

Medium-term budget policy in times crisis

Policy options for African countries

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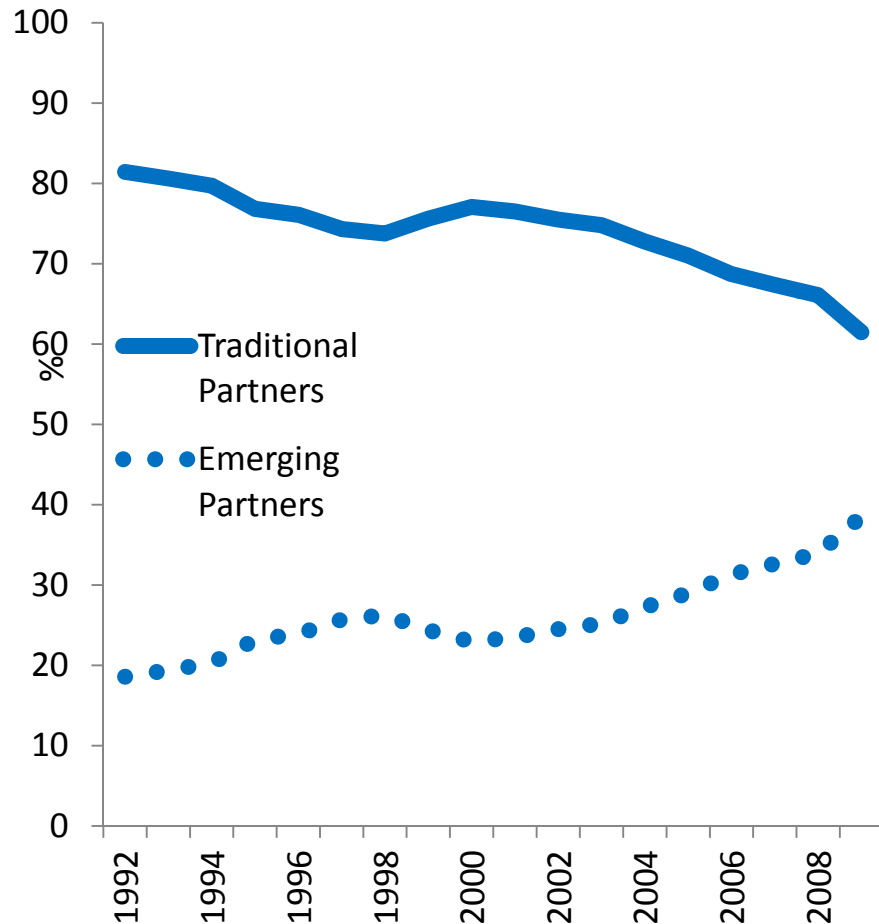
AFRICAN FISCAL FORUM
“FISCAL POLICY CHALLENGES IN
AFRICA”

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Outline

- 1 Macroeconomic risks for the African continent
- 2 The impact on budget outlook of African countries
- 3 How to improve risk management in the budget?
- 4 How can countries be supported?

1. Macroeconomic Risks on the Continent (1/3)



Relatively weak **financial linkages**
BUT

Trade linkages are relatively important (although less so than amongst OECD countries).

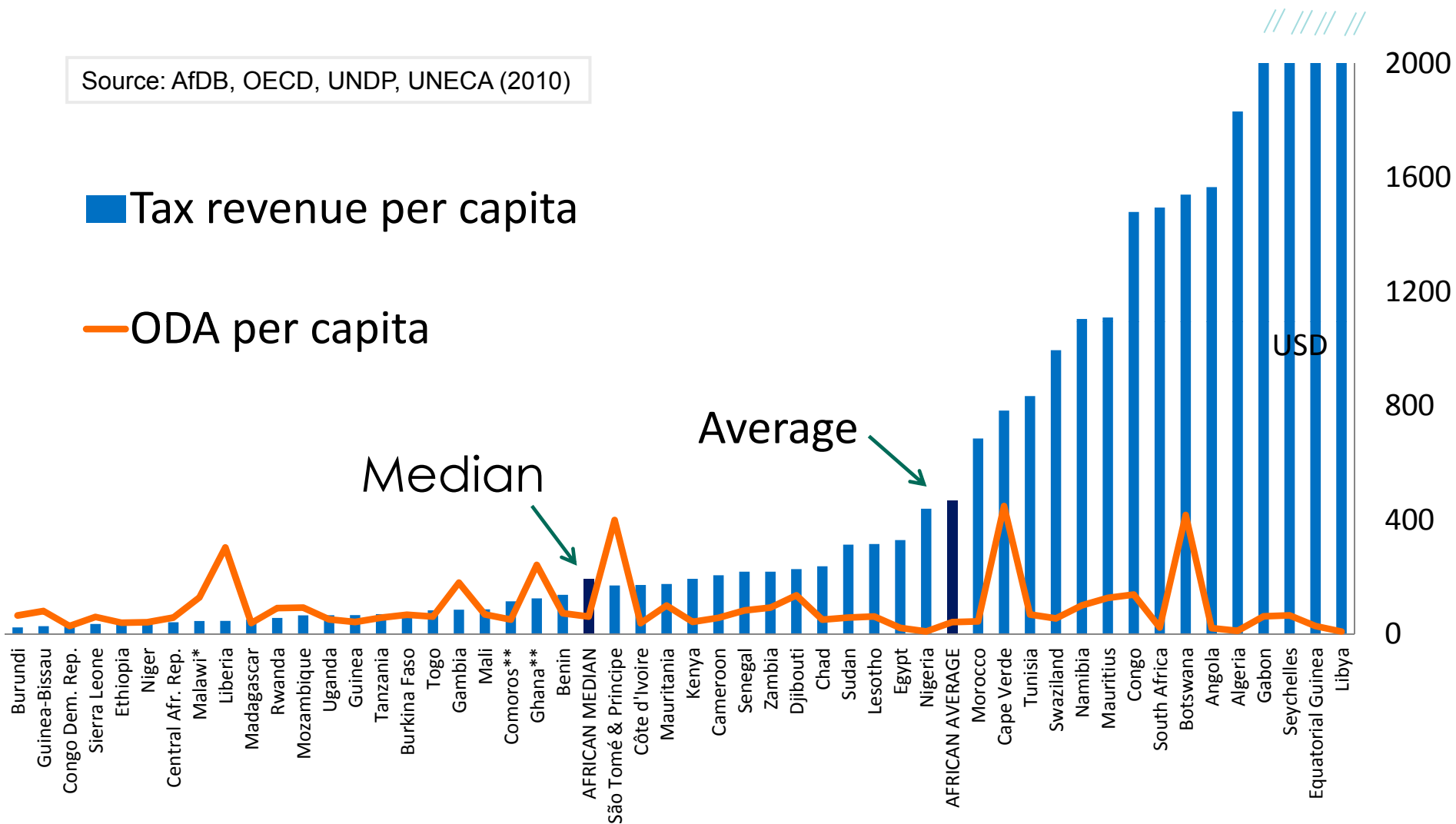
Things to keep in mind:

- The rise in importance for African countries of Emerging economies as trading partners...
- The impact of the global business cycle depends on the type of commodities that the country exports...

