

BP/21-01/07

Growth and Adjustment in IMF-Supported Programs for Africa

Peter F. Allum, Ajai Chopra, and Marco Pinon-Farah

IEO Background Paper
Independent Evaluation Office
of the International Monetary Fund

Growth and Adjustment in IMF-Supported Programs for Africa

Prepared by Peter F. Allum,^{*} Ajai Chopra,[†] and Marco Pinon-Farah[‡]

June 30, 2021

The views expressed in this Background Paper are those of the authors and do not necessarily represent those of the IEO, the IMF or IMF policy. Background Papers report analyses related to the work of the IEO and are published to elicit comments and to further debate.

^{*} Consultant, Independent Evaluation Office of the IMF.

[†] Consultant, Independent Evaluation Office of the IMF.

[‡] Consultant, Independent Evaluation Office of the IMF.

Contents	Page
Abbreviations _____	vii
Chapter 1. Benin _____	1
Executive Summary _____	2
I. Introduction _____	4
II. Context _____	4
III. Program Design _____	8
A. Program Growth and Adjustment Objectives _____	8
B. Strategies to Support Growth and Inclusiveness _____	13
C. Realism of the Macro Framework _____	15
D. Contingencies and Program Adjustments _____	15
IV. Program Implementation and Outcomes _____	16
A. Program Implementation _____	16
B. Growth Outcomes _____	18
V. Authorities and Staff's Perspectives _____	19
VI. Assessment and Lessons _____	21
Figures _____	
1. Benin—Selected Economic Indicators _____	6
2. Benin—IMF Disbursements _____	8
3. Benin—Evolution of Program Indicators _____	10
4. Benin—Balance of Payments Need Decomposition _____	12
5. Benin—Structural Conditions by Depth and Growth Orientation _____	14
6. Benin—Growth vs. Benchmark _____	18
Table _____	
1. Benin—Fiscal Balance, After Grants _____	9
References _____	25
Chapter 2. Cameroon _____	27
Executive Summary _____	28
I. Introduction _____	30
II. Context _____	30
III. Program Design _____	35
A. Program Growth and Adjustment Objectives _____	35
B. Strategies to Support Growth and Inclusiveness _____	39
C. Realism of the Macro Framework _____	40
D. Contingencies and Program Adjustments _____	41
IV. Program Implementation and Outcomes _____	41
A. Program Implementation _____	41
B. Growth Outcomes _____	43
V. Authorities and Staff's Perspectives _____	44

VI. Assessment and Lessons	46
A. Assessment	46
B. Lessons	48

Figures

1. Cameroon—Selected Economic Indicators	32
2. Cameroon—IMF Disbursements	34
3. Cameroon—Program Targets and Indicators	37
4. Cameroon—Balance of Payments Need Decomposition	38
5. Cameroon—Structural Conditions by Depth and Growth Orientation	40
6. Cameroon—Growth vs. Benchmark	43

Table

1. Cameroon—Overall Fiscal Balance, After Grants	37
--	----

References	51
------------	----

Chapter 3. Ghana 53

Executive Summary	54
-------------------	----

I. Introduction	55
-----------------	----

II. The 2009 ECF Arrangement	57
------------------------------	----

A. Context	57
------------	----

B. Program Design	57
-------------------	----

C. Outcomes	62
-------------	----

III. The 2015 ECF Arrangement	65
-------------------------------	----

A. Program Design	65
-------------------	----

B. Implementation and Outcomes	70
--------------------------------	----

IV. Authorities and Staff's Perspectives	75
--	----

V. Assessment and Lessons	78
---------------------------	----

Figures

1. Ghana—Real GDP and Investment	55
----------------------------------	----

2. Ghana—Foreign Direct Investment and Exports	56
--	----

3. Ghana—IMF Disbursements	56
----------------------------	----

4. Ghana—Inflation and Real Effective Exchange Rate	59
---	----

5. Ghana—Depth and Growth Orientation of Structural Conditions, 2009 ECF	60
--	----

6. Ghana—Balance of Payments Need Decomposition	61
---	----

7. Ghana—Depth and Growth Orientation of Structural Conditions, 2015 ECF	68
--	----

8. Ghana—Fiscal Deficit and Public Debt	73
---	----

9. Ghana—Current Account Deficit and External Debt	73
--	----

10. Ghana—Growth vs. Benchmark	74
--------------------------------	----

Tables

1. Ghana—Overall Fiscal Balance (Cash): 2009 ECF Program vs. Estimated Outturn	63
--	----

2. Ghana—Growth: 2009 ECF Program vs. Outturn	65
---	----

3. Ghana—Overall Fiscal Balance (Cash): 2015 ECF Program vs. Estimated Outturn	72
--	----

4. Ghana—Growth: 2015 ECF Program vs. Outturn	74
---	----

Annex	
I. Ghana: Technical Assistance 2014 to Mid-2017	81
References	83
Chapter 4. Malawi	85
Executive Summary	86
I. Introduction	88
II. Country Context	89
III. Program Design	91
IV. Program Implementation and Outcomes	101
V. Perspectives of the Authorities and Fund and World Bank Staff	108
VI. Conclusions and Lessons	112
Figures	
1. Malawi—IMF Disbursements	88
2. Malawi—Selected Economic Indicators	89
3. Malawi—Balance of Payments Need Decomposition	94
4. Malawi—Actual and Benchmark Growth	102
Tables	
1. Malawi—Real GDP Growth Rates	92
2. Malawi—Factors Identified as Important for Economic Diversification	92
3. Malawi—Programmed Fiscal Adjustment Under Fund Programs	93
4. Malawi—Structural Conditionality Under ECF Arrangements	94
5. Malawi—Number of Fund Technical Assistance Missions, 2008–2017	95
6. Malawi—Delivery of Fund Technical Assistance (FTEs)	95
7. Malawi—Monetary Program Objectives, 2009–2020	98
8. Malawi—Structural Conditions by Depth and Growth-Orientations: 2012 ECF	100
9. Malawi—Sectoral Contributions to GDP Growth, 2006–2018	102
10. Malawi—Potential Factors Influencing GDP Growth	103
11. Malawi—Domestic Financing of Central Government	104
12. Malawi—Public Investment	105
13. Malawi—Monetary Indicators	106
References	118
Chapter 5. Senegal	119
Executive Summary	120
I. Introduction	122
II. Context	122
III. Program Design	126
A. Program Growth and Adjustment Objectives	126
B. Strategies Used to Support Growth and Greater Inclusiveness	132
C. Realism of the Macro Framework	135
D. Contingencies and Program Adjustments	136

