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Revamping the West African Economic and Monetary Union (WAEMU) Fiscal Framework

Can Sever and Athene Laws

SIP/2023/028

***IMF Selected Issues Papers* are prepared by IMF staff as background documentation for periodic consultations with member countries.** It is based on the information available at the time it was completed on January 19, 2023. This paper is also published separately as IMF Country Report No 23/103.

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Revamping the West African Economic and Monetary Union (WAEMU) Fiscal Framework
Prepared by Can Sever and Athene Laws[*]

Authorized for distribution by Luca Antonio Ricci
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ABSTRACT: This paper aims to provide a broad perspective on the WAEMU fiscal framework. Based on backward looking exercises and forward looking scenarios, it shows that (i) repeated fiscal slippages and historically large stock flow adjustments contributed to the surge in the WAEMU public debt, and (ii) stock flow adjustments can have significant effects on the WAEMU debt dynamics going forward. This paper also discusses that it is essential and urgent to reintroduce the fiscal rules and the Convergence Pact and to enhance the rules. Revamping the fiscal rules should focus on introducing a correction mechanism (which could contain surges in debt in the future) and an escape clause (which would enhance fiscal discipline and predictability), as well as capturing the extensive extra-budgetary and below-the-line operations and strengthening the enforcement mechanism. Any consideration to changing the fiscal deficit target should also encompass addressing extra-budgetary and below-the-line transactions (for example by changing the definition of the deficit). It is not appropriate to increase the debt ceiling.

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Contents

I. Overview 4
II. Debt Dynamics and Stock Flow Adjustments in WAEMU Countries 6
III. Supporting Arrangements 14
IV. Conclusions 17

FIGURES

1. Debt Dynamics 7
2. Stock Flow Adjustments Over Time and 2013-21 Average 8
3. Debt Dynamics and Stock Flow Adjustments Over Time 9
4. Debt, Deficit and SFA 9
5. Debt Dynamics Scenarios 11
6. The Impact of Stock Flow Adjustments Over Time in Member States 12

TABLES

1. Estimated SFA, 2013–21 8
2. Scenario Assumptions 10
3. Countries For Which Debt Does Not Stabilize Under Each Case 12
4. Coverage of Public Debt and Fiscal Deficit 15

ANNEX

I. Reasons for Discrepancies Between Change in Debt and Fiscal Deficit 19

References 21

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I. Overview

The WAEMU's economy was relatively resilient to the Covid pandemic shock, and the growth rebound that started in Q3-2020 has continued in 2022. This strong economic performance was due to the favorable macroeconomic performance achieved prior to the Covid shock, but also to the swift and decisive policy actions by national and regional authorities in response to the pandemic.

However, those policy responses came at a cost on the fiscal front. First, the suspension of the Convergence Pact and the set of fiscal rules in April 2020 led to the loss of a fiscal anchor.[1] Second, debt surged, in part because of the large fiscal deficits, but also due to particularly large fiscal and quasi-fiscal transactions extra-budgetary and below-the-line (so called stock flow adjustments, SFA).

While supporting the economy by avoiding an excessive or premature tightening of public finances is important, implications on debt and the associated risks should be taken into consideration. Although debt may be useful for WAEMU to finance development, social, and security needs (see, for example, Dessus et al (2016) and Dieterich et al (2016)), higher levels of debt bring several risks. First, there are risks related to financing constraints. In particular, due to a shallow regional market, excessive domestic financing to the budget can possibly crowd out bank credit to the private sector, increase financing costs with a possible drag on growth, and pose risks to financial stability by deepening the sovereign-bank nexus. Second, there are risks to fiscal sustainability, as high and rising debt levels—in some WAEMU countries in particular—may be perceived as excessive by some investors and donors who could thereby be deterred from providing much needed funding. Third, excessive fiscal deficit may induce larger current account deficits, and risks of unsustainable debt may deter external financing. Both factors could lead to a weaker official reserves position with the risk of jeopardizing external viability and the sustainability of the peg eventually. The tightening of global financing conditions, which have recently led to a surge in spreads for all emerging and developing countries, exacerbates some of these pressures.

Therefore, going forward, more emphasis should be put on debt and the drivers of its continuous accumulation. In particular, the focus should be on the sustainability of the debt trajectory, as well as revamping the set of fiscal rules in a way that establishes a credible and effective fiscal anchor. At the same time, the authorities should pay particular attention to the ability to generate more revenues in order to increase the capacity to repay debt.

More precisely, in order to preserve debt sustainability and restore fiscal credibility going forward, there is a strong and urgent need for reintroducing a regional set of fiscal rules and a Convergence Pact. The previous fiscal target of 3 percent of GDP has shown its limits in terms of containing debt. A new fiscal anchor is essential to preserve debt sustainability, provide credibility to fiscal policy commitments, anchor expectations, avoid continuing deficit slippages by member countries, and hence contain the

[1] "In April 2020, the Heads of States of the eight WAEMU member countries) suspended their fiscal rules (including a deficit ceiling of 3 percent of GDP and a debt ceiling of 70 percent of GDP). No time horizon was specified to reinstate the rules and other convergence criteria. However, in June 2021, Heads of States of all WAEMU countries committed along with their peers from other ECOWAS countries to converging toward the fiscal deficit anchor over the years 2024–26" (Davoodi et al (2022)). It is also worth noting that the fiscal rules expired following its suspension.

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associated risks. Reintroducing a fiscal deficit rule also provides a window of opportunity to revamp it with the following major blocks.

The most important change to the previous fiscal rule would be introducing a debt correction mechanism to ensure the debt ceiling is not breached. Indeed, repeated deviations from the fiscal deficit target, as well as significant extra-budgetary and below-the-line operations, have generated an excessively rapid increase in debt. Going forward, these factors could even push debt beyond the ceiling. Exceeding the fiscal deficit target and/or debt ceilings should therefore be compensated through appropriate fiscal adjustments in the following years, except under exceptional circumstances.

Implicitly or explicitly, the fiscal rule needs to capture extra-budgetary and below-the-line operations that increase debt. As the analysis in this paper indicates, those operations were historically large, and are responsible for a large portion of the outstanding stock of debt. Going forward, if those extra-budgetary and below-the-line operations persist as in the past, the debt path would increase much more than implied by the 3 percent of GDP fiscal deficit target and would be on a non-sustainable path. Hence, even reintroducing the same fiscal rule as before, without addressing extra-budgetary and below-the-line operations, would not stabilize the debt, particularly in the case of new macroeconomic and financial shocks in future. There are feasibility challenges associated with including SFA in a deficit measure, hence an alternative option to address the impact of SFA on debt is to establish a well-designed and enforced correction mechanism, triggered when debt increases too fast (due to SFA or other reasons).

The new set of fiscal rules should be improved via various supporting arrangements. Those include an escape clause (to both ensure more predictability for the circumstances under which the target may need to be temporarily altered and avoid the uncertainty about when the rule will resume), and broader mechanisms for assessment, accountability, enforcement, and discipline, as well as possibly additional operational frameworks based on intermediate and complementary targets.