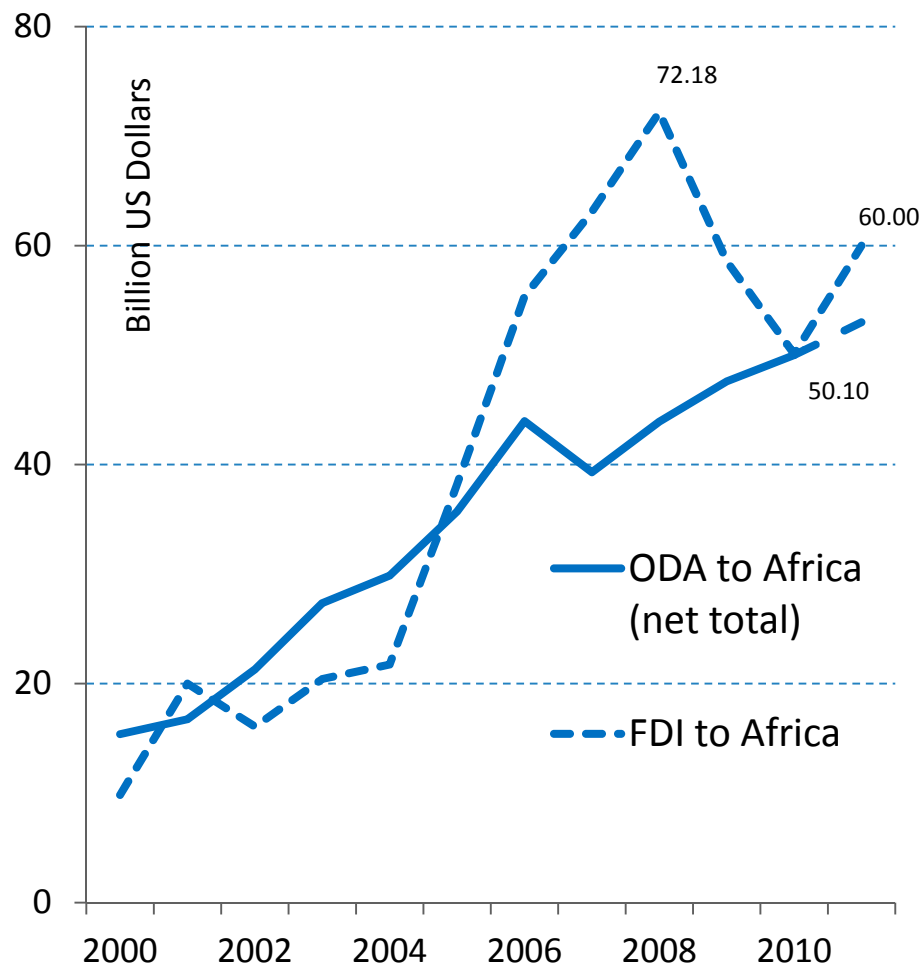
Source: AfDB, OECD, UNDP, UNECA (2011)

1. Macroeconomic Risks on the Continent (2/3)

Source: AfDB, OECD, UNDP, UNECA (2010)



1. Macroeconomic Risks on the Continent (3/3)



- ODA: The most optimistic scenario one can possibly contemplate is that ODA flows will remain constant in nominal terms going forward...

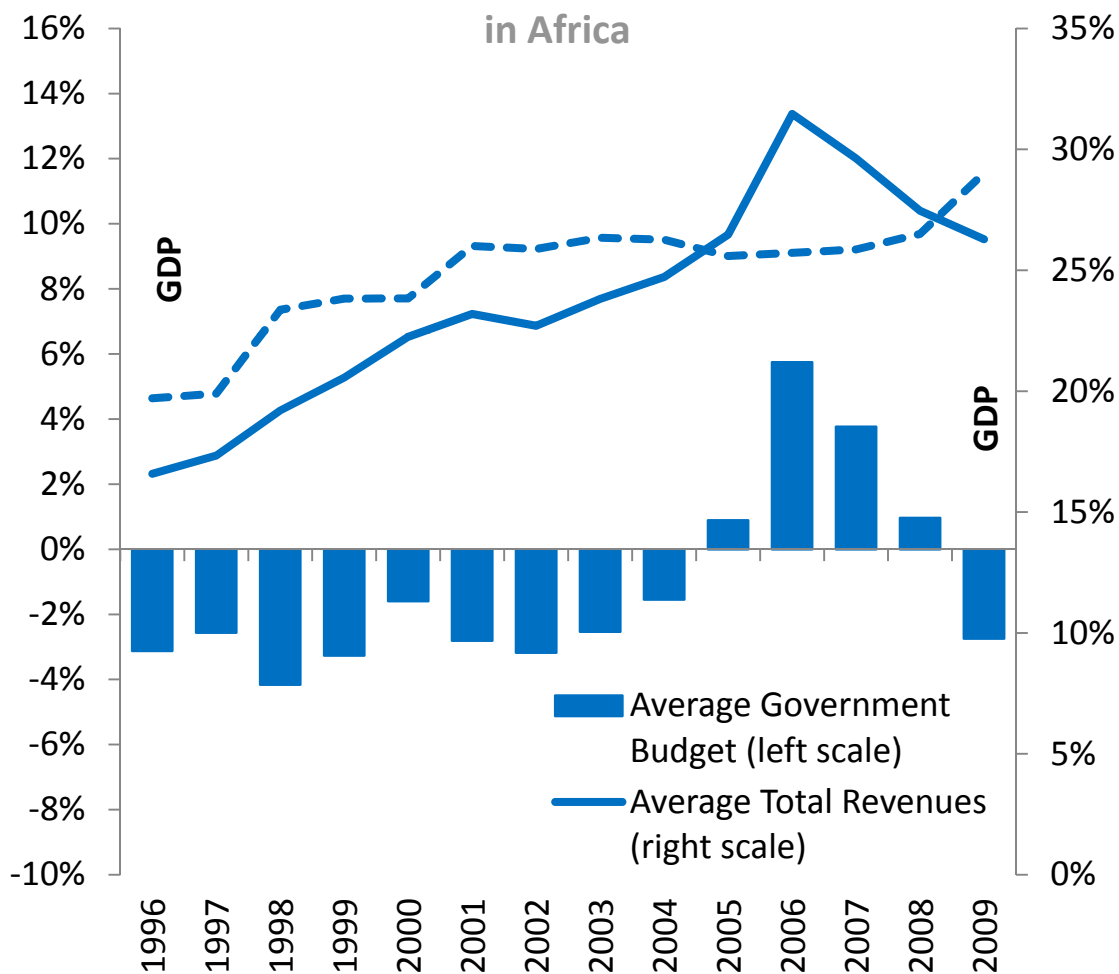
- $\frac{3}{4}$ of Africa-bound FDI still originates from OECD countries.

- Remittances took a severe hit during the crisis and will be impacted by a deepening of the crisis.

Source: AfDB, OECD, UNDP, UNECA (2011)

2. Impact on Budget Outlook of African Countries (1/2)

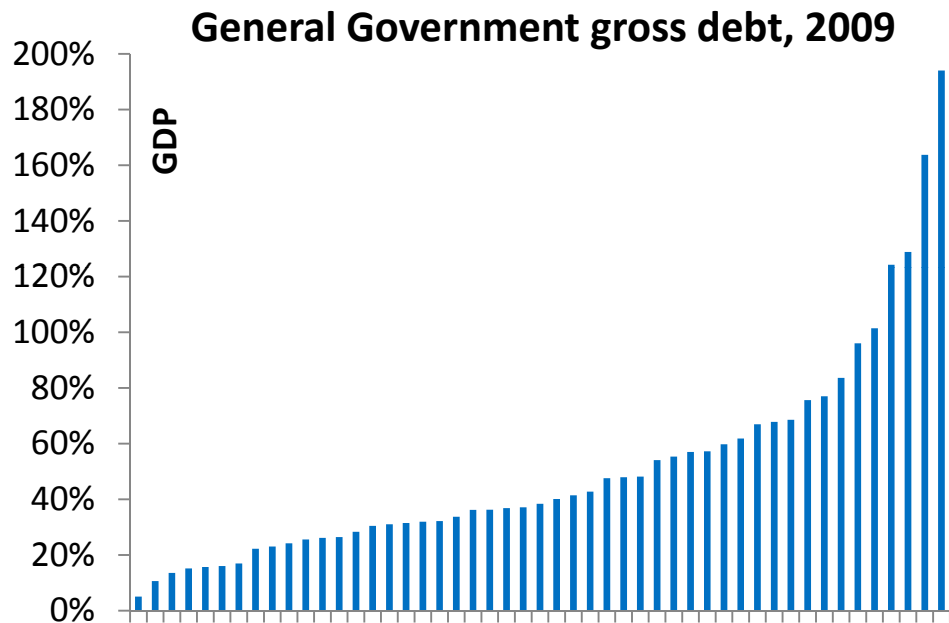
Average Government Budget (Incl. Grants)



Conduct of fiscal generally sound but can be strengthened along important dimensions:

- Improving fiscal management over the cycle and avoid
 - Overheating during the boom
 - Subsequent worsening in the headline fiscal position

2. Impact on Budget Outlook of African Countries (2/2)



- Medium term sustainability of public finances
- Careful not to undermine hard-won sustainability of fiscal policy

In fact:

- Countries where the fiscal position was sound and inflation under control were better able to cushion the shocks.
- Discretionary fiscal policy in countries running larger deficits tends to be pro-cyclical.

