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Fiscal Policy in Sub-Saharan Africa in Response to the Impact of the Global Crisis

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Fiscal Policy in Sub-Saharan Africa in Response to the Impact of the Global Crisis¹

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EXECUTIVE SUMMARY

The global financial crisis poses significant challenges to fiscal policies in Sub-Saharan African countries. Growth will weaken considerably as export prices and volumes, remittances, tourism, and capital flows decline. The fiscal effects of the crisis are likely to be large and to operate mainly via revenue losses, with commodity-related revenues particularly hard hit.

Countries will need to weigh their options for fiscal policy responses. Countries with output gaps and sustainable debt and financing options have scope to implement expansionary policies, by letting automatic stabilizers work, accommodating declines in commodity-related revenues, and in some cases implementing discretionary fiscal stimulus. The main focus of fiscal stimulus should be on the expenditure side, particularly infrastructure and social spending given pressing needs, as reducing tax rates may be inequitable and the scope for doing so is limited given low revenue ratios. Other countries will have to adjust, in a way that will not affect critical spending. Additional donor support would reduce the need for adjustment. In all cases, countries should give priority to expanding social safety nets as needed to cushion the impact of the crisis on the poor.

I. INTRODUCTION

The global financial crisis poses important challenges to fiscal policies in sub-Saharan African (SSA) countries.² Growth is set to weaken considerably as exports, remittances, tourism, and foreign direct investment decline. Revenues will suffer because of falling commodity prices and lower economic activity. Governments will be under pressure to maintain or increase spending, including in social sectors. Public finances will come under further strain if the crisis leads to a decline in aid flows and private financing prospects continue to tighten.

This paper discusses issues related to fiscal policy responses to the crisis. The rest of the paper is structured as follows. Section II provides an overview of the macroeconomic situation of SSA countries at the onset of the crisis and how the crisis is affecting the region's economies. Section III discusses the main channels through which the crisis is likely to affect the fiscal position of these countries. Section IV sets out general conditions that need to be taken into account in setting fiscal policies in SSA countries. Section V discusses the considerations that should guide SSA policymakers in framing sound fiscal policy responses to the global financial crisis. Finally, Section VI sets out the fiscal areas where the IMF provides technical support to SSA countries.

² This paper complements the recent Staff Position Note on policy options in response to the current crisis in emerging market economies (Ghosh and others, 2009).

II. OVERALL IMPACT OF THE CRISIS ON MACROECONOMIC CONDITIONS IN SSA

During 2004–08, SSA countries enjoyed high growth rates (averaging about 6½ percent), and a number of these countries achieved macroeconomic stability, as reflected in low inflation and sustainable debt. Improved economic policies, market-oriented reforms, and the reduction in the number of armed conflicts have contributed to strong performance. Rapid growth has been facilitated by improvements in terms of trade, growth of exports, debt relief under different initiatives, and increasing aid flows and private inflows.

Macroeconomic conditions in SSA countries are now being adversely affected by the global financial crisis. The negative effects in Africa were felt first in emerging and frontier markets, where financial sector linkages are better established, but have now reached most countries in Africa.³ In the latest IMF *World Economic Outlook* (WEO), growth projections for SSA in 2009 were revised down to 1½ percent. This projection is almost 5 percentage points lower than both the forecast a year ago and trend growth in 2004–08. Although declining fuel and food prices have eased inflationary pressures in many SSA countries, the region's external current account deficit excluding grants is projected to widen to 8½ percent of GDP in 2009, significantly higher than the forecast a year ago.

III. SUB-SAHARAN AFRICAN FISCAL POSITIONS ARE BEING HIT HARD BY THE CRISIS

The fiscal effects of the crisis are likely to be large and to operate predominantly via revenue losses, in part as a result of the operation of automatic stabilizers associated with slower economic growth (Box 1). Revenue losses will take place even if revenue ratios to GDP are constant, owing to lower economic activity.

- Revenues from consumption taxes are declining as economic activity is slowing. Pressures on remittances from abroad may take a toll on consumption. Tourism, an important source of revenue in some countries, is being affected. Declines in foreign direct investment are also cutting into government revenues.⁴
- Commodity-related revenues are being particularly affected as commodity exporters face major drops in export prices and lower demand for their exports. In several SSA countries, commodity-related revenues account for a significant share of budgetary revenues (e.g., Angola, Botswana, Chad, Gabon, Republic of Congo, and Nigeria).

