Republic of Yemen
Prime Minister
The Executive Bureau for the Acceleration of
Aid Absorption and Support for Policy Reforms

Policy Brief

The Impact of War Risk Insurance on Food Commodity Price

January 2022

Aden – Khormaksar – Security Roundabout
www.ebyemen.org

Republic of Yemen
Prime Minister
The Executive Bureau for the Acceleration of
Aid Absorption and Support for Policy Reforms

Policy Brief

The Impact of War Risk Insurance on Food Commodity Prices

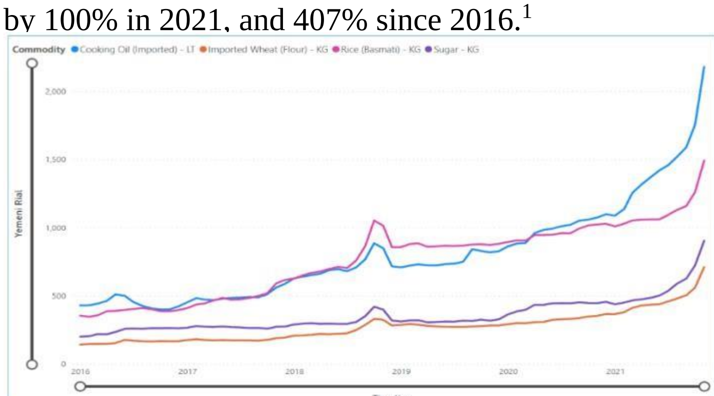
Date: 1 January 2022

Abstract:

The prices of basic food commodities witnessed significant increases of more than 300% during the past six years, as a result of many internal and external economic and security factors. Through the analysis, it appears that there is an inflation in the costs of importing food commodities along the supply chain, as the past years have witnessed increases in food and shipping prices worldwide. As for Yemen, the restrictions imposed on sea, land and air traffic for years, in addition to the classification of Yemen as a war zone, have also inflated import and supply costs, which is reflected in the final consumer prices. This paper addresses one of the factors contributing to the inflation of the final prices of basic food commodities, namely the war risk insurance costs, which were added in 2017. The paper provides an analysis of the extent to which these costs affect the final prices, and it discusses the possible ways that would contribute to reducing food prices.

Factors affecting the prices of basic food commodities:

The prices of basic food commodities in Yemen have been on the rise since 2016. It reached levels beyond the people's purchasing power as Figures No. 1 & 2 illustrate. Sugar prices increased by 106% in 2021 alone, and 349% since 2016. Rice prices increased by 48% in 2021, and 321% since 2016. Flour prices also witnessed an increase of 94% in 2021, and an increase of 394% compared to the year 2016. As for oil prices, they increased by 100% in 2021, and 407% since 2016.[1]



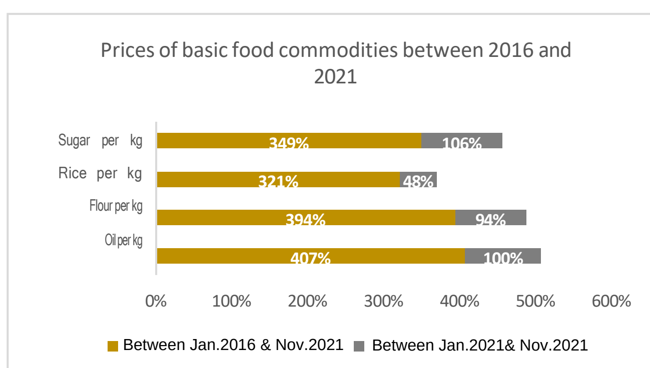


Figure (1,2) shows the rates of increase in food commodity prices 2016 and 2021

Commodity prices are affected by many factors that are of varying nature: external factors (about which the government can do nothing), and internal factors (about which the government can adopt policies to address them). As for the external factors, they are related to the global economic inflation, which led to a significant increase in the prices of food commodities such as wheat, flour, oil and the like. Figure 3 shows the rise in global wheat prices between November 2019 and November 2021, with an annual change of about 37.2%. The other external factor relates to the international shipping costs, which have also witnessed significant increases during the past five years.