Consideration should also be given to the convergence period. Any delay of fiscal convergence from 2024 should be grounded on solid justifications, such as exceptional needs for expenditure in response to future shocks, additional security and social challenges, or excessive strain on the economy from a large and fast consolidation. Such delays should also be supported by reasonable expectations that the required additional financing would be available at terms in line with debt sustainability.

Preserving the debt ceiling. Some authorities would favor a debt ratio ceiling higher than 70 percent of GDP, but the heightened global volatility calls for buffers. Going forward, global market rates may no longer revert to the historically low levels (at least not soon), making it harder to control the interest payment burden in the budget allocation. Moreover, in light of recent high volatility and global shocks, it may be essential to ensure higher future fiscal space to cope with shocks. All this argues against an increase of the debt ceilings.

Finally, the fiscal strategy should also crucially encompass efforts towards increasing domestic revenues (in addition to considering debt sustainability, the fiscal framework, and extra-budgetary and below-the-line operations). Ultimately, what makes debt sustainable is the ability to service it, and domestic revenue mobilization is a crucial part of this process. While debt has helped WAEMU countries to finance development and social spending—and, more recently, cope with major global shocks—going forward this

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trend is not sustainable and domestic revenue mobilization should increasingly become the key tool to finance development and social needs, and countries should find the right balance between domestic revenues and debt for that purpose.

II. Debt Dynamics and Stock Flow Adjustments in WAEMU Countries

Debt Has Been Persistently Increasing

WAEMU public debt has been rising since 2010s. Various vintages of IMF WEO show that the WAEMU public debt as share of regional GDP has been persistently increasing over the years, despite a persistent forecast each year of a debt decline over the horizon (Figure 1). The top left chart illustrates that debt to GDP ratio has been increasing based on the most recent data from WEO Live (orange line, which encompasses all data updates as of August 2022), and also from the same-year vintages of WEO for each year (dotted blue line, which instead reflect debt ratios as of the vintage from that particular year). The top right chart shows that in each WEO vintage, debt was projected to decline, but as the blue line in the top left chart shows, it was increasing with respect to the previous year. 2 Moreover, WAEMU public debt has been rising more than the government revenues undermining the capacity to repay debt (Figure 1).

Stock Flow Adjustments Have Been a Key Driver

The countries' debt dynamics were affected not only by the fiscal deficit but also by stock flow adjustments (Figure 1). The level of debt in any given year is a function of the previous year's debt, fiscal deficit, a nominal growth effect, an exchange rate effect, a guarantees effect, and a residual (so called SFA). SFA represent any extra-budgetary and below-the-line operations not taken into account in standard above-the-line, because they do not reflect standard spending and revenue (see Annex I for a detailed explanation of possible reasons driving SFA). Although they are not captured in the normal budget envelope—they need to be financed and therefore feed into debt accumulation. Ideally, SFA should be around zero.

[2] Note that each dot on the top left chart corresponds to the beginning point of the corresponding WEO vintage on the top right chart. Regional debt to GDP ratio has been revised over the years, notably due to the national GDP rebasing exercises between 2015 and 2019. As a result of this rebasing process over the years, WEO Live (the most recent data as of August 2022, orange line in the top left chart) shows a lower debt ratio for the earlier years than the original (same-year) vintage (blue line in the top left chart). This implies that in Figure 1 the rise in debt over time (as shown by the orange line in the top left) is even higher than what is visible from the chart with the various vintages (top right chart).

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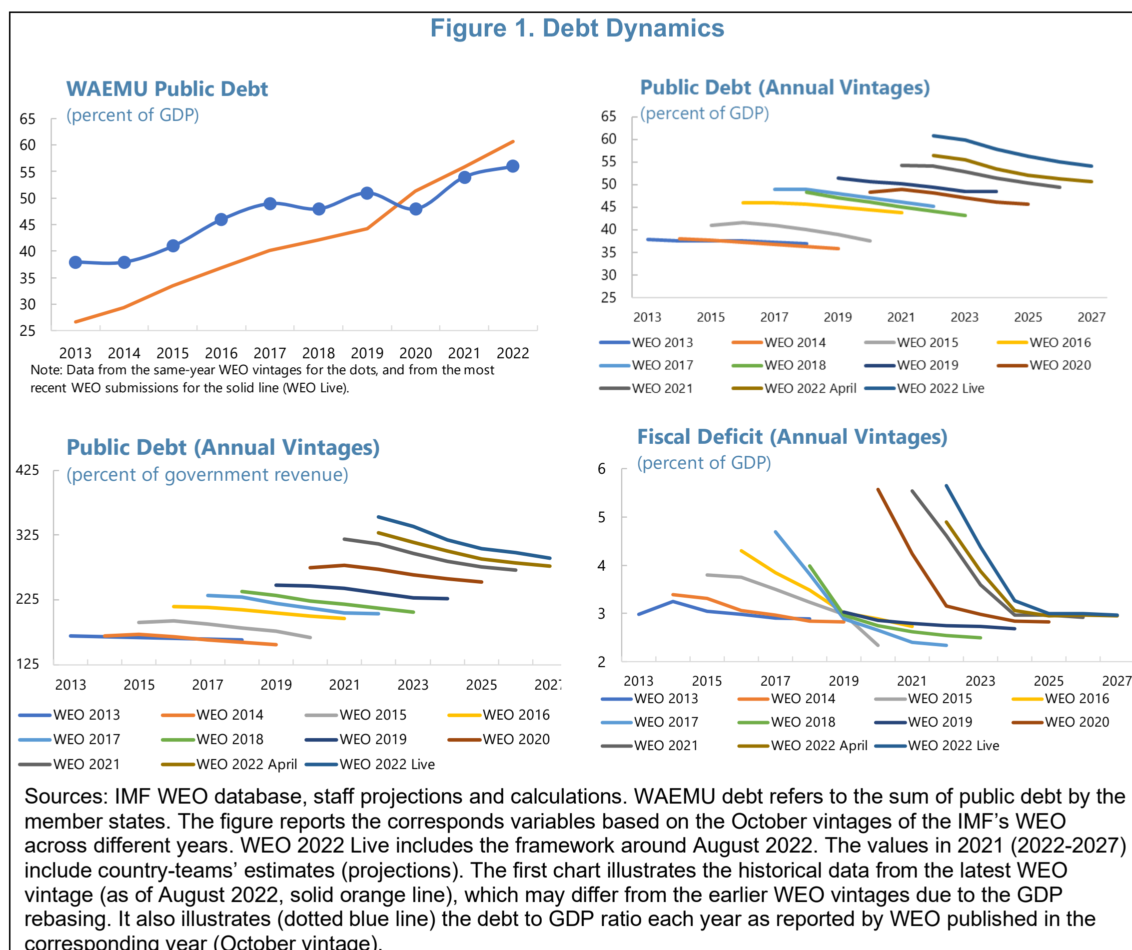
Figure 1. Debt Dynamics



Sources: IMF WEO database, staff projections and calculations. WAEMU debt refers to the sum of public debt by the member states. The figure reports the corresponds variables based on the October vintages of the IMF's WEO across different years. WEO 2022 Live includes the framework around August 2022. The values in 2021 (2022-2027) include country-teams' estimates (projections). The first chart illustrates the historical data from the latest WEO vintage (as of August 2022, solid orange line), which may differ from the earlier WEO vintages due to the GDP rebasing. It also illustrates (dotted blue line) the debt to GDP ratio each year as reported by WEO published in the corresponding year (October vintage).