³ South Africa is considered an emerging market economy, and has the most developed financial system in SSA. A second group of economies are not yet considered emerging markets, but rather are on the frontier between developing and emerging markets. These countries typically have well-functioning stock exchanges and few restrictions on capital repatriation. In this paper, these countries comprise Botswana, Cape Verde, Ghana, Kenya, Mauritius, Mozambique, Namibia, Nigeria, Seychelles, Tanzania, Uganda, and Zambia.

⁴ In Zambia, mining companies announced plans to curtail operations or suspend investments in the copper industry, adversely impacting mining revenues. Widespread downsizing has already been announced in the gold and diamond sectors across Africa, with South Africa, Botswana, and Namibia among those affected.

Box 1. Automatic Stabilizers in Non-Oil-Exporting SSA Countries

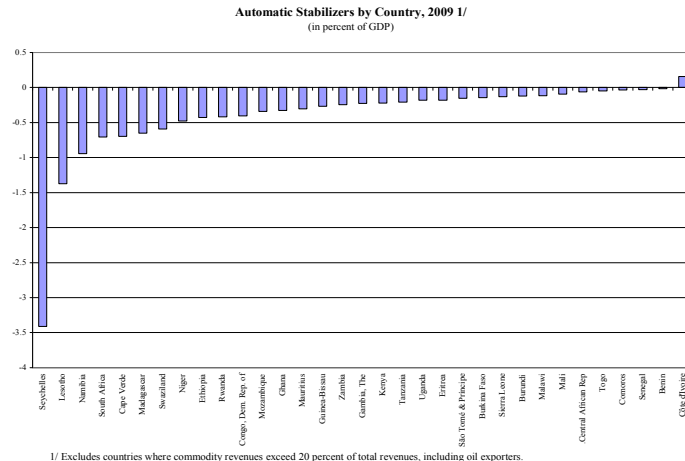
The budgetary elasticity with respect to the output gap is estimated at about 0.2 for SSA countries. The latest WEO 2009 growth projections and associated calculations suggest a widening of the output gap for non-oil-exporting SSA countries of close to 2 percentage points.¹ This implies that, on average, automatic stabilizers in these countries would worsen the fiscal balance by 0.4 percent of GDP in 2009, compared with -1.2 in the G-20 countries (IMF, 2009a).²

This masks large heterogeneity among the countries in the sample (see figure).

These estimates should be treated with caution in light of the well-known shortcomings of using the HP filter for approximating potential output. Economic cycles and output gaps are particularly difficult to measure in SSA, where structural breaks and supply shocks are frequent and data can be of poor quality (see Balassone and Kumar, 2007).

The size of automatic stabilizers is smaller in SSA countries because of generally lower revenue-to-GDP ratios, and tax systems and public expenditure structures that are not very sensitive to the cycle. In particular, the average revenue-to-GDP ratio in non-oil-exporting SSA countries is 21 percent, compared to an average revenue-to-GDP ratio of over 40 percent in developed countries. In addition, a large fraction of revenue in SSA countries is generated by indirect taxes, which tend to vary proportionately to the output gap (i.e., the elasticity with respect to the output gap is close to 1). On the expenditure side, a number of studies have highlighted that transfer programs are small in low-income and emerging countries. In particular, unemployment, welfare, and other social protection programs are not very developed (see Fatás and Rose, 2001; Lane, 2003; Suescún, 2007; and Thornton, 2008. And when such programs do exist, their poor countercyclical design limits their impact on declining output.

On the other hand, other factors besides changes in output and unemployment can automatically affect the budget, including commodity prices, interest rates, inflation, exchange rates, and asset prices. Indeed, for many SSA countries changes in commodity prices will be the main driver of the fiscal outcome in 2009.



Source: IMF, African Department database, and Fund staff estimates.

Note: This box was prepared by Ding Ding, Alejandro Hajdenberg, and Abdoul Wane.

¹ The output gap was computed relative to trend GDP using a Hodrick-Prescott (HP) filter with smoothing parameter of 6.25.