3. Improving Risk Management in the Budget

- Binding **fiscal rules** can induce a more **counter-cyclical fiscal policy**:
 - Budget balance rules, debt rules, expenditure rules, structural balance rules...
 - Budget balance targets are widespread, fewer countries also implement spending rules.
 - Spending rules are less likely to give rise to significant pro-cyclicality. Even so, they also have drawbacks in constraining policy reactions to sudden cyclical developments.
- Policy-making should be informed by a **more accurate assessment of cyclical developments**
- “**Fiscal councils**” or other independent entities can facilitate public acceptance of the need for fiscal prudence.
- Existing **multi-year expenditure projections** could be given greater status:
 - make the expenditure envelope for the out-years **legally binding**;
 - legal amendments would be required to revise them;
 - expose such amendments to **greater** public and parliamentary **scrutiny**.

3. Improving Risk Management in the Budget

The structural budget balance

- is in principle a preferable target over the headline budget balance as it permits the full working of the automatic stabilisers, which should attenuate the cycle.
- is challenging to use in practice
- the techniques related to the estimates and forecasting of the structural balance need to be sufficiently robust for such rules to become effective.

An expenditure rule

- may be useful in restraining fiscal expansion in upturns
- are particularly important in supporting fiscal consolidation
- are relatively transparent and easy to implement and monitor
- are not usually set as permanent, but are renewed through the political process or on a rolling basis (for the next three years, for example).
- should not be viewed as externally imposed targets
- there is no “right” level of expenditure unambiguously associated with better economic outcomes.
- based on social consensus and reflect the preferences of the society.

3. Improving Risk Management in the Budget

For fiscal rules to be effective, they have to be:

- transparent and easy to monitor
- supported by institutions that enhance transparency and accountability
- sufficiently flexible to respond to various shocks
- tailored to the needs of the economy
- backed by political will to maintain prudent public finances

Suspending fiscal rules in the wake of extreme economic shocks begs the question of how to re-establish credibility:

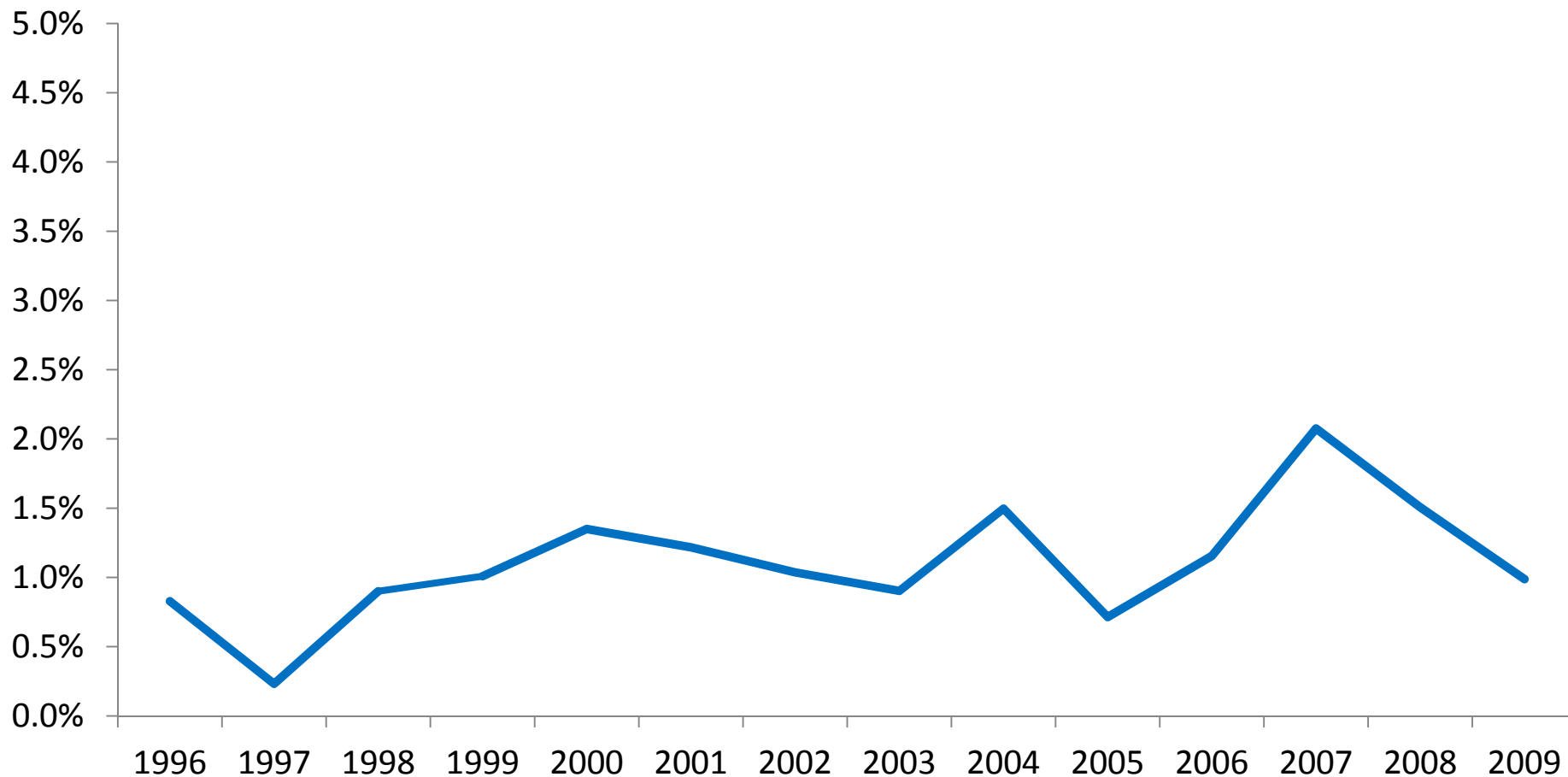
- Establishing a strong track record helps to anchor expectations that fiscal policy will return to a sustainable paths.
- Defining the conditions under which the fiscal rule can be suspended temporarily and setting out the path for returning to the rule may also underpin credibility

4. Supporting African countries with budget risks...

- Stick to commitments and more than ever try to make aid more predictable...
- Stand by African countries as much as possible, as **investment and trading partners**. In particular the temptation of protectionism and beggar-thy-neighbour policies should be resisted.
- Finally, a special note of caution applies to **North African countries...**
- Support initiatives that help African countries improve the capacity to better manage their public finances in general:
 - Africa Centre for public debt management
 - African Tax Administration Forum
 - CABRI (Collaborative Africa Budget Reform Initiative)