IV. Program Implementation and Outcomes _____	137
A. Program Implementation _____	137
B. Growth Outcomes _____	139
V. Authorities and Staff's Perspectives _____	140
VI. Assessment and Lessons _____	142

Figures

1. Senegal—Selected Economic Indicators _____	123
2. Senegal—IMF Disbursements _____	125
3. Senegal—Evolution of Program Indicators _____	128
4. Senegal—Balance of Payments Need Decomposition _____	129
5. Senegal—Structural Conditions by Depth and Growth Orientation _____	134
6. Senegal—Growth vs. Benchmark _____	140

Table

1. Senegal—Overall Fiscal Balance, After Grants _____	127
---	-----

References _____	145
------------------	-----

ABBREVIATIONS

AfDB	African Development Bank
AFRITAC	Regional Technical Assistance Center in the Africa Region
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AQR	Assessment Quality Review
BEAC	Bank of Central Africa States (<i>Banque des États de l'Afrique Centrale</i>)
BoG	Bank of Ghana
BOP	Balance of Payments
CEMAC	Central African Economic and Monetary Union
CPI	Consumer Price Index
DSA	Debt Sustainability Analysis
ECF	Extended Credit Facility
ESF	Exogenous Shocks Facility
FA	Financial Assistance
FAD	Fiscal Affairs Department (IMF)
FDI	Foreign Direct Investment
FISP	Farm Input Subsidy Program
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
IFMIS	Integrated Financial Management Information System
JMAP	Joint Management Action Plan
LEG	Legal Department (IMF)
MCC	Millennium Challenge Corporation
MCM	Monetary and Capital Markets Department (IMF)
MDRI	Multilateral Debt Relief Initiative
NDA	Net Domestic Assets
NPL	Non-Performing Loan
NPP	New Patriotic Party (Ghana)
NDC	National Democratic Congress (Ghana)
PCI	Policy Coordination Instrument
PER	Public Expenditure Review
PFM	Public Financial Management
PIMA	Public Investment Management Assessment
PPP	Public-Private Partnership
PRGT	Poverty Reduction and Growth Trust
PRS	Poverty Reduction Strategy
PSE	<i>Plan Sénégal Émergent</i> (Emerging Senegal Plan)

PSI	Policy Support Instrument
RCF	Rapid Credit Facility
RFI	Rapid Financing Instrument
REER	Real Effective Exchange Rate
SB	Structural Benchmark
SC	Structural Condition
SDR	Special Drawing Rights
SME	Small Market Economy
SNH	National Hydrocarbons Company (<i>Société Nationale des Hydrocarbures</i>)
SOE	State-Owned Enterprise
SWAp	Sector-Wide Approach
TA	Technical Assistance
UNFPA	United Nations Population Fund
UNICEF	United Nations International Children's Emergency Fund
WAEMU	West African Economic and Monetary Union
WB	World Bank

CHAPTER 1. BENIN

MARCO PINON-FARAH^{*}

^{*} Consultant, Independent Evaluation Office of the IMF.

EXECUTIVE SUMMARY

This report presents an evaluation of the IMF-supported programs in Benin during 2008–19, in terms of how well growth was supported while delivering the necessary adjustment.

Benin is a low-income country that historically has experienced highly variable growth rates, in large part because it is tightly tied to external developments, including weather, commodity prices, and trade with Nigeria, its larger neighbor. As a member of the West African Economic and Monetary Union (WAEMU), its macroeconomic toolkit is essentially constrained to fiscal policy. This evaluation is based on discussions with country officials and Fund staff held prior to the COVID-19 pandemic.

During the period covered by this evaluation, the authorities' programs have been supported by two Extended Credit Facility (ECF) arrangements (the first for 2010–14 and the second for 2017–19). In both cases, the arrangement was requested following weaker demand for exports from its large neighbor, Nigeria, and fiscal slippages, among other causes. Access under the most recent ECF arrangement was augmented to respond to the financing needs of the COVID-19 pandemic.

Overall programs seem to have struck a reasonable balance between encouraging necessary adjustment and protecting/promoting growth, although the significant changes made to the 2010 program during its first review raise important questions. Growth does not appear to have been hurt by fiscal adjustment and the programs seem to have contributed to increased medium-term growth. Both programs pursued gradual fiscal adjustment and structural reforms to create fiscal space for infrastructure spending, while improving the quality of public spending and the business environment. Social spending during the last few years has benefited from increased emphasis. That said, the accommodation of substantial tax revenue shortfalls during the 2010 program, offset by large reductions in public investment, resulted in a less pro-growth orientation than initially envisaged.

Benin's programs highlight the importance of fostering perseverance with reforms, particularly when difficult, through domestic ownership and the "right" type of flexibility. With the benefit of hindsight, a pause to reassess the 2010 program strategy, including the extent of the authorities' ownership, would have been warranted, instead of continuously adjusting to shortfalls in revenue performance with additional restraint on public investment. The subsequent deterioration in implementation illustrated the authorities' lack of commitment to the strategy under the Fund program. In contrast, the consistent implementation of the 2017 program suggests stronger ownership, including by the adoption of firmer measures to mobilize domestic revenues.