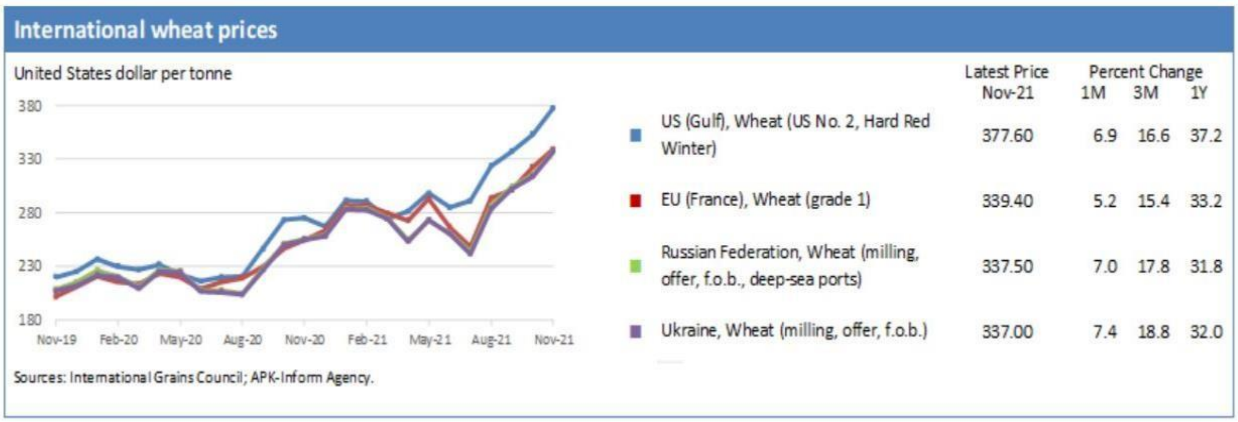


Figure 3 shows the rise in global wheat prices between November 2019 and November 2021[2]

At the local level, commodity prices, on the other hand, are affected by other internal factors, most notably the following:

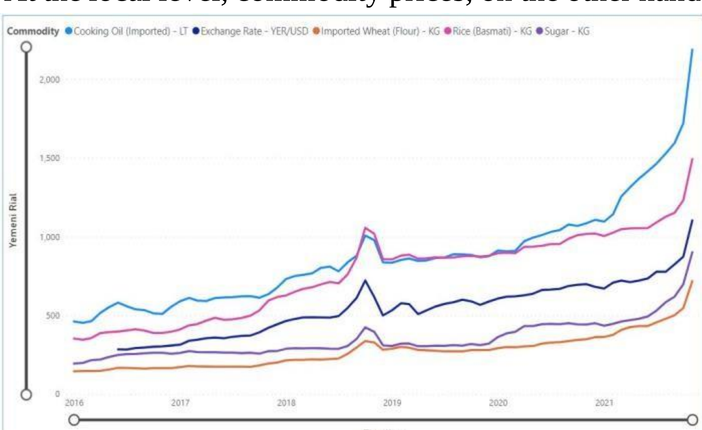


Figure (4) shows the relationship of commodity prices to exchange

1. **Exchange Rates**: The ongoing depreciation of the national currency against foreign currencies as a result of many reasons, the most important of which is the strong demand for foreign currencies to meet imports of basic and secondary commodities. Data from the World Food Program (WFP) confirm the positive relationship between commodity prices and exchange rates, as shown in Figure 4.

2 https://www.fao.org/giews/food-prices/international-prices/detail/en/c/1459550/

2. **Slow Flow of Goods into Yemeni Ports:** The inspection procedures take between 2 and 4 weeks, and sometimes more than that. This delay imposes additional costs upon importers such as fines for delaying goods at the inspection berths, and the costs of unloading containers, as well as re-loading them during the inspection process.