SFA have been historically large in WAEMU, significantly contributing to the increasing trend in debt, on top of fiscal deficits. Table 1 and Figure 2 present annual SFA at the regional and country levels from 2013 to 2021. They indicate that SFA varied considerably across countries and years, from negative contributions to debt in a few cases, to large positive additions. SFA averaged 1.5 percent of regional GDP per annum from 2013 to 2021. If the pandemic period (2020-2021) is excluded, the historical SFA would still be large (on average, 1.1 percent of the regional GDP over the period of 2013-2019). There is substantial heterogeneity across countries, with two countries exhibiting an average SFA of 2 percent of GDP or above, and two countries with SFA below 1 percent of GDP.

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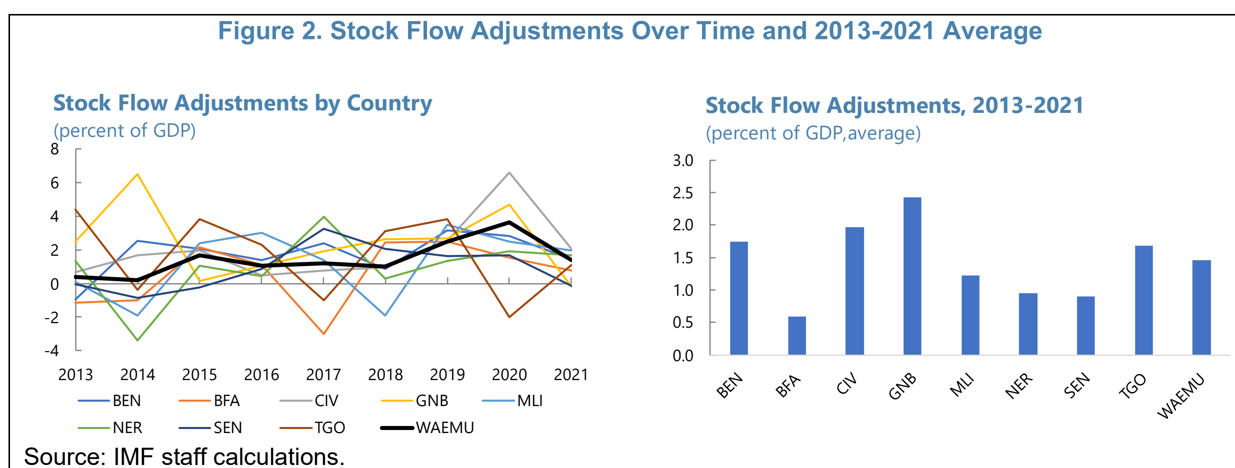
Table 1. WAEMU: Estimated SFA, 2013–2021

SFA, % of GDP	2013	2014	2015	2016	2017	2018	2019	2020	2021	Avg: 2013-2021
BEN	-1.0	2.5	2.0	1.4	2.4	0.9	3.2	2.8	1.4	1.7
BFA	-1.1	-1.0	2.2	1.1	-3.0	2.4	2.5	1.5	0.8	0.6
CIV	0.7	1.7	2.0	0.5	0.8	0.9	2.5	6.6	2.0	2.0
GNB	2.5	6.5	0.1	1.0	1.9	2.6	2.7	4.7	-0.2	2.4
MLI	0.1	-1.9	2.4	3.0	1.4	-1.9	3.5	2.5	2.0	1.2
NER	1.3	-3.4	1.1	0.4	4.0	0.3	1.3	1.9	1.7	1.0
SEN	-0.1	-0.9	-0.2	0.9	3.2	2.1	1.6	1.7	-0.2	0.9
TGO	4.4	-0.4	3.8	2.3	-1.0	3.1	3.8	-2.0	1.1	1.7
WAEMU	0.4	0.2	1.7	1.1	1.2	1.0	2.5	3.6	1.4	1.5

Sources: IMF staff calculations.

Figure 2. Stock Flow Adjustments Over Time and 2013-2021 Average



Source: IMF staff calculations.

Counterfactual Analysis: The Contribution of SFA to WAEMU Debt Dynamics

SFA has contributed to the existing debt in the amount of about 13 percentage points of regional GDP since 2013. An initial question to explore is the contribution of SFA to existing debt overtime. At region and country levels, Figure 3 displays the level of debt in 2013 (green bars) against the 2021 estimated debt level (light blue bars). A counterfactual scenario where historical SFA were zero during this period is also shown (dark blue bar). For all countries, in the absence of SFA, the 2021 debt would have been substantially lower than the actual estimated level. For WAEMU as a whole, debt is almost 13 percentage points of GDP higher than would have been without SFA, so that SFA account for about half of the increase in debt to GDP over that period (28 percent). Looking at a much narrower time window, i.e., 2019-2021 only, SFA contributed to regional debt in the amount of 5 percentage points of regional GDP (again almost half of the total increase in debt to GDP, about 12 percentage points, hence a similar share).

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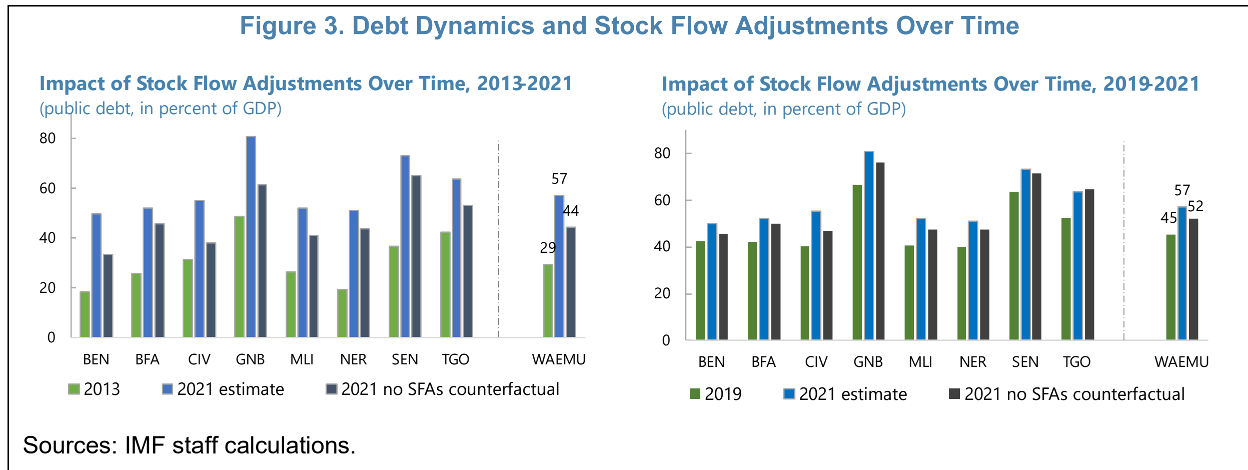
Figure 3. Debt Dynamics and Stock Flow Adjustments Over Time