The authorities' desire for higher public investment through increased external borrowing is understandable but there is a need for a more detailed and systematic assessment of growth returns from higher investment and the risks from greater indebtedness. Borrowing on reasonable terms to fund carefully selected and efficiently executed projects can clearly be an

important contributor to growth and development, which can support somewhat greater debt without raising vulnerabilities excessively. However, hasty execution of expensive or insufficiently productive projects can lead to a build-up in high cost indebtedness that raises vulnerabilities. A recent Public Investment and Management Assessment mission's conclusion that the quality of public investment has remained low even by regional standards, points to a need for: (i) a more explicit analysis of infrastructure gaps, costing of needed investments, and a schedule of implementation; (ii) a more formalized, systematic, and publicly disclosed methodological framework for cost-benefit analysis of all large projects; (iii) a more transparent and systematically applied selection process; and (iv) increased implementation appraisal capacity.

Growth has picked up considerably in recent years, but significantly more ambitious reforms are needed if Benin is to make a transition to higher income levels over the medium to long run, particularly after the COVID-19 pandemic has increased these challenges. Over the years, progress has been made in several areas. For example, port operations have been improved considerably and there has been progress in revamping the cotton sector. The successful strengthening of tax administration under the 2017 program also represents some success in reducing informality. However, growth is hampered by low quality of public investment and is still significantly tied to external developments. Perhaps more importantly, difficult and far-reaching reforms will be needed to encourage private sector development, including steps to improve the business environment. In this connection, addressing more head-on informality, smuggling and governance could lay the basis for a sustained and more meaningful economic expansion.

I. INTRODUCTION

1. **Several factors make Benin an interesting case study.** While generally considered to have adopted sound macroeconomic policies, overall economic performance has been uneven. Growth has accelerated considerably in recent years, while the commitment to sound structural and macroeconomic policies has deepened, but underlying fragilities continue to jeopardize sustainability and per capita income remains low. Economic developments are strongly influenced by conditions in its larger neighbor, Nigeria, which effectively exposes Benin to Nigerian economic performance and policy changes and, in particular, to oil price shocks. They are also influenced by developments in the cotton sector, Benin's principal agricultural export. As a member of an economic and monetary union (WAEMU), its macroeconomic policy toolkit is essentially constrained to fiscal policy. Development partners play a significant supportive role, including two Extended Credit Facility (ECF) arrangements with the Fund over the past ten years.¹
2. **This evaluation focuses on IMF-supported programs and outcomes during 2008–19, while providing updated information on key developments in 2020.**² The evaluation draws on program documents and interviews with country officials and staff held prior to the COVID-19 pandemic. As has been the case elsewhere, the COVID-19 pandemic has changed substantially Benin's economic outlook, but the associated challenges are beyond the scope of this case study. In addition, the base year of the national accounts was updated in late 2019, resulting in a 37 percent upward revision in the GDP level. In this case study, the reported ratios to GDP are generally based on the official GDP series in effect until 2019, unless otherwise specified. That said, the implications of the GDP revision for the analysis and conclusions are discussed in the report.

II. CONTEXT

3. **During the evaluation period, Benin was a low-income country that was highly vulnerable to external developments.**³ GDP per capita was estimated at \$920 in 2019 (\$1,215 using the new GDP series), with a population of about 11.8 million. Some 35–40 percent of its population lives below the poverty line, with a large informal sector. Benin's economy is highly vulnerable to weather and terms of trade developments, particularly the price of cotton. It is also

¹ Arrangements under the ECF provide financial assistance to countries with protracted balance of payments problems and are the Fund's main tool for providing medium-term support to low-income countries. The ECF supports countries' economic programs aimed at moving toward a stable and sustainable macroeconomic position, consistent with strong and durable poverty reduction and growth. The ECF is also intended to help catalyze additional foreign aid.

² Specifically, this evaluation focuses on IMF-supported programs that were approved and ended between September 2008 and March 2020. This evaluation therefore does not include Benin's ECF from 2005–09.

³ Benin graduated to lower middle-income status in 2020 (justifying access to an RCF/RFI at the end of 2020).

deeply interconnected with Nigeria, a much larger economy, including through informal trade and the use of the Cotonou port, smuggling,⁴ and worker remittances.

4. **Benin’s macroeconomic policy framework is, to an important extent, defined by its membership in the West African Economic and Monetary Union (WAEMU).** With a joint central bank, members share a common currency, pegged to the euro.⁵ This arrangement is generally seen as having served the country well to maintain low, although still quite variable, inflation. However, it has meant that despite being prone to external shocks, the exchange rate is not available as a shock absorber.

5. **In recent years, widespread poverty and lack of confidence in government have contributed to high socio-political tensions.** More than 40 percent of the Beninese live abroad, mostly in Nigeria and Cote d’Ivoire, and almost 65 percent are under the age of 25, given Benin’s high population growth rates. Since 2006, Benin has had multiparty presidential elections. In 2016, Mr. Patrice Talon, a businessman, was elected president for a five-year term, pledging to restore public confidence in the government. Elections were peaceful but public finances suffered. Discontent following the April 2019 Parliamentary elections created a tense political and social environment.

