unilateral tax/tariff reductions and price controls applied by other WAEMU countries. As for gasoline, the authorities intend to keep retail prices unchanged for the time being, based on the existing price stabilizing mechanism agreed with the private importers and retailers.

Staff advice: For the short term, staff has advised to rely on: (i) targeted use of grain stocks, (ii) appeal for international support, (iii) pension arrears clearance, (iv) targeted support to farmers by facilitating access to fertilizer and seeds, while avoiding excessive fiscal costs and limiting the scope for cross-border arbitrage, and (v) seeking a harmonized WAEMU-wide reduction in import tariffs on food. Staff advised against price controls, export controls and broad-based food subsidies. For the longer term, Togo should: (i) raise agricultural productivity through investment in rural infrastructure, better stock and distribution systems, facilitating competition, and lower trade barriers, and (ii) improve social services.

Next steps and Fund role: Raising productivity in agriculture will require significant technical and financial assistance from donors, which is not yet identified. The authorities will make the case during an upcoming donor roundtable. WAEMU finance ministers have not agreed on fiscal measures, but envisage large financial support to improve agriculture, including from the BCEAO, the BOAD, and the donor community. The Fund could consider a modest augmentation of PRGF access at the time of the first review, tentatively set for late this year.

ZIMBABWE

Macroeconomic impact: As Zimbabwe is a net importer of food items and fuel, the increase in prices would worsen the current account balance (if not offset by lesser non-food/oil imports). Zimbabwe's central bank finances fuel and food imports through money printing to buy currency on the parallel market. Therefore, increased prices may have led to increased money printing and/or lower non-food/oil imports.

Macroeconomic context: Zimbabwe is in hyperinflation caused by substantial quasi-fiscal activities undertaken by its central bank that are financed through money printing. 12-month inflation is estimated to have exceeded 2,000,000 percent in May.

Policy response: Price controls on *food* items predate the global food crisis. Since June 2007, the government has been controlling and monitoring prices for all food items. These controls have contributed to widespread and severe shortages of basic staples in the formal market. Food prices on the parallel market have increased with inflation and world market conditions, rendering many items unaffordable to large parts of the population. Recent farm invasions are further disrupting food production. The price of *fuel* is also officially controlled. However, the government is distributing fuel at these controlled prices only to select groups and government institutions (practically free). Fuel is available on the parallel market with prices reflecting world market conditions.

Staff advice: Staff has advised the authorities that price controls on food items will lead to shortages and to higher rather than lower inflation. Staff also advised that the current practice of distributing government imported fuel practically for free leads to rent-seeking and corruption because it is resold on the black market with a huge profit. The authorities should charge market prices when distributing fuel (if they intend to continue importing fuel through government channels) and to use targeted support schemes to protect vulnerable groups instead of employing price controls. Staff also urged the authorities to cease all quasi-fiscal activities and move essential import requirements (including food) to the central government budget. Staff believes that macroeconomic stabilization as well as several structural reform measures in the agricultural sector will be necessary to improve the food situation in Zimbabwe.

Next steps and Fund role: The most important step is to stop hyperinflation and restore macroeconomic stability. Donors and the WFP already provide substantial food aid to vulnerable groups. This aid might need to be increased with the ongoing economic, social, and political crisis. Zimbabwe is ineligible for Fund financial assistance and prohibited from receiving TA.