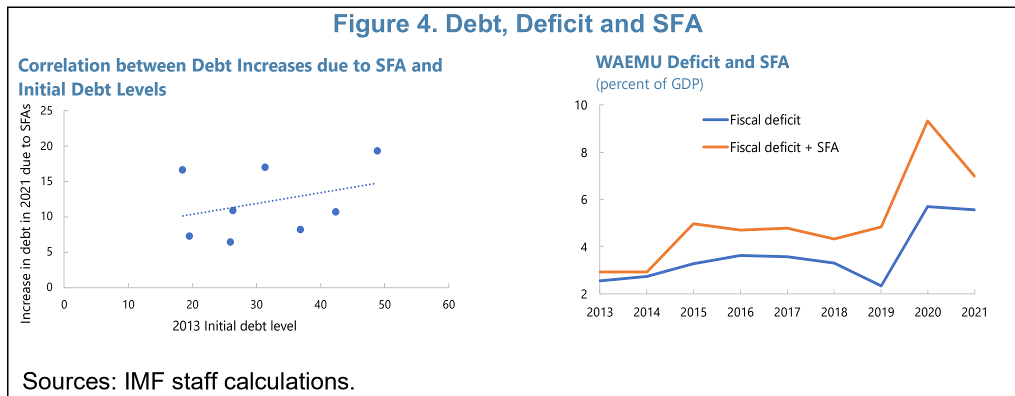


Sources: IMF staff calculations.

The Relation of SFA with Debt and Deficit

Countries with initially higher debt accumulated more SFA over time. There is a positive correlation (0.34) between the level of initial debt and the contribution of SFA to debt accumulation (over 2013-2021) at the country level. Put differently, countries with higher initial debt to GDP ratios accumulated more debt through SFA, on average, than those who began with lower debt to GDP ratios. The positive correlation may suggest that more highly indebted countries turn to transactions that create SFA under increased scrutiny with respect to their debt or deficit numbers, or they simply have less PFM capacity to contain SFA. Looking at the evolution of above-the-line operations (fiscal deficit) together with other debt-increasing factors (i.e., SFA) at regional level over time, it is clear that the fiscal deficit offers highly incomplete information in assessing debt accumulation in WAEMU over the years (Figure 4).

Figure 4. Debt, Deficit and SFA



Sources: IMF staff calculations.

Debt Dynamic Simulations: Alternative Assumptions About Fiscal Targets and Extent of SFA

We undertake scenarios to examine the implications of different fiscal deficit targets and SFA paths on future WAEMU debt dynamics. Table 2 represents four scenarios, based on: (i) two assumptions on SFA (future SFA being close to zero versus staying at the historical average, i.e. 1.5 percent of regional GDP per annum), and (ii) two possibilities for the fiscal deficit target (convergence by 2025 to 3 percent versus 4 percent deficit, both as above-the-line measurements). The scenarios with zero SFA going forward could be

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considered as scenarios in which the deficit target is no longer measured above-the-line, and it instead includes extra-budgetary and below-the-line operations, i.e. the deficit is measured as financing minus accumulation of assets.[3] One of the four scenarios correspond to the baseline scenario associated with the IMF country teams' forecasts, which envisage minimal levels of SFA starting from 2022, which may not be realized in practice given the persistence of SFA historically. The other three scenarios reflect those alternative SFA and/or deficit combinations.

Table 2. WAEMU: Scenario Assumptions

	Converge in 2025 to 3 percent deficit	***Converge in 2025 to 4 percent deficit***
Zero SFA	Baseline	Scenario 1
Historical SFA	Scenario 2	Scenario 3

Simulations show that bringing SFA under control is essential to ensure debt stabilization over medium term. Figure 5 illustrates the debt dynamics for the WAEMU region for the different scenarios, as explained above. When SFA are assumed to be zero and countries converge 3 percent deficit target by 2025, i.e. the baseline in Figure 5, debt gradually declines (the solid blue). If, instead, countries were to agree to a 4 percent deficit but still with zero SFA (Scenario 1) debt would be slightly higher in 2027 and broadly stable (dotted line). This scenario is equivalent to a deficit measure as financing minus accumulation of assets (or deficit above- and below-the-line and also accounting for extra-budgetary operations) aimed at partially accounting for SFA (to the tune of 1 percent of GDP instead of the historical 1.5 percent). Although this option seems to somewhat stabilize debt over medium term, debt would no longer decline, and hence buffers would not be restored, so that any adverse shock would continue to ratchet debt upwards. Next, Scenario 2 illustrates the debt dynamics with a 3 percent deficit target but allowing for historical SFA. This combination, which represents the *status-quo* (in the sense of the historical target and the historical SFA), would imply a non-stabilizing debt path over medium term, although the increase would be mild (dashed green line). Strikingly, a hypothetical deficit level of 4 percent of GDP combined with SFA persisting as in the past would lead to a quickly explosive debt pattern over medium term (Scenario 3, dotted gray line). It is worth noting that the simulations as represented above do not account for additional negative shocks that could continue to derail the debt ratio upwards. Also, when dealing with debt stabilization forecasts it is important to continue checking the impact of possible medium-term changes to growth and interest rate paths for each country.

The only option to stabilize debt and recover buffers is to stick to the 3 percent fiscal deficit target while addressing the SFA. The simulations indicate that the only scenario consistent with both debt stability and the recovery of some fiscal buffers to cope with future shocks is the baseline scenario, with a deficit target of 3 percent of GDP and elimination of the SFA. This corresponds to measuring the deficit to include both above- and below-the-line as well as extra-budgetary operations (i.e., conceptually equivalent to financing minus accumulation of assets), although including SFA in a deficit measure directly is not necessarily desirable from a feasibility point of view. Moving the deficit target to 4 percent and eliminating the historical SFA would barely stabilize the debt, without the ability to recover buffers. Therefore, future shocks would likely increase debt, and reduce the fiscal space, thereby exposing the member states to external vulnerability. In the other two scenarios, where it is not possible to reduce SFA from their historical SFA, debt would be on an

[3] To the extent they are known, other drivers of SFAs (as summarized in Annex I) should also be accounted for.

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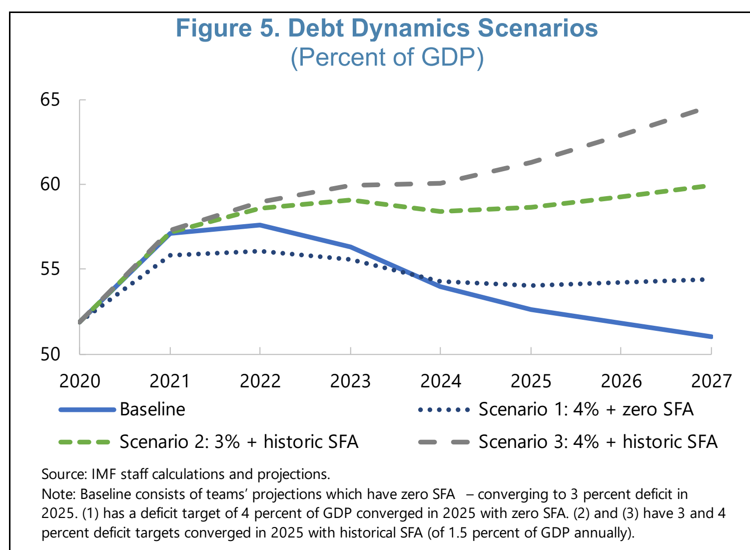
increasing path. Hence, the deficit target is important, but the ability to control SFA and contain extra-budgetary and below-the-line spending is crucial for debt dynamics, under any reasonable parametrization of the fiscal rule.