² According to the methodology described in IMF (2009a), the effect of automatic stabilizers is computed as the change in the cyclical fiscal balance between two consecutive years. For simplicity, it was assumed that revenue and expenditure elasticities with respect to the output gap are 1 and 0, respectively.

Tighter global financial conditions will have a negative effect, and foreign aid flows may be under threat.

- The global financial crisis is hindering countries' abilities to raise funds in capital markets. Some countries have postponed bond offerings and are expected to rely more on domestic financing.
- Potential reductions in aid flows (given difficult budgetary conditions in donor countries) are a serious concern in many recipient countries, particularly in those where aid finances a substantial share of the budget. Fragile states are likely to be most affected as they depend heavily on such financing (e.g., Burundi, Guinea-Bissau, and Liberia). On the other hand, currency depreciation in real terms, if it occurs, would raise the domestic currency value of aid flows.

Spending pressures will increase.

- Countries will need to expand safety nets and pro-poor spending to address rising poverty levels. By contrast, countries that increased subsidies for fuel and food products during the 2007–08 price spike should be able to scale back these subsidies. Countries that have already phased out temporary suspensions of customs duties and taxes include Burkina Faso, Mozambique, Niger, and Senegal.
- Currency depreciation and rising interest rates may also add to spending pressures. Depreciation would increase external debt servicing costs—but taxes collected at the border (including import duties and VAT on imports) and resource-related revenues may increase. Countries able to access international capital markets may have to pay higher interest costs because of flight to safety and increased risk aversion by lenders.
- Falling commodity prices may lead to pressures to keep producer prices at previous levels, higher than the corresponding export prices. In particular, commodity marketing boards may come under pressure to cover the difference, putting budgets at risk.
- Public-private partnerships for public projects and concessions (such as ports and power generation) could come under strain. Lower-than-anticipated demand for services may trigger calls on revenue guarantees, and private operators may be affected by the lack of available financing or by higher interest rate spreads on existing lines of credit.
- There may be a need in some countries for government support to domestic financial institutions and depositors. The economic slowdown and exchange rate volatility in some countries are likely to increase credit risk and nonperforming assets and weaken financial institutions' balance sheets. Domestic financial sectors may be particularly exposed to the crisis if credit to domestic commodity exporters is sizable.

Because of these pressures, fiscal positions in SSA are projected to deteriorate in 2009.⁵

- Oil exporters could be particularly hard hit by the crisis. Most oil exporters closed 2008 with sizable fiscal surpluses, excluding grants. Owing at least in part to the drop in world oil prices, those surpluses could turn into sizable fiscal deficits of about 7½ percent of GDP on average. However, the non-oil primary deficits in most oil exporters are projected to decline under current policies (Table 1), reflecting adjustment measures.

Table 1. Non-Oil Primary Fiscal Deficits, 2003-09
(Percent of non-oil GDP)

	2003	2004	2005	2006	2007	2008	2009 Projection
Angola	69.9	61.1	60.9	50.3	56.9	61.3	54.0
Cameroon	0.7	2.7	0.0	-30.2	1.5	6.8	3.7
Chad	3.2	4.3	5.2	14.8	19.3	28.0	17.9
Republic of Congo	28.2	28.6	33.5	53.1	56.8	45.5	41.0
Equatorial Guinea	47.3	68.2	63.7	66.0	61.3	75.6	60.9
Gabon	8.9	9.1	17.5	18.0	13.3	15.1	13.9
Nigeria	32.2	30.2	33.4	34.1	34.3	33.4	28.2
Average (unweighted)	27.2	29.2	30.6	29.4	34.8	37.9	31.4

Source: IMF, African Department database.
Note: (-) Denotes surplus.

- For oil importers, fiscal deficits excluding grants are projected to increase by 2¼ percentage points of GDP, to close to 6 percent of GDP.