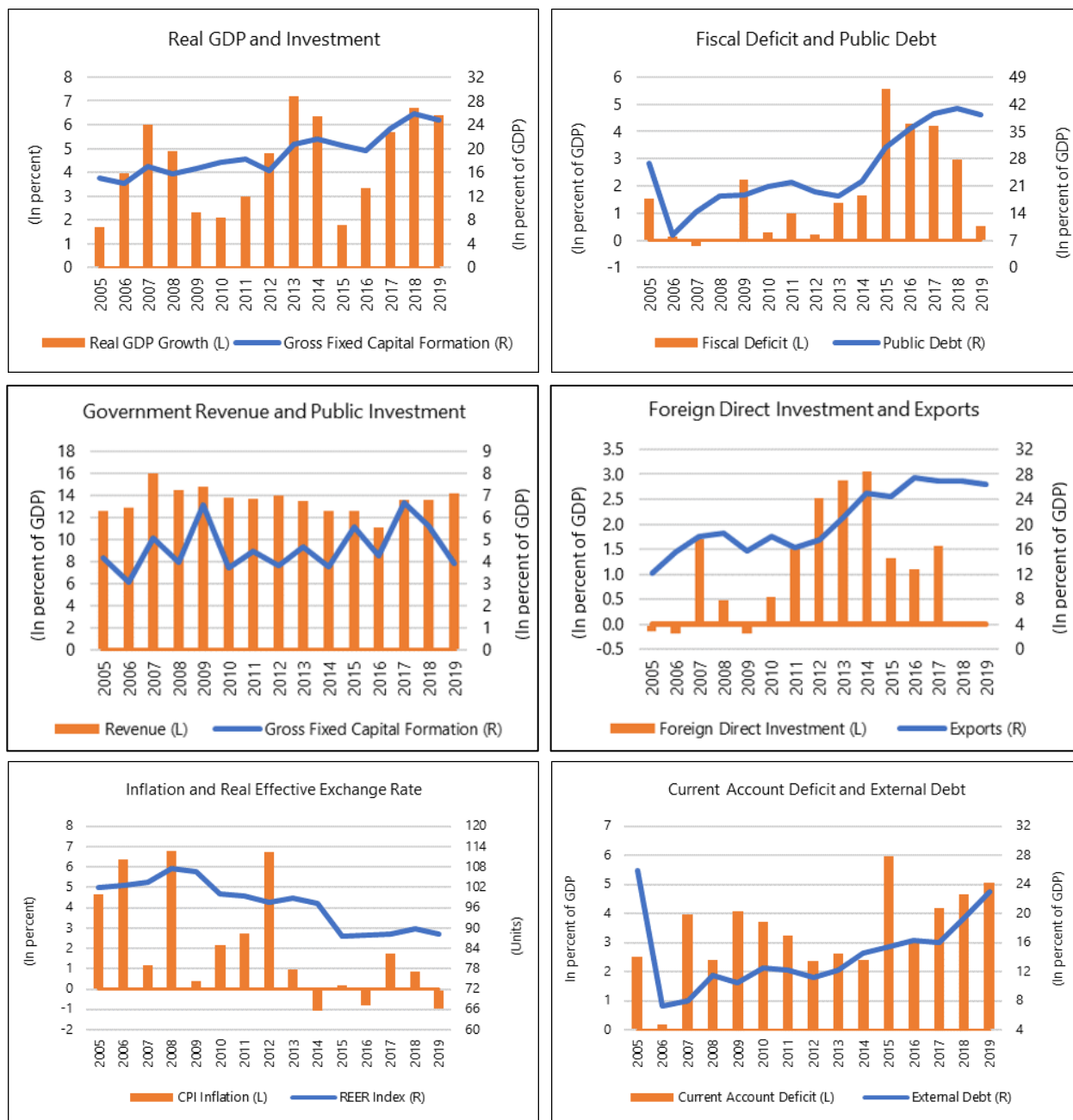
6. **Despite some progress, a weak business environment remains a key constraint to sustained growth and development.** The efficiency of public investment is low. Significant informal trade and smuggling to and from Nigeria presents major challenges to governance, which have proven difficult to address. Key impediments to doing business often cited include limited access to finance, corruption, and poor infrastructure. The Global Competitiveness Report ranked Benin 125th (out of 141) in 2019.

7. **Since 2008, Benin has achieved high but very variable growth rates (Figure 1).** While external shocks played an important role in explaining the uneven economic performance, a weak business environment, low quality of public investment and, at times, unsustainable fiscal policies also contributed significantly.

8. **The global financial crisis had a deeper impact on Benin than in other member countries of WAEMU.** Growth dropped by more than half to 2.5 percent during 2009–11. The downturn was explained by lower cotton prices, weaker demand for exports—notably from Nigeria—and lower foreign direct investment, while the country was also affected by severe floods in 2010. As a result, the fiscal deficit widened considerably. Benin obtained a 3-year ECF arrangement from the IMF in July 2010 in support of a tightening of fiscal policies.

⁴ Exacerbated by import bans and high tariffs, as well as low domestic fuel prices in Nigeria.

⁵ Membership also includes other commitments contained in the “Convergence, Stability, Growth and Solidarity Pact,” including a 3 percent of GDP ceiling on fiscal deficits.

Figure 1. Benin—Selected Economic Indicators¹

Sources: April 2020 WEO database; INS database; FFA database.

¹ Indicators expressed as ratios to GDP are based on the 2019 national accounts, prior to the GDP rebasing in late-2019.

9. **Macroeconomic performance improved considerably during 2012–14.** GDP growth accelerated to 6.1 percent on average owing to improved weather and cotton crops, as well as reforms envisaged under the 2010 ECF to improve the management of the Cotonou port, which resulted in increased traffic and efficiency.

10. **A sharp slowdown in 2015 and early 2016 was brought about in part by negative spillovers from Nigeria.** GDP growth decelerated below 2 percent in 2015 and recovered partially to 3.3 percent in 2016. Fiscal conditions deteriorated significantly compounded by excessive election-related spending—both on and off budget—and substantial increases in public investment (mostly roads) with costly domestic financing from the regional debt market. As a result, the fiscal deficit widened sharply.

11. **In December 2016, the new administration launched the Government Action Program for 2016–21 aimed at a structural transformation of the economy.**⁶ The plan aimed to orient the economy towards more value added in agriculture and tourism—both seen as major potential sources of growth—and reduce dependence on Nigeria. A law on Public-Private Partnerships (PPP) was adopted to encourage private sector participation in public investment. Further revamping of the cotton sector and the port were expected to also contribute to higher growth.

12. **Growth accelerated in the context of a new IMF-supported program approved in early 2017.** GDP growth reached an average of 6.8 percent in 2018–19, and the fiscal deficit was brought down sharply to about 4 percent of GDP in 2018 and 0.7 percent of GDP in 2019 (2.9 percent and 0.5 percent of the new GDP adopted in 2019, respectively). However, Nigeria's closure of its border with Benin since August 2019, owing to frictions between the two countries, and the impact of the COVID-19 outbreak led to a sharp drop in growth in 2020.