Source: IMF staff calculations and projections.
Note: Baseline consists of teams' projections which have zero SFA – converging to 3 percent deficit in 2025. (1) has a deficit target of 4 percent of GDP converged in 2025 with zero SFA. (2) and (3) have 3 and 4 percent deficit targets converged in 2025 with historical SFA (of 1.5 percent of GDP annually).

The implications of SFA for country-specific debt dynamics differ significantly. Having explored these scenarios at region level, the next set of analyses illustrate country-specific debt simulations by using the country-specific data (Figure 6). Table 3 reports the countries for which debt would not stabilize in the medium term (based on the criterion that debt as share of GDP increases in the last year of the period) under each scenario. Under the baseline with 3 percent deficit but zero SFA, debt stabilizes for all countries in the region, except Mali. Under the same deficit target, when historical levels of SFA are assumed to persist for each country (i.e. status-quo), six member states appear to have non-stabilizing debt patterns, re-emphasizing the importance of addressing SFA. Switching to a hypothetical 4 percent deficit target by measuring the deficit accounting also for below-the-line and extra-budgetary operations (i.e., including SFA), three member states have non-stabilizing path, whereas all countries have such a non-stabilizing path if SFA persist under that 4 percent deficit target.

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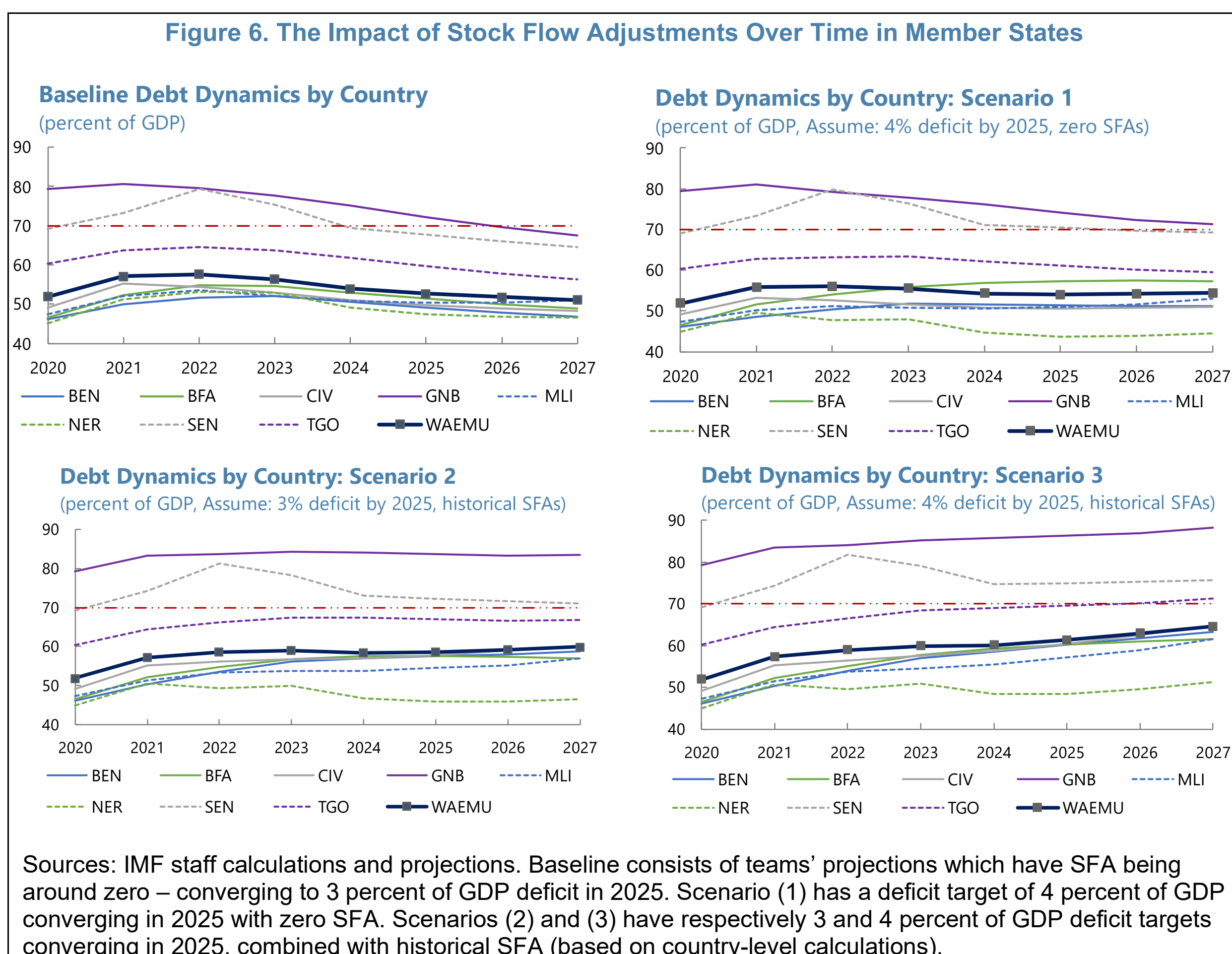
Figure 6. The Impact of Stock Flow Adjustments Over Time in Member States



Sources: IMF staff calculations and projections. Baseline consists of teams' projections which have SFA being around zero – converging to 3 percent of GDP deficit in 2025. Scenario (1) has a deficit target of 4 percent of GDP converging in 2025 with zero SFA. Scenarios (2) and (3) have respectively 3 and 4 percent of GDP deficit targets converging in 2025, combined with historical SFA (based on country-level calculations).

Table 3. WAEMU: Countries For Which Debt Does Not Stabilize Under Each Case

	Converge in 2025 to 3 Percent Deficit	***Converge in 2025 to 4 Percent Deficit***
Zero SFA	MLI	CIV, MLI, NER
Historical SFA	BEN, CIV, GNB, MLI, NER, TGO	BEN, BFA, CIV, GNB, MLI, NER, SEN, TGO

Sources: IMF staff calculations and projections. The countries are listed if their debt level is at an increasing path, and indeed increases in 2027 as share of GDP.