3. **War Risk Insurance Costs:** It is imposed on bulk ships that carry commodities such as wheat, and on containers used for shipping other food commodities. For a bulk ship, the war risk insurance costs about USD170,000, while it is about USD 700 per container.[3]

4. **Demurrage Fines at the Local Ports:** As a result of the poor equipment in the two ports of Aden Free Zone, food commodities are delayed either on board the ships or on the berths of the port due to the poor logistical equipment of the ports, which appear to be unable to deal with the large flows of goods, leading in the process to fines being imposed on traders of up to 11% of the consumer price in the case of flour, as shown in Figure 5. It is worth noting that the Free Zone port used to receive about 13% only of the imports of basic food commodities, while the bulk of it used to be received by the ports of Hodeidah and Salif, which are better equipped to receive and store this type of commodities. Due to the current conditions, the flow of goods at the Free Zone port has significantly increased, which caused it to be unable to respond to this level of flow of goods in the required manner.

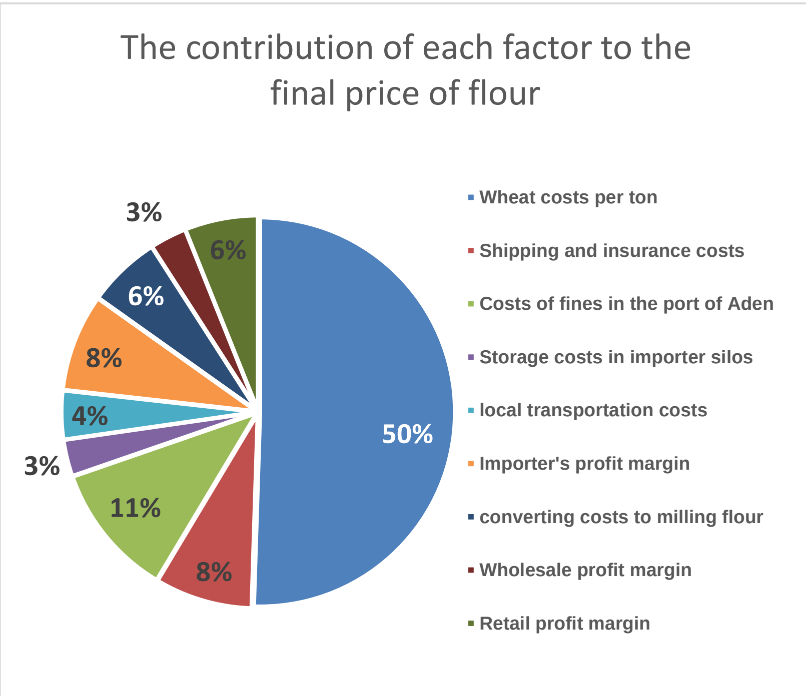
5. **Inland Transportation Costs:** The high costs of inland transportation of goods in the process of transporting goods from ports to importers' warehouses. For example, inland transportation costs for flour increased by 25% between 2017 and 2019. These costs are 4% of its final consumer price, according to 2019 statistics, as shown in Figure 5. There are many factors causing the rise of inland transportation costs, such as the rise of prices, the deterioration of inland transportation network and the interruption of some main transportation lines, forcing transportation companies to switch to other further and rugged transportation routes that take more time and are more difficult for the trucks to pass through them. This is in addition to the royalties levied on each truck by some military or armed parties along the local transport network.

All of these external and internal factors, and perhaps other factors not mentioned here, have contributed in one way or another to the inflation of the price structure of the imports of basic food commodities during the past years, as shown in Table No. 1. The table compares between the structure of wheat flour import prices in

[3]According to the statements of some businessmen and shipping companies that have been interviewed by the CSO team.

2017 and 2019 and we recommend that the table is updated to cover 2021. It appears that freight and insurance costs increased by 50% between 2017 and 2019 and have continued to rise through 2021 as well.