4. Supporting African countries with budget risks...

Share of ODA for Public Finance Management in Africa



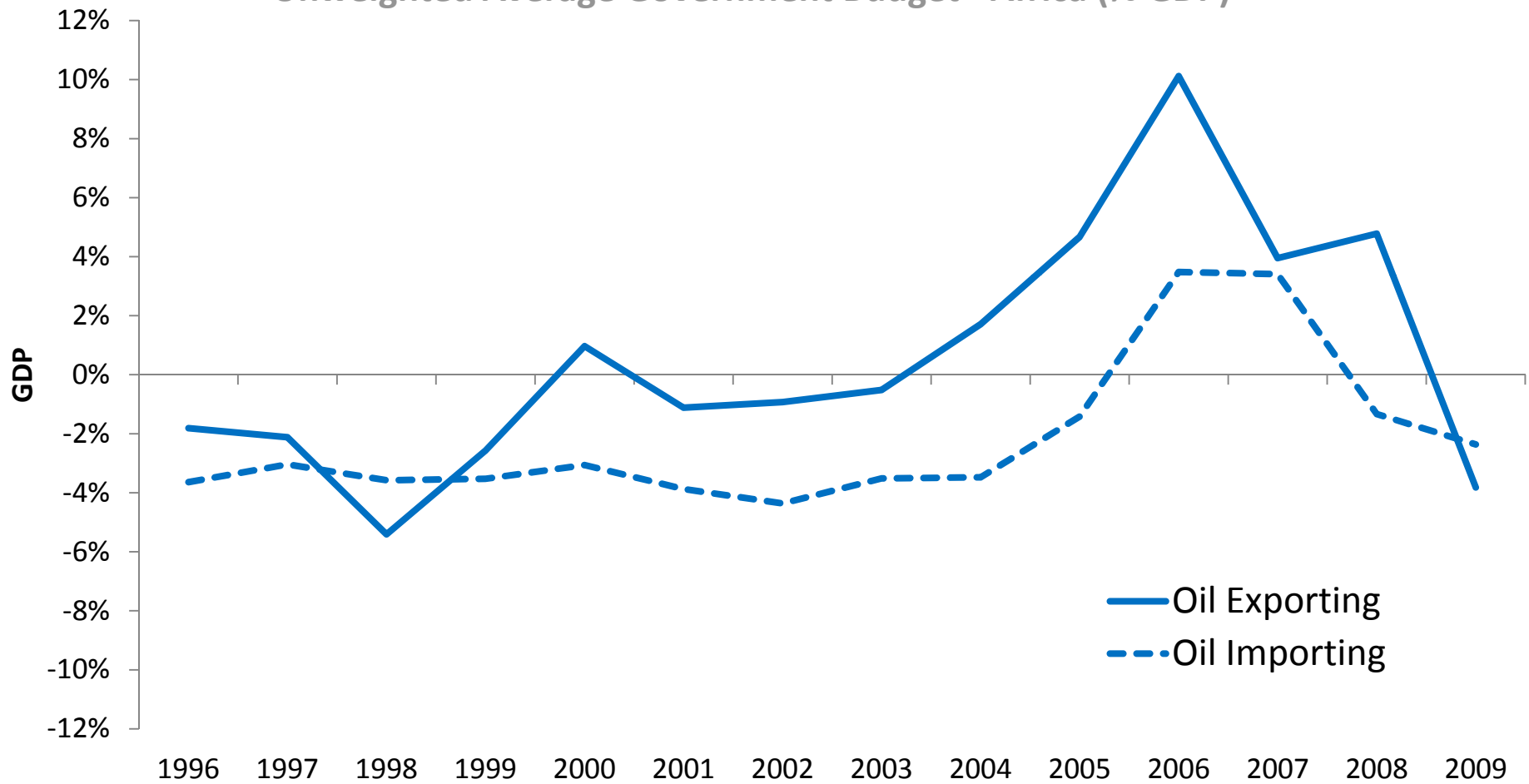
Thank you



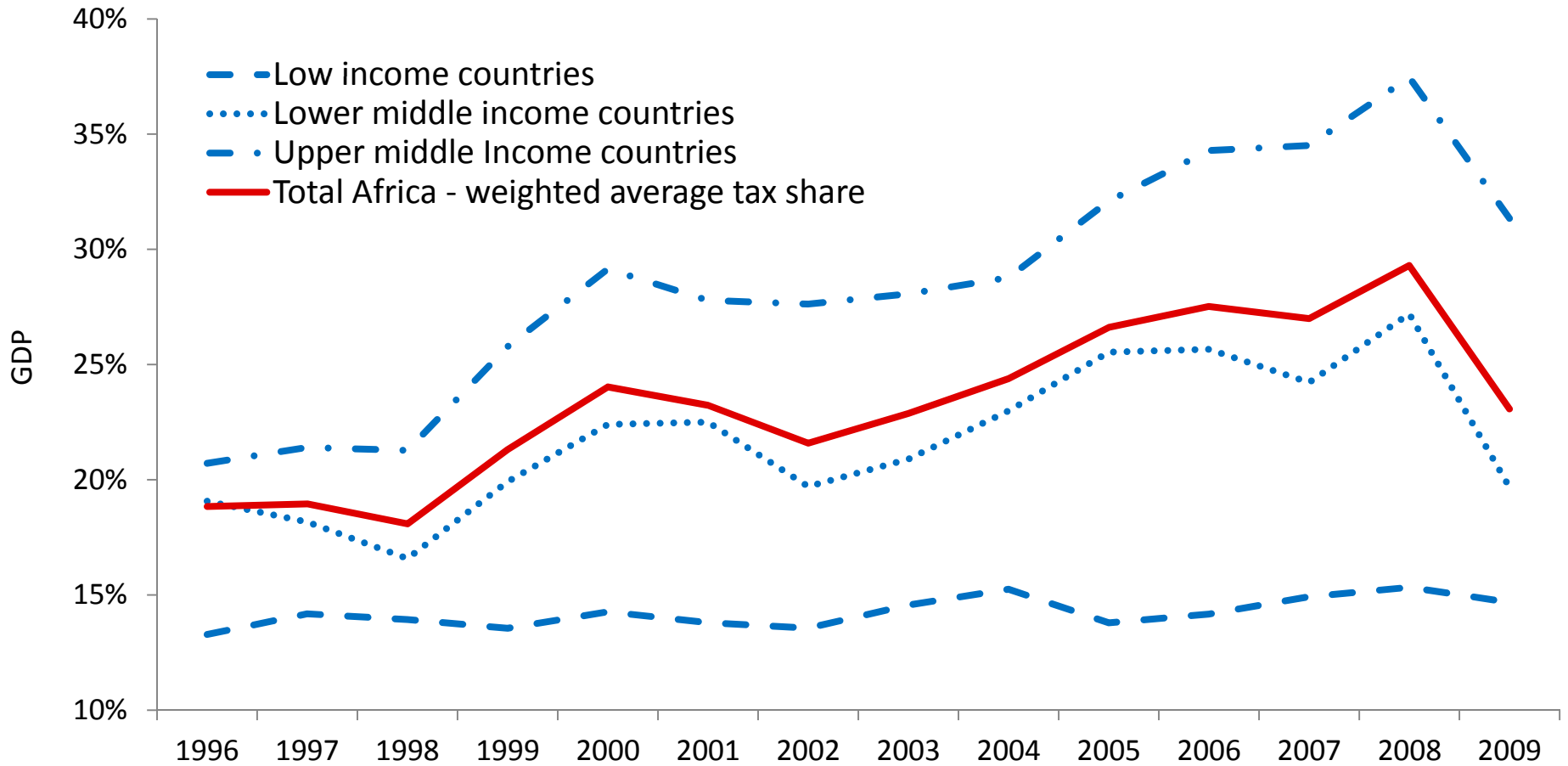
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Oil exporters showing more volatility ...

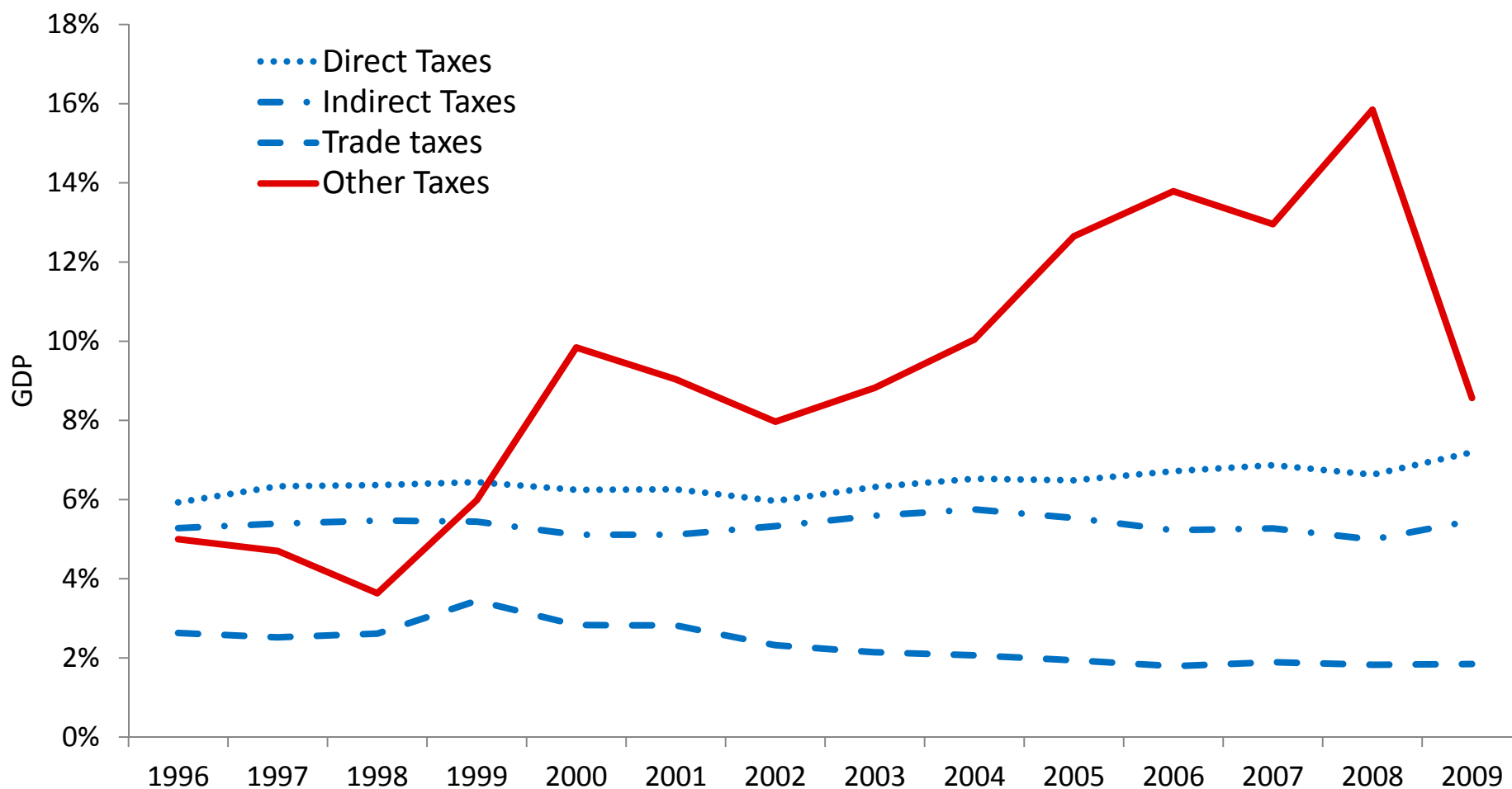
Unweighted Average Government Budget - Africa (% GDP)