IV. FRAMEWORK FOR FISCAL POLICY FOR SUB-SAHARAN AFRICA

As in other parts of the world, the appropriate fiscal policy response to a negative demand shock in SSA depends on the size and nature of the shock, as well as country-specific characteristics. Fiscal policy may be able to help smooth the impact of the crisis, maintaining critical government services and investment programs and providing countercyclical support to domestic demand. Countries that have macroeconomic stability and fiscal space (i.e., sufficiently strong fiscal accounts that allow them access to financing at sustainable rates) can run expansionary fiscal policy by allowing automatic stabilizers to work and through additional discretionary fiscal stimulus, when appropriate, to contain the impact of a sharp decline in private sector demand in the short run.⁶ However, when countries are constrained by a lack of financing or high levels of debt distress, then the scope for an expansionary fiscal policy is limited and there may be no alternative to tightening fiscal policies in the near term. The appropriate speed of adjustment will again depend on debt levels and the availability of financing on sustainable terms.

⁵ The projections include the impact of policy responses in countries where they have been announced.

⁶ In this paper, the terms “expansionary fiscal policy” and “fiscal expansion” cover both cases in which automatic stabilizers are allowed to work and those in which, in addition, discretionary fiscal stimulus measures are implemented.

The shock faced by countries in Africa is to some degree different from the shock confronted by developed countries. In developed countries, the shock is predominantly in the form of a decline in domestic demand, while in SSA countries it is mostly an *external* shock—a shock to the terms of trade, export demand, remittances, and capital flows.

- The mainly external nature of the shock gives rise to a balance of payments constraint, which can be relaxed temporarily through sustainable external financing or by running down reserves.
- In contrast with the case for many developed countries, for SSA countries the shock may be concentrated in narrow but important sectors of the economy, particularly in resource-rich countries.⁷ In these cases, stimulus may be unable to directly replace the lost external demand, while the scope for substituting with demand elsewhere depends on whether unemployed factors can readily switch to new activities. For example, capital, land, and possibly skilled labor associated with mining are likely to be less useful in other activities, while unskilled labor involved in light manufacturing could presumably redeploy to construction in response to demand pressures. Within the external constraint, fiscal policy can still aim at limiting the spillovers of lower external demand and falling inflows by supporting demand for domestically-produced goods.
- Exchange rate flexibility can provide greater scope for fiscal policy, but only up to a point. A fiscal expansion would require a larger exchange rate depreciation to restore external balance, which may lead to higher inflation or a disruption in household and corporate sectors' balance sheets.

Some economic and financial characteristics of SSA countries deserve special attention in designing the fiscal policy response:

- In principle, the crowding-out effect of fiscal policy may be larger in SSA countries than in advanced and emerging market economies because they have less access to international capital markets and the size of domestic financial markets is more limited. The recent withdrawal by foreign investors from frontier markets has also thinned out the domestic debt markets. In addition, if unemployed factors are concentrated in sectors that are hit by shocks and are not readily reallocated, overall rates of GDP decline may overstate the scope to increase output elsewhere without hitting capacity constraints. This said, in countries where output remains clearly below potential and substantial resources are underemployed, crowding out is unlikely to be strong (Box 2).

⁷ For example, in Botswana the collapse in world demand for diamonds is leading to a projected 10 percent decline in real GDP in 2009.

Box 2. The Crowding-Out Effects of Fiscal Policy in SSA Countries

Fiscal policy can “crowd out” private investment when a deterioration of the fiscal balance reduces public saving, pushes up interest rates, and thus reduces private investment. Some features of LICs can make them more vulnerable to crowding out. However, this effect is unlikely to be strong as long as output remains substantially below potential.

Aisen and Hauner (2008) provide some evidence that budget deficits have a greater impact on domestic interest rates when domestic financial development is limited, domestic debt is higher, and capital accounts are more restricted. While SSA countries tend to have low domestic debt levels, they also have smaller financial markets and more restricted capital accounts than industrial and emerging market countries (see figure). That said, individual characteristics vary across countries, suggesting that the interest rate effects of budget deficits will also vary.