It also appears from Figure 5 that external factors such as the costs of wheat, shipping and insurance account for 58% of the final price of flour in the local market. The internal factors, on the other hand, account for the remaining 48% and include the costs of delay fines at the berths of Aden port, wheat storage and milling, as well as costs of goods transportation between cities in addition to profit margins.



Wheat Flour Price Structure in Riyals per kg			
Factors affecting wheat prices	2017[4]	2019[5]	Difference
Wheat costs per ton	73	123	68%
Shipping and insurance costs[6]	14	21	50%
Costs of fines in the port of Aden	-	27	-
Storage costs in importer silos	-	7	-
local transportation costs	8	10	25%
Total import costs	95	188	98%
Importer's profit margin	22	21	-5%
Converting costs to milling flour	21	16	-24%
The price at which the importer sells	138	225	63%
wholesale profit margin	2	7	250%
Wholesale Price	140	232	66%
Retailer profit margin	35	16	-54%
Retailer Price	175	248	42%

Figure 5 shows the contribution of each factor to the final price of flour

Figure 4 compares the flour price structure in 2017 and 2019

War Risk Insurance Cost Effects:

The cost of war risk insurance imposed by shipping companies on imported goods contribute to the inflation of final commodity prices in several ways. As shown in Figure 6, it contributes not only to increasing the final price of commodities, but also the balance of payments and exchange rate, which are the most important factors causing the continuous rise of food commodity prices. This part of the paper addresses the extent to which the cost of war risk insurance premiums on importing basic commodities contribute to the final prices of basic food commodities. This part uses the statistical data of 2019 for analysis, because the import and export situation this year were stable compared with the next year, in which the global import flow was affected by the Covid-19 pandemic. To clarify in principle, war risk insurance costs are those fees that are

[4]World Bank 2017, Securing Imports of Essential Commodities to Yemen.

[5]ACAPS 2020, Yemen Food Supply Chain.

[6]It is not clear to the CSO's team whether this factor includes the costs of insuring war risks or no

levied on each container or on each ship carrying bulk goods, when it is shipped to a country, which is classified as a war or armed conflict zone, as insurance on containers or ships used in the shipping process and not on the goods being shipped and covered by conventional insurance (freight insurance).

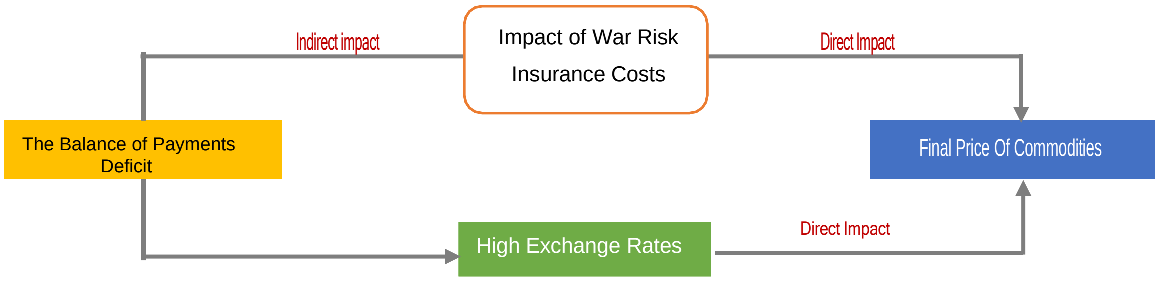


Figure 6 shows the impact of war risk insurance on

War Risk Insurance Costs:

War risk insurance premiums on bulks shipments are different from war risk insurance premiums on containers. Goods that are shipped in bulk, such as wheat, are usually shipped directly to Yemen, and the insurance cost for them is about USD170,000 per shipment. As for the goods that are shipped inside containers, the war risk insurance cost varies according to the size of the container. The insurance cost for 20-foot containers is about USD 600, while it is USD 900[7] for 40-foot containers. Table No. 2 shows the details of war risk insurance costs in different types of shipments.