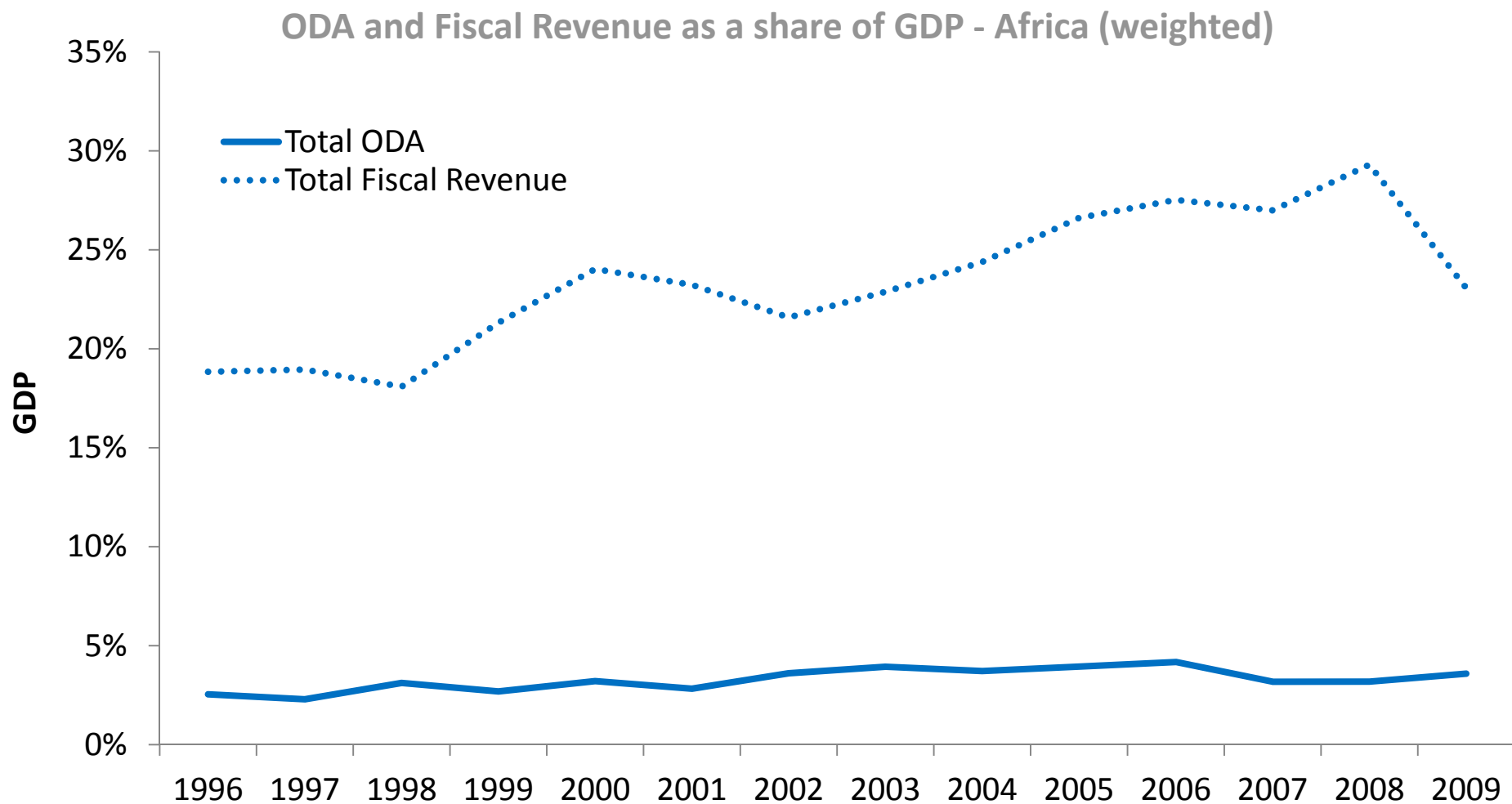
Average African Tax Share per income grouping



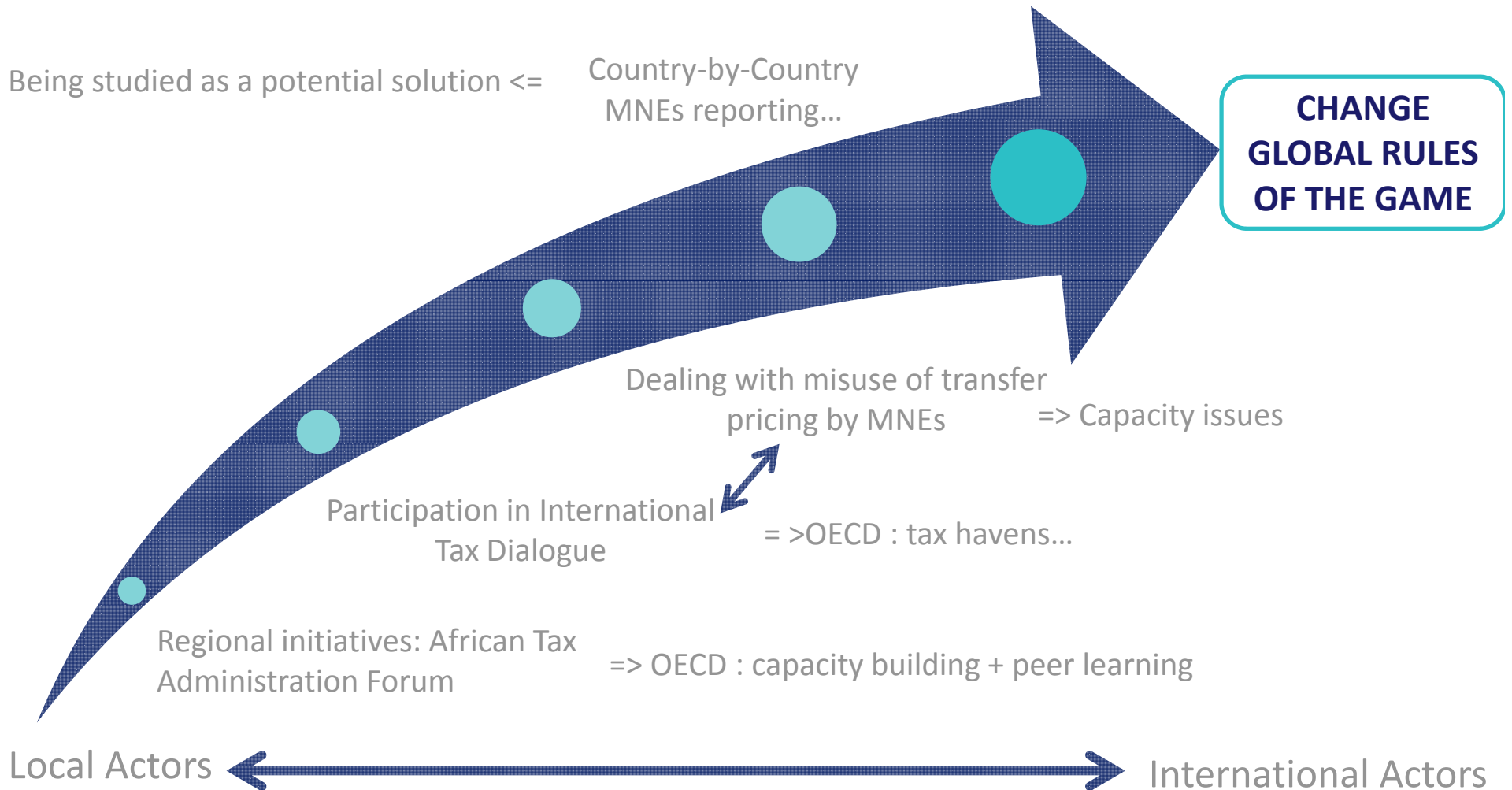
Tax shares of different tax categories – Africa