Heterogeneous SFA across countries also imply an unfair fiscal burden across countries from the previous fiscal rule. For some countries (with large historical SFA), addressing SFA will imply an effective tightening. Nevertheless, it would offer an essential way to deal with ongoing fiscal slippages which are delivering a non-stabilizing path for debt, thereby threatening debt sustainability. It is also important to note also that having the same above-the-line deficit target (e.g. 3 percent as historically) but persistently different SFA implies an unfair difference across countries in the effective fiscal constraints imposed by a common rule (i.e. an implicitly different overall impact on change in debt); and a persistent difference in the overall deficit and debt accumulation is not fair within the context of a common rule. The most urgent step is to monitor the SFA, understand its key contributors, and take it into account when preparing the budget and planning the medium-term fiscal strategy. This would help include the effect of SFAs in the debt dynamics and avoid the

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risk that it would unduly affect the debt sustainability of the countries and the external viability of the union. Authorities should also step up their efforts to improve accounting practices, such as the adoption of the GFSM 2001/14 (rather than GFSM 1986, currently prevailing in most WAEMU countries), consistent institutional coverage in the transactions (i.e., the same institutional coverage above and below the line) and broader institutional coverage (i.e., beyond the budgetary central government, to include all government units). In principle, one possible (but difficult to implement) solution to address SFA is to measure the overall deficit for the purpose of the target from the flow of financing minus asset accumulation (if the overall deficit is instead measured from the change in stock of debt, then for the purpose of assessing compliance ex post, it would be essential to correct for the exchange rate and other valuation effects).[4] At the same time, it is also important to note that international experience shows that there are risks associated with asset accumulation accounting in the fiscal framework: for example, governments can accumulate poor quality assets with on-lending operations to SOEs or state banks, or be exposed to implicit subsidies in SOEs (differences between lending and borrowing costs).

Reasons For the Discrepancy Between the Deficit and Change in Debt

In general, there are several possible reasons for the disconnect between the fiscal deficit and the change in debt, i.e. the presence of non-zero SFA. Those factors include asset valuation affects, differences in the institutional coverage, extra-budgetary and off-budget funds, change in financial assets (due to privatizations, contingent liability realizations/recognitions or accumulation/depletion of government deposits), arrears, carryover, differences in accounting between debt and deficit, financial instruments covered in the debt, and debt relief (see Annex I for a more detailed explanation). Overall, to the extent that those factors are sizable, the fiscal deficit may not be a fair representation of the size of the financing needs. In principle, debt may increase more (or less) than the fiscal deficit. In the case of WAEMU, a significant portion of SFA is likely to be a result of low capacity, or poor PFM. However, it is not possible to quantify which drivers are more important in general due to data limitation and lack of information, which makes it even harder for member states to contain SFA in the short term.[5]

Within the context of PFM, some recommendations are generally made to contain SFA. First, increase coverage of the measured fiscal deficit to better align the fiscal deficit measure with debt coverage, and improve the comprehensiveness and reliability of fiscal data. For example, many WAEMU fiscal deficits currently cover budgetary central government only, whereas debt data covers all public and publicly guaranteed debt.[6] Second, limit off-budget operations, including quasi-fiscal operations carried out by state

[4] With respect to measurement, generally speaking, above-the-line is more accurate if government liabilities are not well accounted for, like in the presence of unaccounted arrears, while below-the-line would be more accurate if spending is not well recorded, like if spending from different public entities and agencies are not well tracked or their accounting centralized.

[5] Given the important role played by SFA in WAEMU debt dynamics, a deeper analysis and quantification of the drivers of SFA in WAEMU remains important for future research, as more information and data become available. Going forward, as countries identify the exact sources of SFA, this would increase the feasibility of containing the effect of those individual drivers on debt.

[6] To help alleviate the coverage challenges, a WAEMU directive requires members to gradually update their fiscal statistics frameworks from the Government Finance Statistics Manual (GFSM) 1986 to GFSM 2014. GFSM 1986 is a framework for cash-based transactions and so is unable to account for broader debt accumulating factors. Sustained progress, with continued support from IMF technical assistance, will be important to achieving this policy objective.

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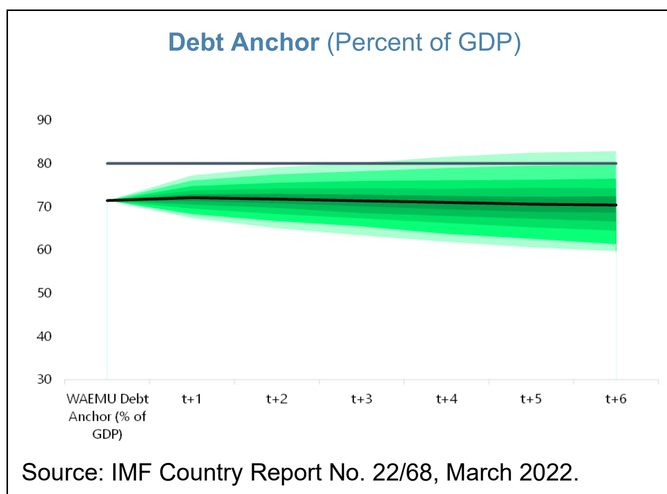
owned enterprises (SOEs).[7] Relatedly, strengthen the oversight of SOEs to limit fiscal risks, such as contingent liabilities. Third, strengthen internal control over expenditures, and fourth, implement the accrual accounting system. Fifth, strictly prevent the accumulation of new expenditures arrears and prepare settlement plans to reduce old arrears. Lastly, improve the management of public-private partnerships to reduce fiscal risks. Addressing these PFM priorities are necessary conditions for a more credible medium term fiscal framework.

The Debt Ceiling Should Not be Increased

The existing debt ceiling envisages the role of a buffer, and uncertainty has been increasing in recent years. The authorities have mentioned their possible interest in raising the debt ceiling. However, if anything, the debt ceiling should be reduced or at most kept unchanged, for various reasons. First, the recent global shocks have pointed to heightened uncertainty and hence the need for larger buffers to cope with shocks. Second, the growing role played by the extra-budgetary and below-the-line operations has increased the expected uncertainty of debt creating flows, thus also suggesting the need for larger buffers. Third, market access at historically low rates may be changing, as global rates are increasing: even if the recent spike in spreads of mid-2022 were to be short-lived, overall interest rates for external borrowing may not come back quickly to the historically low levels of the past few years. Analyses by IMF staff indicate that the 70 percent of GDP debt ceiling seems appropriate, striking the right balance between growth and fiscal sustainability in the region (see the SIP associated with the 2021 WAEMU Regional Consultation). Hence, in light of the increasing uncertainty, it is not advisable to increase the debt ceiling. It is also worth noting that spending related to development and social objectives remains important, but also that domestic revenue mobilization—rather than debt—constitute a more sustainably fiscal strategy to attain those goals.

Debt Anchor (Percent of GDP)



Source: IMF Country Report No. 22/68, March 2022.

III. Supporting Arrangements[8]

A well-designed correction mechanism is essential to contain debt, and it is fundamental irrespective of whether the level and definition of the deficit target is changed or not. As discussed, repeated deviations from the fiscal deficit target (and large SFA in the current system) may generate an excessively rapid increase in debt or even debt to surpass the ceiling. Coping with this issue generally requires that such deviations from the fiscal and/or debt targets should be compensated in future years, for example after they

[7] When quasi-fiscal operations relate to payments based on exceptional expenditures procedures, the use of exceptional procedures should be limited to only eligible expenditures as defined in the PFM regulations, and the regularization of payments made through exceptional procedures should be accelerated.