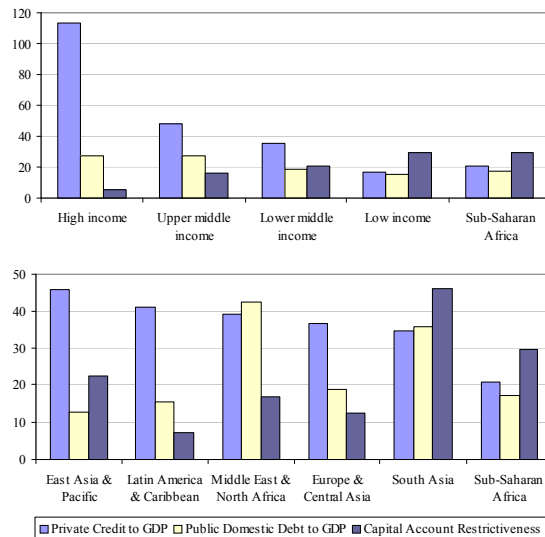
As noted above, substantial underemployed financial and physical resources as a result of the crisis are likely to reduce the upward pressure on interest rates from fiscal expansions and mitigate potential crowding out effects. In addition, many SSA countries have relatively high real interest rates, providing scope for monetary easing, as long as output remains below potential.

Letting automatic stabilizers work and providing a well-designed stimulus could therefore take place without large crowding out effects in the current context, but this would require careful attention to the goals and limits of these fiscal policy actions:

- The scope for countercyclical fiscal policy to raise output depends on the size of the gap between actual and potential output, and not just the size of the shock. Income effects may be larger than output effects—for instance, some exporters may face lower prices but export volumes may remain unchanged. Fiscal policies that attempt to compensate for the full income effects might push output above potential, at which point crowding out concerns would become relevant.
- The initial external shock faced by some of the countries in this crisis is likely to affect a narrow export segment of the economy, and in some of these cases factors may not be readily available to satisfy increased demand in other sectors. For example, resources used in the mining sector are not easily reallocated to other activities. In such cases, a broad-based stimulus may be able to close only part of the gap arising from the shock before crowding out other activity.
- As noted in Box 1, reliable assessments of output gaps are a difficult task in many SSA countries.

Note: This box was prepared by Andrew Berg and Martin Schindler.

Financial development, debt and capital account openness



Sources: World Development Indicators, International Financial Statistics, Schindler (2009) and staff calculations.

In developing countries, sustainable public debt levels tend to be lower than in developed countries.⁸ Thus, risk premia may rise with growing debt and looser fiscal policies (Baldacci,

⁸ Studies find evidence that high debt levels are associated with lower economic growth in developing countries (Clements, Bhattacharya, and Nguyen, 2004, and Pattillo, Poirson, and Ricci, 2002 and 2004).

Gupta, and Mati, 2008). Hence, decisions on whether to adopt an expansionary fiscal stance should be informed by debt sustainability analyses tailored to the features of these countries.

- Some SSA countries, particularly those where inflation has recently been on a declining path, have some room for a more countercyclical monetary policy. Although monetary policy transmission mechanisms are weak in several countries,⁹ few SSA countries face the “zero interest rate policy” bound that leaves little room for monetary policy to act, particularly those that are not members of a currency union.¹⁰ More generally, coordination of monetary and fiscal policies will be important for an effective policy response to the crisis.
- Special institutional characteristics in SSA countries should also be taken into account. While increasing public spending quickly and efficiently poses institutional challenges even in advanced economies (Spilimbergo and others, 2008), this problem is often more acute in SSA countries. In particular, the capacity to implement efficient and well-targeted investment and social programs relatively quickly is limited.

Unfortunately, there is little empirical evidence to guide countercyclical fiscal policies in SSA countries during this crisis. Perotti (2007) concluded that methodological and data consistency problems are so severe that it is difficult to evaluate the countercyclical effects of fiscal policies in developing countries. Also, several studies have found—presumably reflecting financing constraints and institutional weaknesses—that fiscal policy was generally procyclical in low-income countries (e.g., Gavin and Perotti, 1997), making it difficult to assess the effects of countercyclical fiscal policy.

V. FISCAL POLICY RESPONSE

On the basis of the considerations discussed above, countries will need to weigh their options for fiscal expansion or, conversely, for taking fiscal adjustment measures.