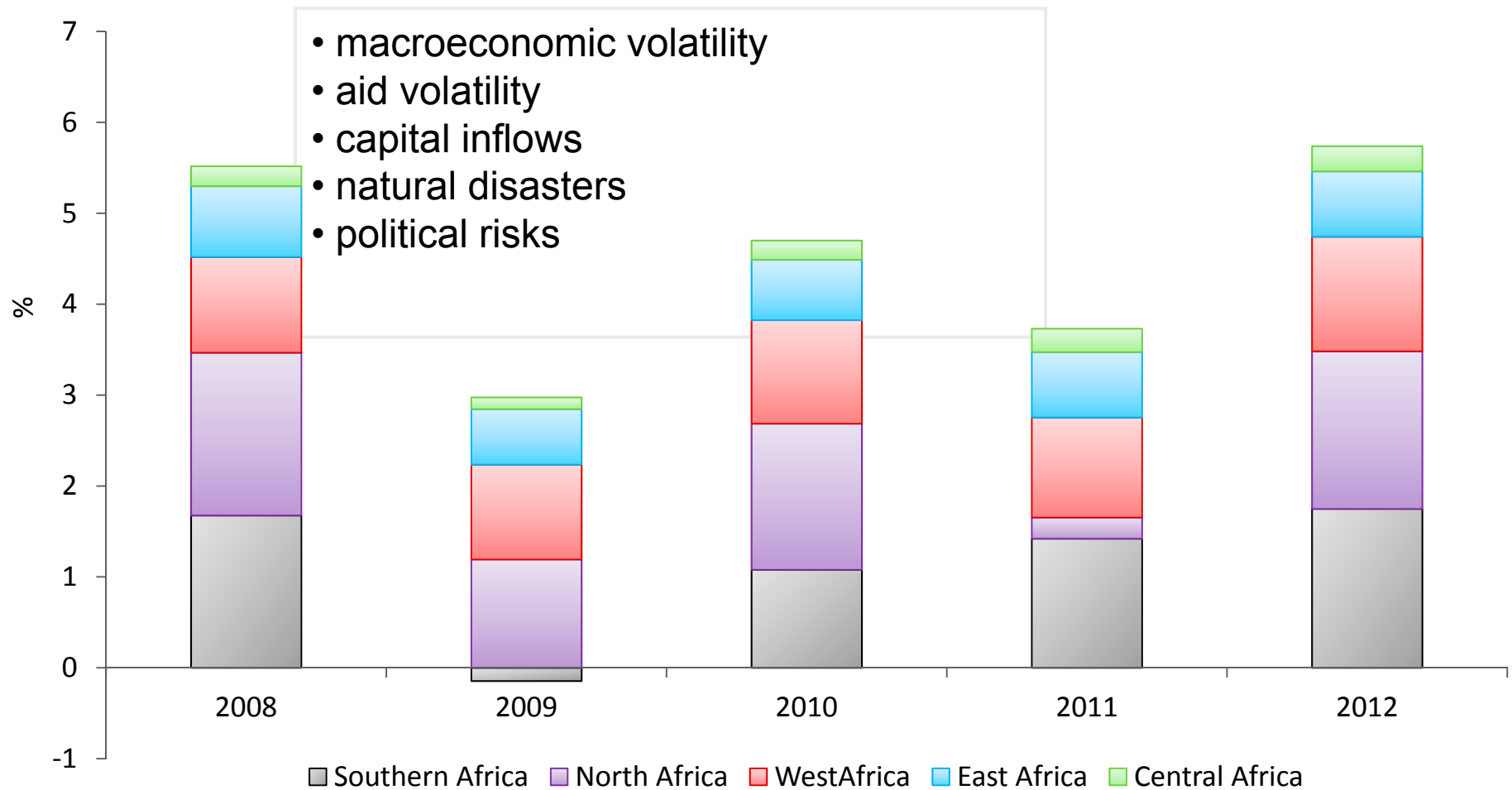
ODA plays a marginal role in the aggregate...