Shipping Type	Container		Bulk
	20 feet	40 feet	
Insurance costs.	$600	$900	$170,000

Table (2) shows the cost of war risk insurance for each type of freight.

To calculate the total bill for war risk insurance in one year, this requires knowing the number of containers that entered Yemen, as well as the number of ships that arrived at Yemeni ports carrying bulk goods such as wheat and the like. Official Yemeni statistics indicate that 268,169 T.E.U. containers entered Yemen during

[7]According to the statements of some employees of some shipping companies and importing businessmen who were contacted, the average was adopted, as the numbers varied, but with minor differences.

2019[8]. This means that the insurance cost that was paid for containers that entered Yemen in 2019 amounted to USD 201,126,750.[9]

The Impact of War Risk Insurance Costs on Prices of Basic Food Commodities:

Taking into account the costs of insurance against war risks, Table No. 3 illustrates the contribution of insurance costs to the prices of sugar, flour, oil and wheat. It seems that war risk insurance costs to the final prices of food commodities is small, as it is not more than 1.1%. In comparison with other influencing factors that were previously reviewed in this paper, the costs of war risk insurance are comparatively small compared to other factors such as inflation in the value of the local currency, fines imposed at ports, wheat price inflation as well as global shipping costs, and other factors.

Commodity	Container size	Number of units	Insurance cost	Insurance cost per unit
Sugar	20 feet	540 bags	$600	$1.1
Flour		540 bags		$1.1
Oil		3000 cans		$0.2
Wheat	Bulk ship	600 thousand bags	$170,000	$0.28

Table 3 shows the cost of risk insurance on each type of freight.

Impact of the War Risk Insurance Bill on the Balance of Payments and Exchange Rates:

Moreover, the costs of war risk insurance have an impact on the exchange rates in the local market through its impact on the balance of payments deficit. Given that war risk insurance is also part of the import bill and it is therefore partly responsible for the strong demand for foreign currency in the local market by importers to cover import credits in general and food commodities in particular, which ultimately affects the prices of those commodities. Given that the import bill for 2019 amounted to about USD10.49 billion, and that the balance of payments deficit was estimated at USD 890 million, according to International Monetary Fund,[10] this means that the war risk insurance bill accounts for about 2% of the total import bill. This means that the cost of war risk insurance during 2019 accounted for 2% of the demand for foreign

[8]According to reports issued by the governing bodies of Yemeni ports and published on their websites.

[9] To calculate this value, the insurance cost was set at $750 per container, as the average insurance cost for 20-foot and 40-foot containers. This value does not include insurance costs for ships that arrived at Yemeni ports carrying bulk goods such as wheat and like.

[10] IMF staff, Yemen Economic Developments, Oct. 2021 Official use only.

currency in the local market. On the other hand, the cost of war risk insurance accounts for about 23 % of the balance of payments deficit as shown in Figure 7.

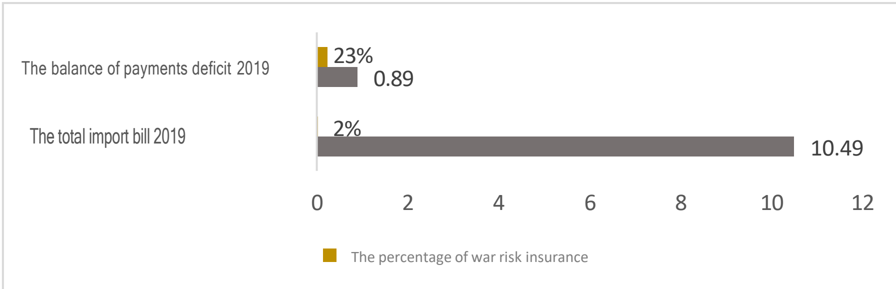


Figure 7) The percentage of war risk insurance from both the import bill and the deficit in financing it for the year 2019.