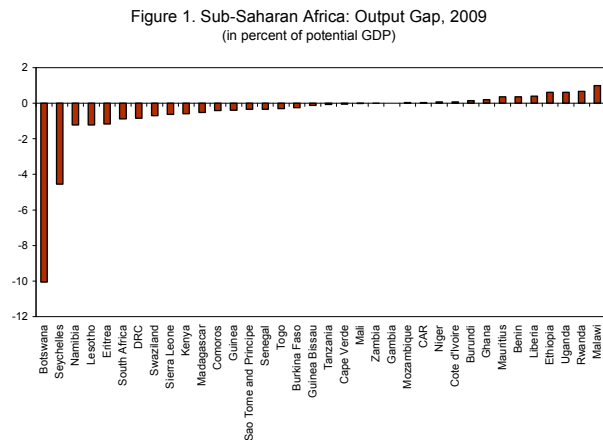
⁹ For further discussion of the role of countercyclical monetary policy in low-income countries, see IMF (2009b).

¹⁰ The relative importance of monetary policy, particularly in the context of fiscal sustainability constraints, is also emphasized in Ghosh and others (2009).

Fiscal expansion

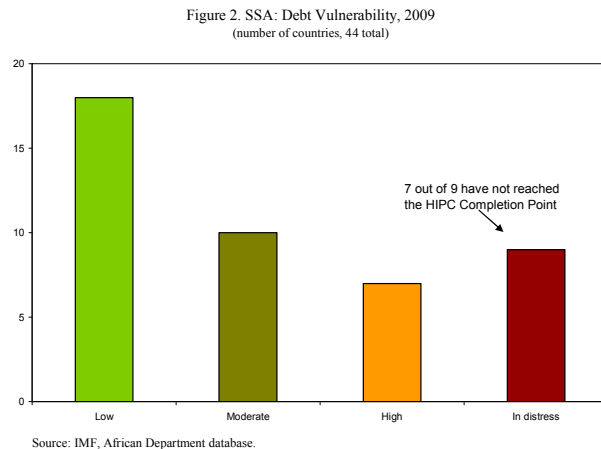
SSA countries with output gaps and sustainable debt and financing options would have scope to implement an expansionary policy.

- Output gap.** The average output gap for non-oil-exporting countries is projected to widen by close to 2 percentage points in 2009. A number of countries are expected to have sizable negative output gaps (Figure 1).
- Debt sustainability.** Almost two-thirds of SSA countries have low to moderate levels of debt distress (mainly due to earlier debt relief), which would allow some scope for fiscal expansion (Figure 2).



Source: IMF, African Department database

- In these countries, automatic stabilizers should be allowed to work.** This would involve letting non-commodity-related revenue and expenditure items adjust endogenously to the slowdown in economic activity, thereby allowing a cyclical worsening of the fiscal balance (excluding commodity-related revenues). Automatic stabilizers on the expenditure side, such as social safety nets, are virtually nonexistent in SSA countries.



Source: IMF, African Department database.

- Declines in commodity-related revenues may be accommodated in some cases.**¹¹ These revenues largely originate abroad and are not perfectly correlated with output fluctuations.¹² Some commodity exporters that built up financial cushions during the

¹¹ The fiscal impact of lower commodity export receipts on domestic economic activity would be captured through non-commodity-related revenue items. For example, indirect tax collections would decline if lower incomes in the export sector lead to lower consumption, investment, and imports.

¹² In countries that are heavily dependent on commodity-related revenues, the overall balance should be supplemented by other fiscal indicators, notably the non-commodity primary balance, to better gauge the fiscal

(continued)

boom years may be in a position to maintain spending levels despite the decline in commodity prices if sustainability is not at issue. Exporters with sustainability concerns that need to adjust may be able to do so gradually by drawing down financial reserves. Some countries dependent on nonrenewable resource revenues use permanent income frameworks to determine their sustainable non-resource primary deficits; these countries will need to reassess such frameworks, given the prospect of lower resource prices in the medium term than projected earlier.

- ***In some countries, discretionary fiscal stimulus aimed at sustaining demand could be implemented.*** Countries suffering a significant impact from the crisis, with low risk of debt distress and access to sustainable financing, could consider discretionary measures in addition to letting automatic stabilizers work.

Fiscal stimulus packages should be timely, targeted, and reversible.