Africa's voice must be heard on the international scene




Economic Outlook and Political Risks





1. Drivers of growth

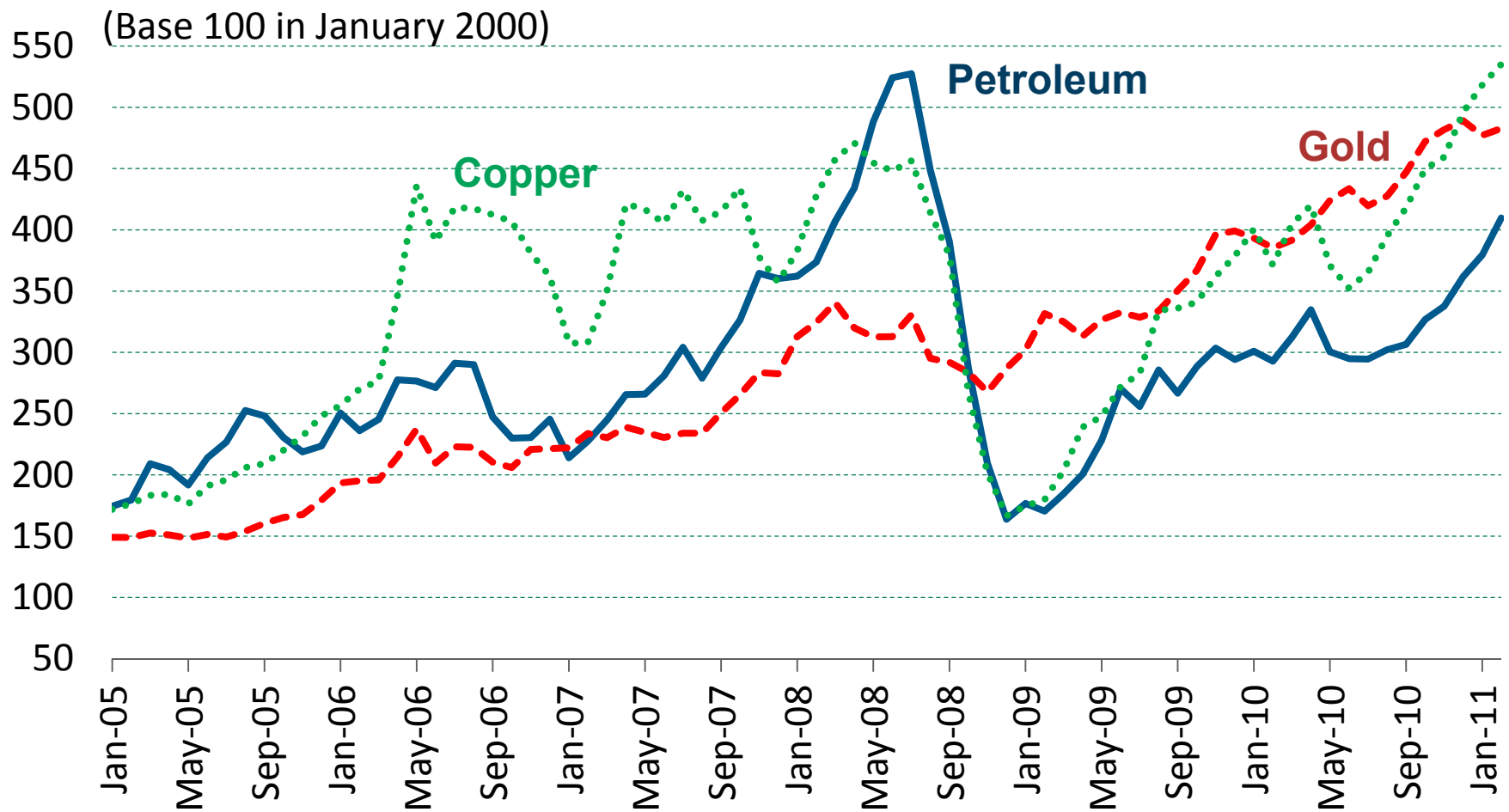
Internal

- Domestic consumer demand 
- Good macroeconomic policies and management

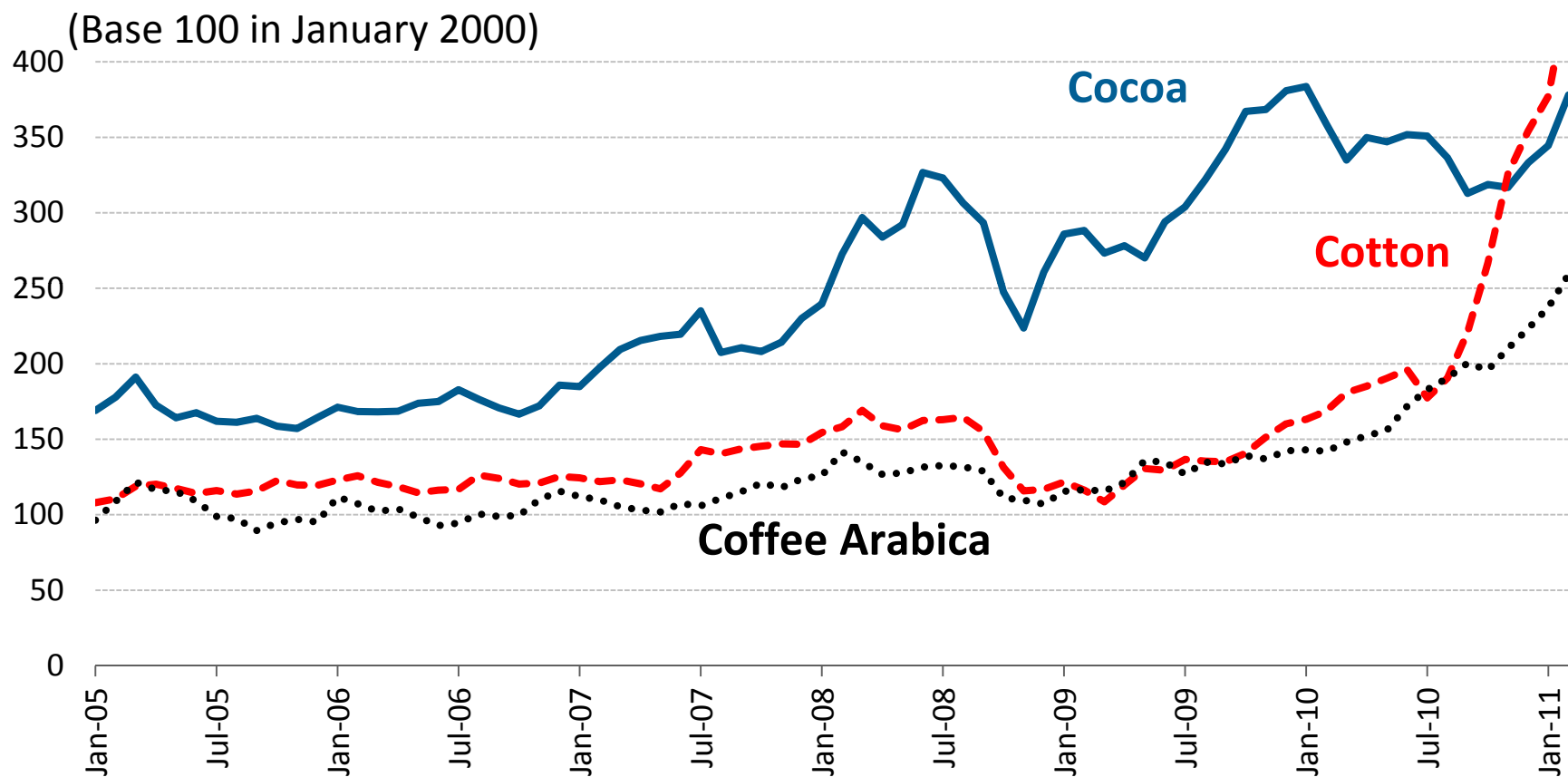
External

- Commodity prices 
- Prices of agricultural export 

Drivers of growth: commodity prices



... and export prices of agricultural products

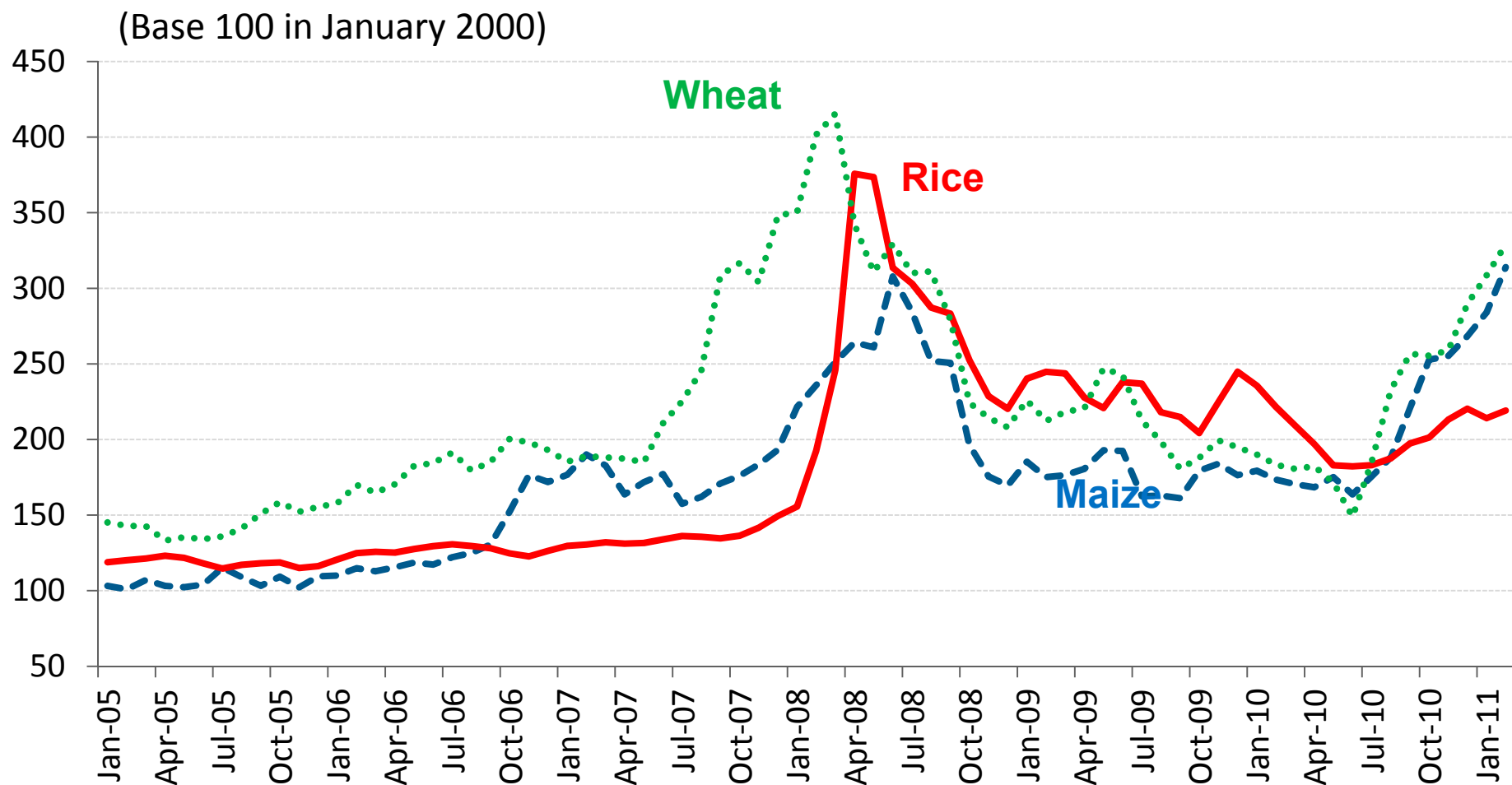


Challenges: The North African Revolutions

- ▶ Strong demand for more accountability and good political governance
- ▶ Need for more inclusive growth
- ▶ The youth bulge deserves urgent attention