[8] Supporting arrangements encompass all monitoring and enforcement mechanisms, including: design of escape clause; definition and computation of the rule (including the definition perimeter and how to measure the variable subject to the rule—deficit and debt); existence of a fiscal council to monitor the rule and offer advice in case of deviations; design of correction mechanism; design of the law supporting the rule; any possible sanctions (reputational and financial) in case the rule is breached.

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exceed a cumulative threshold (as in the debt brake model), unless there are extreme circumstances (as discussed in various review papers from the European Commission). Indeed, one may envisage a correction mechanism that changes the fiscal deficit target temporarily when some conditions are met, mainly to correct for previous deviations from the fiscal deficit rule, or for breaches in the debt ceiling (or in some cases also if debt increases too fast, for example if deficit is measured above-the-line and there are sizable SFA). The mechanism would also need to envisage the duration over which the adjustment is smoothed. A well-organized mechanism covering these dimensions would help the member states have some buffers for unexpected shocks in future.

Defining a common and reasonable feasible perimeter for the debt creating flows would enhance effectiveness of the fiscal rule and its evenhandedness. It is essential to establish a minimum form of harmonization of reporting of fiscal indicators across countries, i.e., a common perimeter for the debt creating flows, both for evenhandedness across countries and for the ability to identify the debt creating institutions. It is also important to create harmonization between the perimeter of the deficit and the debt, as difference between the perimeter of deficit and that of debt would create artificial SFA. This would require an assessment of what perimeter is deemed feasible, and a review of the role and responsibilities of debt agencies in the region—checking the perimeter of their operations—so as to assess which entity is benefitting from the below-the-line or extra-budgetary operations. If the revised rule were to envisage fiscal targets that account for extra-budgetary and below-the-line operations, one would need to make sure to also properly account for the debt creating flows from extra-budgetary units (which are in principle included in central government according to GFS). Ideally, authorities should commit to broaden the perimeter as feasible over time and move all operations through a Single Treasury account, which would significantly enhance transparency.

At present, fiscal deficit often has more limited coverage than public debt in the WAEMU member countries, affecting the SFA. The coverage of fiscal deficit is restricted to central government for all countries in the region, while public debt has often a broader perimeter. Overall, only two countries (BFA, MLI) have the same coverage for fiscal deficit and public debt (Table 4).

Table 4. WAEMU: Coverage of Public Debt and Fiscal Deficit

Country	Debt	Deficit
BEN	Central government, guarantees, and central bank debt borrowed on behalf of the government	Central government
BFA	Central government	Central government
CIV	Central government, and SOEs	Central government
GNB	Central government, guarantees, and central bank debt borrowed on behalf of the government	Central government
MLI	Central government	Central government
NER	Central government, and guarantees	Central government
SEN	Central government, state and local governments, social security fund, guarantees, SOEs, and central bank debt borrowed on behalf of the government	Central government
TGO	Central government, SOEs, and guarantees provided by the central government	Central government

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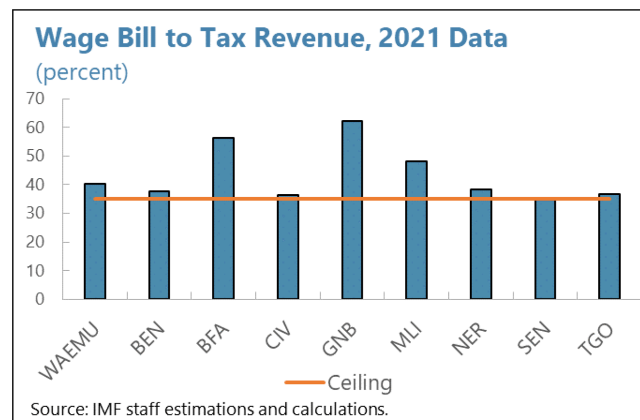
Escape clause. An escape clause is a provision that envisages under what conditions the authorities may not need to respect the standard targets of the fiscal rule, and can follow alternative adjustment paths. A well-designed "escape clause should have (i) a limited and clearly defined set of events triggering the operation of the clause, (ii) time limits on how long fiscal policy can deviate from the targets in the rule, and (iii) a requirement for fiscal policy to return to the targets after the operation of the escape clause is terminated and possibly offset the accumulated deviations." (Eyraud et al (2018)). It is crucial for escape clauses to be well-communicated covering these aspects, and thereby providing feasible and realistic patterns on the adjustment path.

Operational targets. Operational targets can be very valuable for planning, budget, and communication purposes, and ultimately to help them reach the deficit target defined by the fiscal rule. These would be particularly helpful not only to manage the difficult political economy aspects of maintaining the main fiscal targets, but also in case a correction mechanism requires a tighter deficit target than normal (for example, by defining operational targets in terms of wage bill and thus, which aim to prevent that spending gets concentrated in long-term items which are difficult to adjust in the short term, such as the wage bill). One could envisage that different definitions of operational deficit targets could be associated with different levels of targets.



Other issues:

- **Recalibrating the rule at regular time intervals.** The deficit target may need to be revisited over time, especially if the expected growth path declines—for example due to income convergence with advanced economies—which would affect the debt sustainability calculations. A common time interval for recalibration is every 5 years, and general guidelines could be spelled out for what conditions (say growth, interest rates, debt ratios, among other indicators) may warrant a change in the rule.
- **Enhancing monitoring and accountability.** It would be essential to enhance monitoring and accountability. While establishing a full-fledged regional fiscal council may be too difficult at this stage, it may be possible to strengthen the role of the existing WAEMU commission, for example by envisaging the task to publish annually specific assessments related to how fiscal account respect the targets (see Basdevant and Zdzienicka (2016), WAEMU SIP (2019, 2021), Eyraud et al (2018) and David et al (2022)). An alternative approach could be to establish eight national fiscal councils in the WAEMU. In countries where resources are relatively limited, an option may be to associate these national councils with other existing independent institutions (David et al. (2022) IMF (2013)).
- **Establishing fiscal sharing mechanisms.** The absence of formal fiscal-sharing mechanisms makes it difficult for countries that face idiosyncratic shocks (e.g. the Ebola outbreak, or the security problems in Burkina Faso, Mali and Niger) to stabilize their economies without the support of other members (David et al (2022)). Potential approaches to build such mechanisms could include: (1) compensating temporary

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deviations from the deficit rules in the member states experiencing shocks with additional fiscal efforts in countries that are not affected; (2) establishing a regional stabilization fund with the annual contributions from all members in order to provide temporary transfers to countries affected by adverse macroeconomic shocks; or (3) pooling risks through a targeted common budget, which, for instance, could be utilized for security or health emergency allocations.

- **Building a communication strategy.** A successful communication strategy would help the WAEMU preserve credibility and ensure transparency of the reintroduced fiscal rule. The strategy should rely on clear and simple messages aimed at informing the public and the market participants about the assumptions behind fiscal projections and related risks, as well as providing an ex-post assessment of the fiscal position.[9] A successful communication becomes even more crucial in the periods of the activation of escape clauses. In such cases, it is important to explain the implications of the activation, the expected duration and size of the deviation, as well as the adjustment path reverting to the rule. Some elements of good communication include to publish: (1) a credible medium-term fiscal strategy aimed at anchoring expectations; (2) regular reports by the government on the implemented measures (including the associated fiscal costs, and risks to the budget); and (3) reports by independent agencies (such as fiscal council, or an audit agency) assessing the conformity of fiscal policy to the fiscal rule (IMF (2020), and David et al (2022).