- If the fiscal response is not timely—which could happen, for example, if there are lags in identifying and implementing suitable measures and weaknesses in public financial management systems—there is a risk that fiscal policy could end up being unintentionally procyclical.
- Fiscal multipliers (the ratio of the change in output to an exogenous change in the fiscal balance with respect to their respective baselines) are larger when leakages into savings and imports are few, monetary conditions are accommodative and there is limited crowding out, and the fiscal position after the stimulus is sustainable. Studies of fiscal multipliers in developing countries are very limited. One study finds that the average fiscal multiplier (on impact) in developing countries is on the order of 0.6.¹³ The size of fiscal multipliers will vary depending on the type of spending increases and tax cuts implemented. For advanced countries, multipliers for tax cuts have been found to range from 0 to 1.3, those for increases in transfers from 0.1 to 1.7, and those for investment from 0.5 to 1.6.¹⁴ Spending that is intensive in domestic goods and services is likely to be more effective in supporting domestic economic activity.
- The measures chosen should not involve permanent increases in fiscal deficits.

stance. For example, in oil-exporting countries a deterioration in the overall balance due to a fall in oil revenues would mask fiscal adjustment efforts if the non-oil primary balance is simultaneously being tightened.

¹³ Ilzetski and Vegh (2008). See also Spilimbergo, Symansky, and Schindler (2009).

¹⁴ Al-Eyd and Barrell (2005), Freedman and others (2009), and Zandi (2008).

Reductions in tax rates would generally not be recommended.¹⁵

- First, as the direct tax burden in many countries falls mostly on relatively well-off groups, reducing tax rates may be inequitable and seen as benefiting richer groups. These groups also save more than the poor.¹⁶
- Second, most SSA countries have low revenue ratios—which increases their vulnerability to fluctuations in aid flows—and it has often been difficult to make progress on this front. Permanent reductions in tax rates would exacerbate the problem and run counter to longer-term objectives. And if such reductions were superimposed on tax reductions implemented at the time of high food and fuel prices, they could lead to large declines in revenues at a time when expenditure needs are rising.

The primary focus should therefore be on the expenditure side. Countries that have poverty reduction strategies in place should use them to identify areas for discretionary spending measures.

- One area for additional spending would be infrastructure, given pressing needs.¹⁷ In particular, roads, electricity, and telecommunications are three areas where improved infrastructure has been identified as having the largest positive impact on growth (World Bank, 2007; and Straub, 2008).¹⁸ The emphasis should be on bringing forward approved investment projects—new projects or programs should be approached with caution due to weaknesses in implementation capacity. Domestic activity would be supported in particular by projects that bolster employment and have low import content. Existing infrastructure should be preserved by protecting operations and maintenance, which are typically labor intensive.
- Protecting spending in sectors related to the Millennium Development Goals (MDGs), such as health, education, water and sanitation, and social protection, can

¹⁵ In some cases, however, previously planned reductions in tax rates may still be desirable if revenue losses can be offset.

¹⁶ This said, temporary reductions in VAT rates on goods that are consumed more by the poor and that have low import content could stimulate aggregate demand and benefit poor households during the crisis. However, the effectiveness of such reductions would be reduced if the poor purchase most of their goods from informal markets where VAT is not collected. Such tax reductions should be well-targeted and include explicit sunset clauses.

¹⁷ A recent World Bank study estimated that Africa faces an infrastructure financing gap of US\$35 billion per year (Foster, 2008). See also Ter-Minassian, Hughes, and Hajdenberg (2008).

¹⁸ This spending is often linked to long-term concessional financing.

help cushion the impact of the crisis on vulnerable households and preserve the momentum toward the MDGs.

- Expanding targeted social safety net programs should also be given priority as needed. This is discussed below.

Some forms of spending increases would best be avoided. These include universal subsidies, which are not well targeted and benefit the rich more than the poor. Public wage increases would be poorly targeted and are difficult to reverse. Other spending measures such as the introduction of new, hard-to-reverse, and unsustainable large-scale entitlement programs should also be avoided.

Spending plans should ensure that fiscal sustainability is not jeopardized. This could be facilitated by casting these plans in a medium-term framework that incorporates a longer-term view of spending needs and resource availability. Many countries have some form of rudimentary medium-term frameworks in place. Those lacking such frameworks could draw on the macroeconomic scenarios developed in the context of DSAs for a basic medium-term framework. While the design and implementation of a medium-term framework is a complex process that needs to be approached gradually, many SSA countries could make greater efforts in this area.