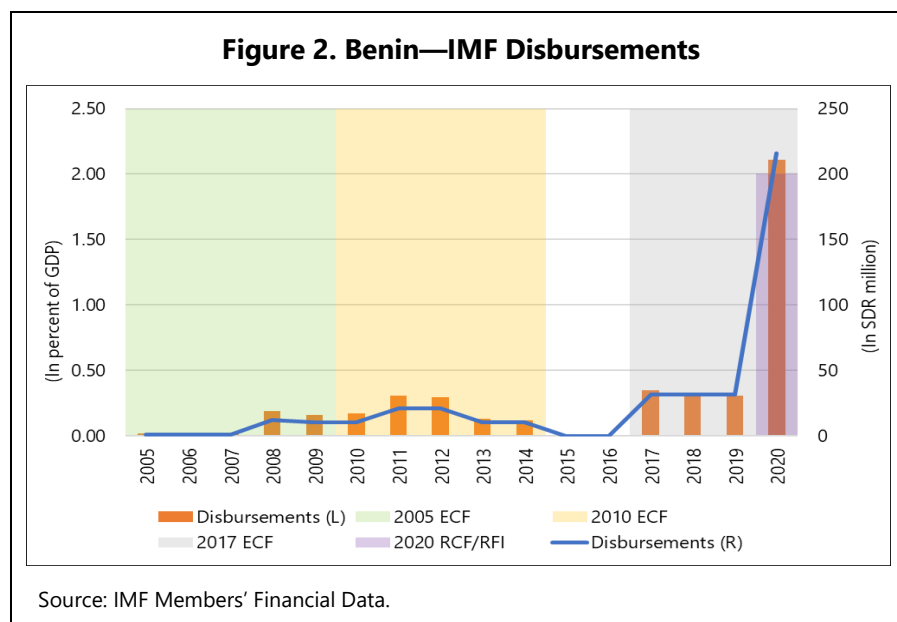
13. **Public debt has increased rapidly in recent years and the IMF debt sustainability analysis (DSA) assessed Benin's debt as in moderate risk of distress.** Notwithstanding fiscal consolidation since 2015, public debt increased from about 19 percent of GDP in 2007 to about 57 percent of GDP in 2019 (41 percent of new GDP). The DSA exercise in the context of the augmentation of the 2017 ECF arrangement in May 2020 reaffirmed the rating of moderate risk of debt distress, despite debt projected to increase further in 2020 as a result of the COVID-19 pandemic. Benin has improved its debt profile in recent years including by using the proceeds of its first Eurobond for EUR 500 million issued in March 2019 to reduce more expensive domestic financing.

History of Fund Engagement

14. **During the period covered by this evaluation, the authorities' programs have been supported by two ECF arrangements (Figure 2).** In both cases, the arrangements were requested following a large decline in world oil prices and the associated negative impact on the activity of its large neighbor, Nigeria, a major oil producer and exporter.

⁶ Presidency of the Republic of Benin (2016).

15. **A three-year ECF was approved in July 2010 for SDR 74 million (120 percent of the quota).** The program aimed to deal with the effects of lower oil (through Nigeria) and cotton prices, in the context of the aftermath of the global financial crisis, and to quickly restore high growth rates. All six reviews were completed and funds disbursed, albeit with some delays, and the arrangement expired in June 2014.



16. **A new three-year ECF was approved in April 2017 for SDR 111 million (90 percent of Benin's quota).** The arrangement was designed to support the country's new economic and financial reform program launched in 2016. Its objectives were to deal with the impact of sharply lower oil prices, restore balanced public finances, and address impediments to higher and more inclusive growth. The 6th and last review was completed in May 2020, together with the approval of an SDR 76 million (61 percent of quota) access augmentation. The augmentation was intended to help meet Benin's fiscal and related BOP financing needs arising from higher expenditure to contain the COVID-19 pandemic as well as the loss of revenues due to the pandemic and the continued closure of the border with Nigeria. Benin also drew \$178 million under the RFI and RCF towards the end of 2020 and took part in the first three tranches of the Catastrophe Containment and Relief Trust (CCRT), but has not requested to participate in the Debt Service Suspension Initiative.

III. PROGRAM DESIGN

A. Program Growth and Adjustment Objectives

17. The two IMF-supported programs targeted stabilizing fiscal deficits and ensuring a recovery in growth, following sharp slowdowns in activity. Program design was circumscribed by the country's membership in WAEMU, under which the main "convergence criterion" is to limit

the fiscal deficit to 3 percent. Other WAEMU criteria include limits on public indebtedness and targets on inflation.⁷ Nevertheless, IMF programs with WAEMU members have not included regional conditionality (on monetary policy or international reserves) or policy assurances.⁸ Table 1 and Figure 3 show several of the key program targets at the time of approval and as adjusted following program reviews.

Table 1. Benin—Fiscal Balance, After Grants¹
(In percent of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
2010 ECF Request – June 2010	-2.8	-3.5	-7.3	-5.9	-5.6	-4.8	-3.9	-3.7	-3.7	...	...	...	...	...
1 st Review – February 2011	-2.8	-3.5	-7.4	-3.0	-4.3	-3.7	-3.1	-2.4	-2.0	...	...	...	...	...
3 rd Review – April 2012	-2.8	-3.5	-7.5	-3.1	-4.3	-3.6	-3.0	-2.4	-2.0	-1.9	-1.8	...	...	...
4 th Review – November 2012	...	...	...	-3.1	-4.3	-3.6	-3.4	-2.4	-2.1	-2.0	-2.0	...	...	...
6 th Review – June 2014	...	...	...	...	-4.3	-2.4	-3.8	-3.1	-3.3	-3.0	-3.0	-2.7	-2.7	...
2017 ECF Request – April 2017	...	...	...	...	...	-2.2	-3.5	-2.8	-8.6	-6.7	-9.3	-5.9	-3.6	-2.4
3 rd Review – December 2018	...	...	...	...	...	...	...	...	...	-6.7	-6.9	-5.6	-4.2	-3.2
4 th Review – June 2019	...	...	...	...	...	...	...	...	...	...	-6.9	-4.8	-4.5	-3.8
After GDP Rebasing in late-2019														
4 th Review – June 2019	...	...	...	...	...	...	...	...	...	...	...	-3.5	-3.2	...
5 th Review – December 2019	...	...	...	...	...	...	...	...	...	...	-5.1	-3.5	-3.4	-2.8
6 th Review – May 2020	...	...	...	...	...	...	...	...	...	...	...	-3.5	-1.7	-5.0
Actual/Latest estimate	-2.8	-3.5	-7.5	-3.1	-4.3	-2.2	-3.5	-2.8	-8.6	-6.7	-6.9	-4.8	...	...
After GDP rebasing	...	...	...	...	...	...	...	...	...	...	...	-3.5	-1.7	-5.0

Source: IMF Staff Reports.