IV. Conclusions

This paper aims to provide a broad fiscal strategy going forward. Overall, fiscal discipline supported by adequate frameworks and institutions will be instrumental to ensure debt sustainability and external viability, as well as containing inflationary pressures. The paper highlights the substantial increase in debt over the past decade, the significant role of extra-budgetary and below-the-line operations, and the need to revamp the fiscal rule with several improvements.

First, the strategy needs to envisage a change in the fiscal rule that includes a correction mechanism when debt exceeds certain thresholds or increases too fast.

Second, extra-budgetary and below-the-line operations need to be addressed. WAEMU countries' debt has been increasing well beyond what was driven by the fiscal deficit, due to large extra-budgetary and below-the-line operations, and simulations show that maintaining the historical levels of SFA would not allow debt to be on a sustainable path, nor to rebuild buffers. Hence a proper discussion of the appropriate level of the deficit and debt accumulation targets has to address extra-budgetary and below-the-line operations.

Third, various supporting arrangements should be included in the revamped fiscal rule, including an escape clause, mechanisms for enforcement and discipline, and operational frameworks based on intermediate and complementary targets. In particular, an escape clause would help ensure more predictability for the circumstances under which the target may need to be temporarily altered and avoid the uncertainty about when the rule will resume.

[9] See Hitaj (2016) for a discussion on the link between fiscal discipline, the role of WAEMU regional surveillance communication, and market responses.

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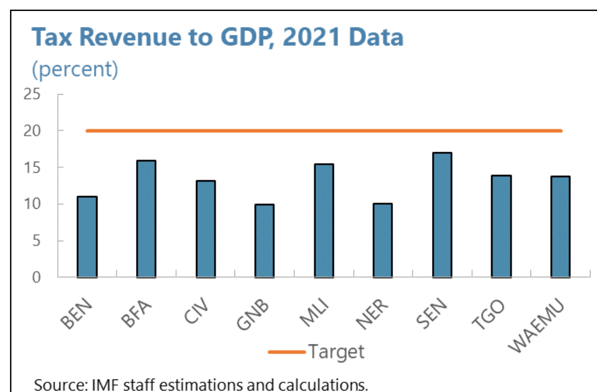
Fourth, the fiscal strategy should also envisage that any delay of the current expected path for fiscal consolidation should be grounded on solid justifications and financing prospects. The delay should be considered in the presence of exceptional needs for expenditure in response to future shocks, additional security and social challenges, or excessive strain on the economy from a large and fast consolidation. Such delays should also be supported by reasonable expectations that the required additional financing would be available at terms in line with debt sustainability.

Finally, domestic revenue mobilization needs to be part of the broad fiscal strategy. Indeed, domestic revenue mobilization is a crucial part of the ability to service debt, which is what ultimately makes debt sustainable. While debt has helped WAEMU countries to finance development and social spending, and more recently cope with major global shocks, going forward this trend is not sustainable and domestic revenue mobilization should increasingly become the key tool to finance development and social needs. Possible measures on revenue administration and tax policy reforms should be taking, including broadening tax bases and simplifying the tax system, and strengthening tax administration and compliance. In this regard, the threshold on the tax revenue to GDP ratio should be put more emphasis.



While this paper provides a broad perspective, Technical Assistance could offer a more detailed elaboration of specific needs and aspects, including necessary PFM reforms to contain SFA.

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Annex I. Reasons for Discrepancies Between Change in Debt and Fiscal Deficit

There are several possible reasons for the disconnect between fiscal balance and change in debt—a phenomenon labeled as "stock flow adjustments". These debt-creating factors include:

- **Extra-budgetary and off-budget funds**. Borrowing may take place outside the central government budget (sometimes due to emergency spending in the context of the Covid-19 pandemic). This would drive a positive SFA.
- **Difference in institutional coverage** between fiscal balance and debt. For example, deficits are measured at the general government level, whereas the debt's coverage is the wider public sector (in this case, profit-losing SOEs could drive a high SFA residual).
- **Asset valuation effects**. For instance, persistent changes in the real exchange rate can create a disconnect between external borrowing and change in the external debt stock measured in local currency (the effect should cancel out over time if RER were to mean revert). Globally and persistently declining interest rates can increase debt valuation over time and explain positive SFA residual on average.
- **Change in financial assets due to privatizations, contingent liability realizations/recognitions** (e.g., bank or SOE recapitalization) or **accumulation/depletion of government deposits.** These should drive a positive SFA residual if the country accumulates assets, and a negative residual when the country sells assets, like in the case of a privatization. However, some financial transactions of government and SOEs needs to be recorded also above-the-line (when these are transfers to SOE, unlike acquisitions of SOE shares which should be below-the-line), in which case they would not affect SFA residual.
- **Arrears**. In principle, there should be full consistency between (i) cash deficit and change in commercial debt, and (ii) accrual deficit and change in total debt including arears stock, according to GFS. But if cash and accrual accounting are used simultaneously for different transactions, this could create a disconnect between debt and deficit—for instance if the cash change in commercial debt is compared to the deficit measured in accrual terms. These should not affect the average SFA residual over many years (unless increasing), as they should be mainly offset the following year.
- **Carryover.** Some expenditure committed in one year may be spent in the following year. As a result, the fiscal deficit is recorded in *t* but debt increases in *t+1*. If the same pattern repeats over time, also these should not affect the average SFA residual over many years (unless increasing), as they should be mainly offset the following year.
- **Government guarantees**. These are sometimes included in debt in IMF programs, but they have no equivalent in the deficit (until they are called and generate a financing need).[11] When guarantees are created, they would drive a positive SFA residual, but not when the stock of guarantees remains constant.
- **Differences in accounting between debt and deficit**. The "cash deficit" measures cash flows and the "accrual deficit" measures accrued flows, but debt data could be compiled using a basis of

[11] Note that, under GFS, guarantees should not be included in debt. But this is a practice in IMF programs.

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valuation different from cash flows or accrual transactions.[12] These differences should not affect the average SFA residual over many years, unless increasing, as they should be mainly offset the following year (or years, in case they take a few years to self-correct).

- **Financial instruments covered in the debt**. In the EU, for example, the definition of debt used for the Maastricht criteria includes only loans, debt securities, and currency and deposits, while the fiscal deficit may have been financed from other financial instruments as well, most notably other accounts payable. This particular example would offer a negative contribution to the SFA residual.
- **Debt relief**. A debt restructuring will disconnect the evolution of debt from the deficit, and would offer a negative contribution to the SFA residual.

[12] For example, in the EU, Maastricht debt is reported at nominal value, which is also equal to face value. This valuation may differ from the flows, because some revaluations such as those resulting from exchange rate changes are not taken into consideration in the transactions. However, flows such as those related to premiums and discounts are not included in the measurement of debt measured at cash flow value.

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