Fiscal adjustment

Countries with few or expensive financing opportunities, where the risk of debt distress is high, and/or where unfavorable macroeconomic conditions constrain policy responses, will have to adjust. These countries would need to implement fiscal adjustment policies to preserve macroeconomic stability and debt sustainability. However, to the extent that donor support is stepped up, the need for fiscal adjustment would be less. Additional aid would reduce financing constraints and help smooth spending.

Countries that need to adjust will have to increase revenue or reprioritize spending. In many cases, such measures are linked to medium-term reform programs.

- ***To the extent possible, revenue-raising measures should focus on broadening tax bases and strengthening revenue administration.*** The low revenue ratio in many SSA countries often reflects narrow tax bases and weak administrative capacity, rather than low tax rates. In fact, in some countries high tax rates on mobile factors of production (such as skilled labor or capital) may be hindering growth. Rationalization of tax incentives (exemptions, tax holidays, and deductions) would broaden the tax base and mobilize additional revenue. In this connection, countries could review the scope for removing tax exemptions in the next budget. Countries dependent on commodity-related revenues should continue to try to diversify their revenue base to reduce fiscal risk. In considering temporary tax options, members of regional currency areas (WAEMU and CEMAC) should ensure that their tax policies are

consistent with regional guidelines. Ongoing tax policy and administration reforms should be speeded up, fully recognizing that they take time to implement. Improved organizational structures of revenue administration, strengthened audit capacity, and fair tax enforcement would contribute to expanding the tax base.

- ***There could be circumstances where countries have no choice but to temporarily raise some tax rates in their short-term adjustment packages.*** This could be the case, particularly, in countries where fiscal adjustment becomes urgent as the impact of the crisis intensifies and options are limited.
- ***Expenditure rationalization and increasing spending efficiency can also create fiscal space.*** While spending reductions are often politically difficult, there may be scope to cut unproductive spending, particularly of the recurrent type (see Gupta and others, 2004). Examples include generalized subsidies, transfers to loss-making public enterprises (which would require adjustment measures in those enterprises), and excessively large government employment. Many countries increased subsidies in response to the surge in international fuel and food prices in recent years—with the fall in these prices, the fiscal cost of subsidies should decline. Fiscal space can also be created by enhancing the efficiency of spending programs. In this context, strengthening public financial management systems could contribute to improving efficiency—as well as ensuring that resources reach intended users. Across-the-board spending cuts should be avoided as they are inefficient, may lead to arrears, and are often not sustainable.

Social safety nets

In all cases, priority should be given to expanding targeted social safety net programs as needed. Protecting or increasing social programs helps cushion the impact of the crisis on the poor and buttresses domestic demand, given the high propensity of the poor to consume. Such support should be generally channeled by scaling up existing programs because the capacity of SSA countries to set up new programs is limited in the short run. Some countries have implemented public works programs for providing income support to the poor while building labor-intensive infrastructure projects. Setting the wage rate relatively low ensures that such schemes are self-targeted to the poor. Channeling additional resources to targeted food distribution or school meal programs can be an effective method of addressing potential losses in human capital during the crisis.

- More than a dozen SSA countries are either piloting or considering cash transfer programs. For example, the use of community institutions for implementing cash transfers is being piloted in Nigeria, Sierra Leone, Tanzania, and Uganda.
- Some SSA countries have begun to implement conditional cash transfer programs that link cash transfers or subsidies to the receipt of health care and/or education to

protect human capital. These include Burkina Faso, Kenya, and Nigeria. The coverage of these programs is very limited.

IMF technical support

SSA countries are likely to need enhanced technical support in fiscal management as they tackle the fiscal impact of the crisis. In addition to providing financing and policy advice, the Fiscal Affairs Department of the IMF, together with the IMF's Regional Technical Assistance Centers, is delivering technical assistance to many SSA countries in areas such as revenue mobilization, enhancing public financial management systems, improving expenditure efficiency, and, in some cases, integrating cost-effective safety nets into budgetary policies.

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