¹ At time of program approval and selected reviews. It contains historical figures and program targets, as presented/estimated at the time.

⁷ The framework also relies on several indicative targets, on a ceiling of the government's wage bill to tax revenue and a floor on the ratio of government tax revenue to GDP. In practice, ceilings are often breached or at times debt creating flows are not recorded in countries' fiscal accounts.

⁸ While the Fund conducts regional discussions with regional bodies, in the case of Benin, the IMF programs did not incorporate regional conditionality nor require policy assurances from WAEMU as its policies were not considered critical for the success of the program. In March 2018, the Executive Board approved a paper on Program Design for Currency Unions, which formalized the conditions for regional policy assurances. Under this policy, regional authorities' policy assurances would be required when those policies are deemed macro-critical, monitorable, and time bound.

Figure 3. Benin—Evolution of Program Indicators

Sources: WEO database; INS database; FFA database; and IMF Members' Financial Data.

*For comparability reasons, all figures are presented in terms of the GDP in effect until 2019. A recent update of the GDP base year resulted in an upward revision of GDP of about 37 percent. For example, the deficit before grants of 7 percent of GDP in 2020 presented in the chart becomes 5 percent of the new GDP.

18. The following paragraphs describe key elements of the strategy and objectives of the two programs, leaving further details about pro-growth policies and reforms for the following section.

2010 ECF⁹

- A key anchor of the program was sustained fiscal consolidation aimed at stabilizing the public debt ratio at 25 percent of GDP. The fiscal deficit before grants was targeted to be reduced from 7.3 percent of GDP in 2009 to below 4 percent of GDP in 2013; after grants the deficit would come down from 4.1 percent to $\frac{3}{4}$ percent of GDP.
- Important revenue mobilization efforts, mostly by strengthening the tax administration, as well as containing nonpriority current expenditure would allow the deficit objectives to be achieved, while sustaining high levels of priority spending.
- Significant IMF technical assistance (TA) was to support the efforts to reform both tax and customs administration. Also, the Fund was to provide technical assistance on establishing an energy regulatory framework and reforms to the organic law on the budget to create results-oriented management. The World Bank would conduct a Public Expenditure Review (PER). A joint IMF-WB work program covered customs assessment, expenditure management and the energy regulatory framework.
- IEO calculations suggest that annual BOP need during 2010–14 amounted to around 5 percent of GDP (Figure 4). Of this, more than half would be filled by a gradual decline in the current account deficit. The rest was to be met by IMF financing (about 0.4 percent of GDP annually), other multilateral and bilateral exceptional financing (1 percent of GDP annually) and other financial account flows, including foreign investment (0.8 percent of GDP annually).
- Growth was projected to increase to 2.7 percent in 2010 and 6 percent by 2013 (4.8 percent on average during 2010–13), reflecting a recovery from the impact of the global crisis, high levels of public investment and, over time, improvements in competitiveness and the business environment.

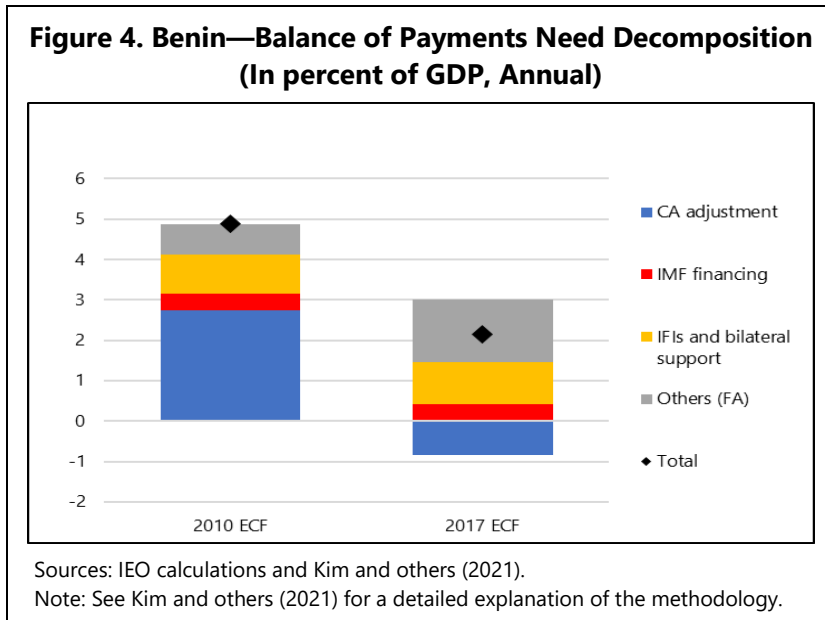
2017 ECF¹⁰

- Fiscal policy would be based on an overarching policy goal of limiting the present value of public sector debt to no more than 50 percent of GDP. To accommodate a temporary surge in public investment spending that had already been approved or that was being implemented, the deficit (and the debt ratio) would widen significantly from 6.7 percent of GDP in 2016 to 9.3 percent of GDP in 2017 (7.9 percent after grants) before gradually declining to 3.6 percent of GDP by 2019 (2 percent of GDP after grants).

⁹ IMF (2010).