Findings

Through the analysis included in the previous sections of this paper, we find that the prices of basic food commodities are affected by many external and internal factors, the most prominent of which is the continuous inflation in the value of the local currency against foreign currencies, which ultimately leads to commodity price inflation. Other factors also include shipping-related costs, such as the costs of fines and handling at the inspection ports, in addition to the costs of fines in the port of Aden resulting from the delay in releasing imported goods. It seems that the port of Aden is facing an influx of goods that exceeds its operational capacity.

As for the war risk insurance bill, it seems that its direct impact on the final prices of food commodities, as an additional cost, is marginal. However, it, to some extent, plays a role in increasing the import cost and raising the balance of payments deficit. For example, the cost of war risk insurance accounted for 2% of the value of imports in 2019 and 23% of the total deficit in the balance of payments in the same year. Any rise in the balance of payments deficit is offset by an inflation in the value of the local currency as a result of the increased demand for foreign currency to meet import costs, which ultimately leads to the inflation in commodity price. It is At present, it is difficult to predict the contribution of war risk insurance costs to exchange rate inflation, because the latter is related to many factors, most of which are difficult to control given that most of the cash flow is outside official banks. Therefore, the inflation in exchange rates is largely not subject to supply and demand, but rather to the personal interests of cash controllers outside the formal banking sector. Eliminating war risk insurance will contribute to reducing the balance of payments deficit by 23%, which means an improvement in the overall economic performance. Although this improvement is not measurable at the present time, it will inevitably be reflected on exchange rates and ultimately on the final prices of goods. It would also be a positive step towards lifting the restrictions imposed on trade to and from Yemen. Besides, the costs of war risk insurance reduce economic efficiency, i.e. by wasting nearly USD 200 million of the limited resources of foreign currencies without getting anything in return. Therefore, eliminating the costs of war risk insurance will enhance the efficiency of the use of these resources under the current conditions of extreme scarcity.

Other Considerations for Eliminating the Costs of War Risk Insurance:

The elimination of war risk insurance premiums will require the government to deposit USD 70 to 100 million in a bank as insurance for containers and ships entering Yemeni ports, an amount that may be invested in supporting certain basic services, such as electricity, port operating capacity or other services. However, freezing this amount as a security deposit will contribute to reducing the import bill and thus the balance of payments deficit. It is worth noting that the elimination of war risk insurance will not guarantee the arrival of ships to Yemeni ports, as this is linked to other technical and military complications. The entry of ships to Yemeni ports requires that a set of security measures are in place in Yemeni ports to ensure the safe entry and departure of international ships. The entry of ships without passing through the inspection ports in Saudi Arabia and Djibouti requires the approval of the Arab coalition to do so.

Recommendations:

Based on the analyzes and findings outlined above, we recommend the following:

1. Investing in the development of the infrastructure of the port of Aden in order to improve its operational capabilities to accommodate the large influx of goods, resulting from the suspension of the port of Hodeidah.
2. Coordinating with the Arab coalition to use the port of Aden as a station for inspecting goods destined for Yemen, instead of the neighboring international ports in order to facilitate the flow of goods to the national market and reduce shipping costs.
3. Communicating with international shipping companies with the aim of eliminating war risk insurance costs, either through placing a security deposit or any other possible methods.

Paper Preparation Methodology:

To prepare this paper, the CSO team has adopted the descriptive analytical, evidence-based approach, in which facts are established and conclusions are drawn based on the argument. The team relied on the primary data collected through holding several interviews with leaders in government institutions such as the Ministry of Industry, the Customs Authority and the Gulf of Aden Ports Corporation. The team also held a series of interviews with some businessmen importing food, and with managers of some Yemeni shipping companies. A wide range of secondary data resources were also used in this paper by reviewing many reports and research papers, as well as analytical papers published on food in Yemen. The team also relied heavily on raw data collected by the Customs Authority, the World Food Program and the World Trade Organization.