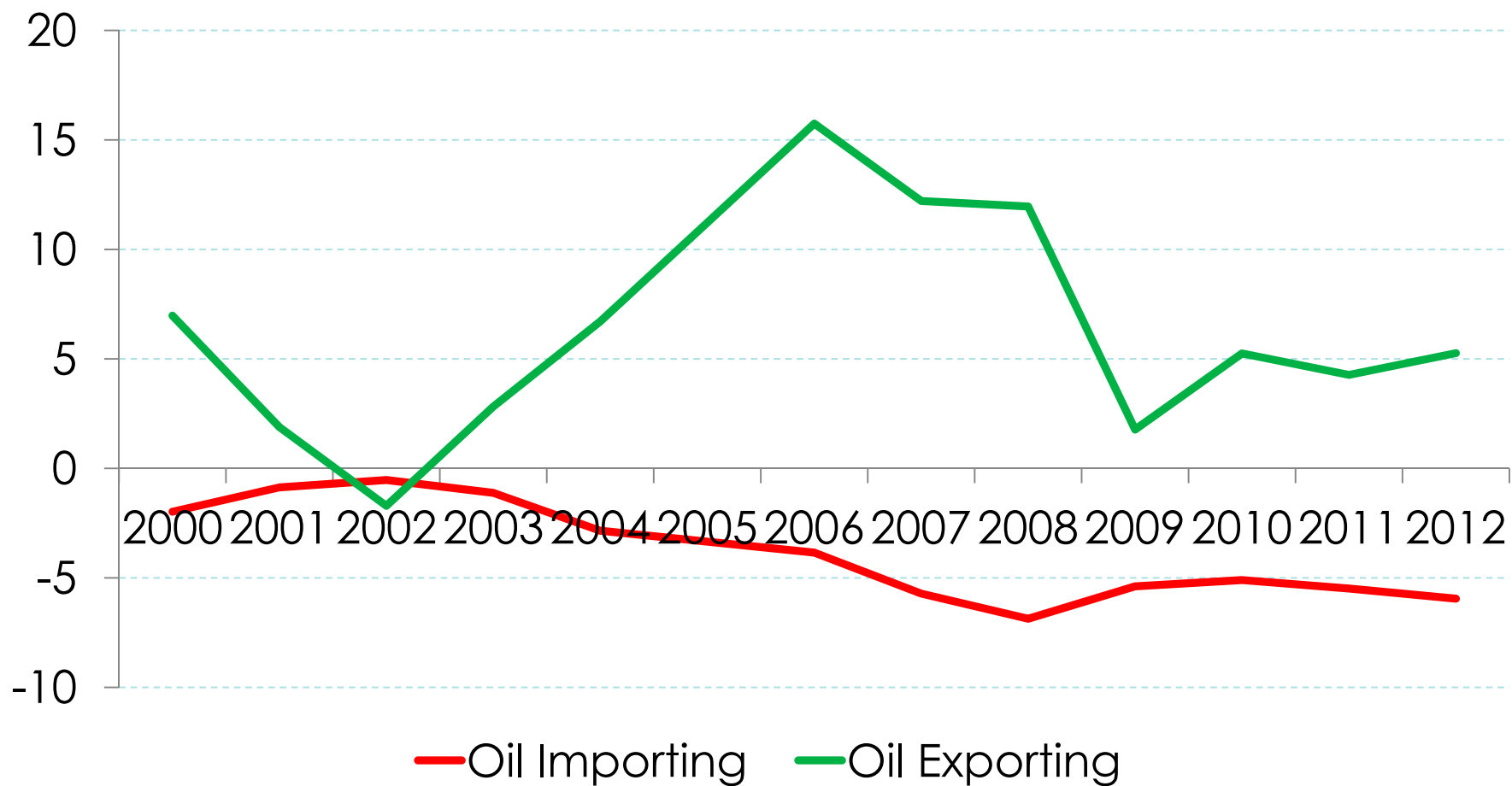
Africa is growing but there are risks

Challenges: World food prices



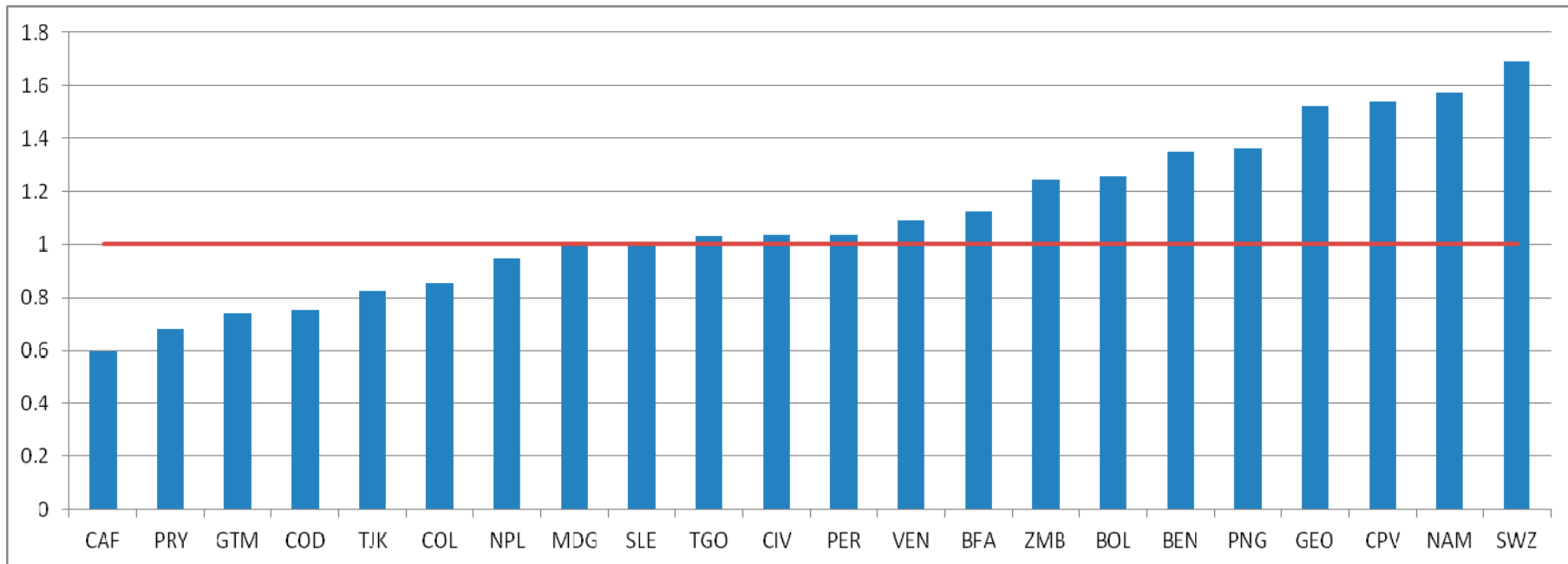
Challenges: The oil divide 1

Current Account Balance (% of GDP)



Calculating tax effort

Tax effort in countries who need extra resources to achieve MDG1



Tax effort = Actual tax ratio / Predicted tax ratio
where

Predicted tax = f (agriculture share, openness,
GNI/cap)

3. How to improve risk management in the budget?

4 cardinal rules: fiscal risks should be

Identified and Disclosed

Mitigated in a Cost-Effective Manner

Managed with a Clear Legal and Administrative Framework

Systematically Incorporated into Fiscal Analysis and the Budget Process