¹⁰ IMF (2017).

- Similar to the initial design of the 2010 program, the reduction of the fiscal deficit was largely to be achieved by modernizing tax and customs administration and reducing tax expenditures and by containing nonpriority current spending.



- Consistent with the expected trend of the fiscal deficit, the current account deficit was projected to increase from 7.2 percent of GDP in 2016 to 9.1 percent in 2017 and return gradually to 7.2 percent by 2019. Calculations by the IEO suggests that the higher current account deficits would increase the BOP need by 0.9 percent of GDP annually (see Figure 4). BOP needs would be filled by IMF financing (0.4 percent of GDP annually), other multilateral and bilateral financing (1.0 percent of GDP annually), and other financial account flows (1.6 percent of GDP annually).
- IMF technical assistance would concentrate on making progress on tax administration by minimizing tax expenditures and simplifying taxes; modernizing customs administration by improving management and governance; consolidating public financial management by strengthening budget execution and control; and identifying areas for improving the quality of public investment through a Public Investment Management Assessment (PIMA).¹¹ The World Bank's technical assistance would help to strengthen the PPP legal and institutional framework.
- After having fallen to 2.5 percent in 2015–16, growth was projected to increase to 5.4 percent in 2017 and to 6.3 percent by 2019. This projection was based on a continued good performance of the agricultural already observed in 2016, a recovery of the Nigeran economy from the oil-price shocks of 2015–16, and a significant increase in public investment, following years of depressed investment levels.

¹¹ IMF (2018d, 2019c).

B. Strategies to Support Growth and Inclusiveness

19. The two ECF-supported programs in 2010 and 2017 entailed similar strategies to dampen a possible negative impact of fiscal adjustment on output, while creating conditions for a sustained expansion, including by addressing competitiveness concerns.

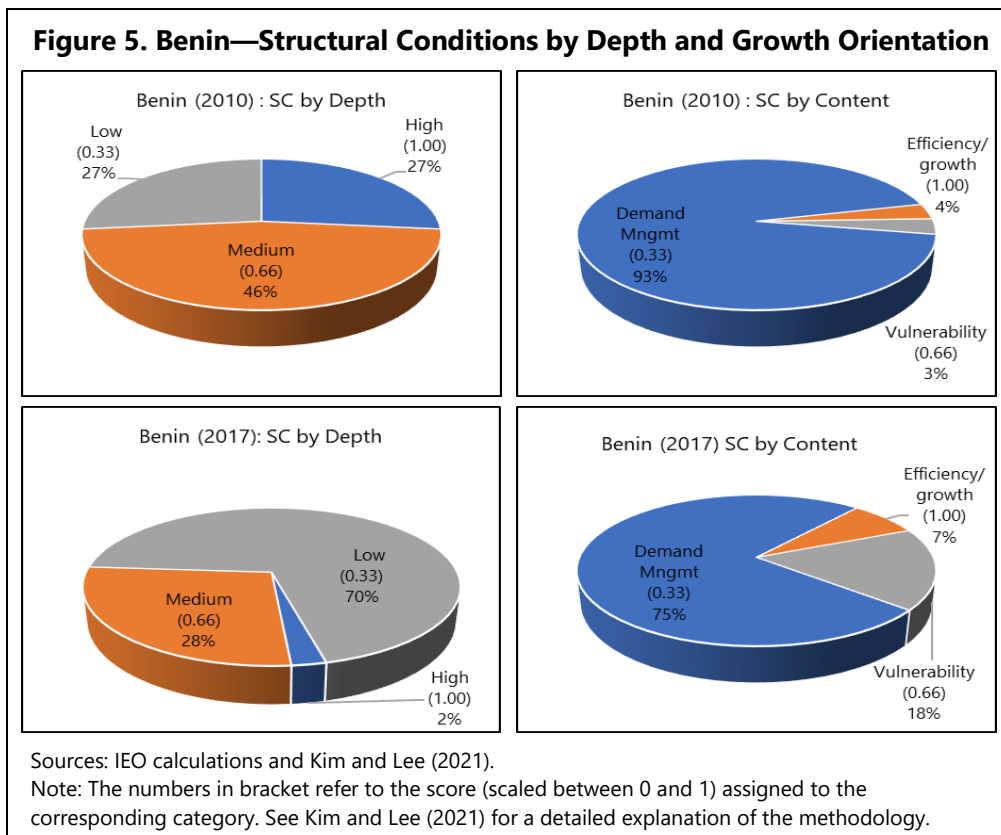
2010 ECF. Key priorities of the program were to contain the impact of the global financial crisis on output; and quickly move to high and sustainable growth rates, making significant progress toward the Millennium Development Goals. With the exchange rate assessed as moderately overvalued, and concerns about competitiveness in some areas, the program placed significant emphasis on measures to boost productivity. In particular, the program included:

- Fiscal consolidation to be achieved gradually over the medium term.
- Public investment would be sustained near 9 percent of GDP over the medium term, primarily financed with external concessional funds.
- Reducing the wage bill (given the previous increase) as a percent of GDP, while implementing a comprehensive civil service reform to address competitiveness concerns related to public wage levels.
- Containing non-priority spending so as to create space for increased social expenditures and the protection of the poor.
- Enhancing competitiveness through improved infrastructure and the provision of utilities at lower costs.
- Improving the business climate through structural reforms on land registration, property rights and the financial and judiciary systems.

2017 ECF. As in the 2010 program, the 2017 program sought to support growth and poverty alleviation, while delivering needed adjustment. However, it had a more difficult starting point, including higher deficits and public debt level. Measures included:

- A substantial increase in public investment to almost 10 percent of GDP in 2017, including to accommodate ongoing projects, particularly roads, which would be scaled back gradually to its 2016 level (6 percent of GDP) by 2020. As a result of these increased expenditures, the fiscal deficit and the government debt were expected to deteriorate sharply in 2017 before starting to decline steadily.
- Increasing social spending and protections, including by new and well-targeted measures for vulnerable groups, with World Bank assistance.

- Improving state-owned enterprise (SOE) performance, including through performance contracts, with technical support from the Millennium Challenge Corporation.¹²
- Enhancing the quality of public spending and reducing arrears to domestic suppliers, with guidance from the World Bank's PER and strengthening the selection of public projects, including through a competitive procurement reform for government contracts, supported by the IMF's PIMA. This would follow significant increases in nontransparent spending that took place during 2015–16.
- Making Benin a more attractive destination for PPP and other investments, with IMF technical assistance and a new institutional framework developed with World Bank assistance.
- Removing barriers to efficient financial intermediation, including by establishing a credit bureau and a regional resolution framework, strengthening banking supervision and formalizing micro-finance institutions.
- Overall, the growth orientation of structural conditions (SCs) increased significantly in the 2017 ECF, although a higher share of SCs was low depth (Figure 5).



¹² The Millennium Challenge Corporation (MCC) is a U.S. foreign assistance agency that provides grants promoting economic growth, reducing poverty, and strengthening institutions.

C. Realism of the Macro Framework

20. **At the design stage, the trade-offs between adjustment and growth assumed under the programs appear reasonable.**¹³ Under the programs, growth was projected to accelerate despite adjustment, supported by increased public investment, improved infrastructure, and a broad set of reforms to improve the business environment. Program documents do not identify how the impact of adjustment on growth was calculated. However, in interviews staff noted that for the 2017 program the level of the fiscal multiplier was part of the discussions with the authorities and that the multipliers used were consistent with previous studies¹⁴ for low-income countries pointing at low short-term, and medium-term multipliers.

21. **That said, significant changes made to the 2010 program during its first review suggest that in some respects the original program may have been too sanguine.** In particular, the original revenue projections were judged to be unattainable, because of both exogenous factors but also domestic capacity, and revised accordingly.

D. Contingencies and Program Adjustments

22. **Key elements of the 2010 program were modified soon after its approval.** The 2010 program did not include specific contingencies. However, following severe revenue underperformance, largely explained by severe floods, the impact of the GFC on the external environment, and delays in adopting measures as well as significant governance issues, the revenue targets were lowered considerably over the entire program horizon. At the same time, with expenditure (especially on infrastructure) falling short, in part as a result of lower external financing available, the spending targets were lowered more than proportionally, resulting in a lower fiscal deficit target. Medium-term growth was also lowered and justified as more in line with regional growth. The new framework was judged as more realistic at the time, but at the cost of abandoning a key priority of the initial program, which was sustaining high levels of public investment.

23. **Unlike the 2010 ECF, the 2017 program request identified specific risks that would be addressed during the reviews should they materialize.** These included: (i) weak institutional capacity and resistance from vested interests; (ii) unforeseen contingent liabilities associated with state-owned enterprises; and (iii) further negative spillovers from Nigeria. However, the program did not specify triggers to determine whether these contingencies had materialized nor the measures that would be adopted.

¹³ As later discussed, however, while ex-post the implementation of the 2017 program was broadly in line with these assumptions, the implementation of the 2010 program fell well short in terms of the envisaged levels of public investment and the structural reform agenda and the growth outcome.

¹⁴ For example, Arizala and others (2020) estimate that multipliers for spending-based fiscal consolidations in Sub-Saharan Africa range between 0.3–0.4 in the short run to 0.4–0.7 over three years. However, they show that multipliers are lower where public expenditure management and revenue administration are more inefficient.

24. **Also, in the 2017 program request, fiscal and investment plans were presented as conditional on developments and program implementation to keep the debt trajectory on a satisfactory path.** In particular, maintaining non-financial public sector (NFPS) debt (in NPV terms) below 50 percent of GDP was seen as an important goal, which would provide a cushion relative to the 56 percent threshold to be rated with moderate risk of debt distress under the DSA. In the event that debt dynamics, revenue mobilization, and borrowing from the regional market were to deteriorate relative to the program projections, fiscal plans and the indicative capital spending plans for 2018 and 2019 were to be reconsidered.

25. **The fiscal targets were adjusted in the course of the reviews.** For example, the deficit target for 2019 was raised in the context of the 4th review (completed in June 2019) to 3 percent of GDP. That said, the upward revision was deemed appropriate as the deficit in 2019 still would be consistent with the 3 percent of GDP convergence criterion for the deficit WAEMU countries and, importantly, public debt was projected to remain below the 50 percent of GDP threshold set at the outset of the program.

26. **Important components of the structural reform agenda were developed in the context of program reviews.** For example, in 2018 during the 3rd Review of the 2017 ECF, two structural benchmarks (SBs) were added on the elimination of tax expenditures in the 2019 budget and the conduct of an audit on the stock of past debt due to domestic suppliers to enhance fiscal transparency. Also, in 2019, in the context of the 4th Review, three new SBs were added on a diagnostic of the main impediments to trade, the reinforcement of the customs administration, and an impact assessment of the Treasury Single Account (TSA) on commercial banks. The new benchmarks under the 3rd and 4th reviews were mostly intended to further strengthen tax mobilization efforts and enhance fiscal transparency, areas that had been problematic prior to 2017.

IV. PROGRAM IMPLEMENTATION AND OUTCOMES

A. Program Implementation

27. **Program implementation under the 2010 program was generally deemed strong on the fiscal front, but the composition of adjustment was less growth-friendly than anticipated.**¹⁵ Fiscal targets for 2010–14 were met (see Table 1 and Figure 3). This left Benin at end-2013 with a debt-to-GDP ratio of 4 percentage points below the Sub-Saharan Africa average and consistent with a low risk of debt distress under the DSA. While social spending targets were missed early in the program, performance improved and was satisfactory thereafter. However, revenue performance fell well below the program's objectives, even after being lowered during the first review and after corrective actions were announced in reviews. This reflected weak implementation of tax administration and other reforms, including persistence of widespread exemptions and an extensive environment of informality. As a result, the deficit targets were achieved only by holding investment significantly lower than envisaged under the program.

¹⁵ IMF (2011a; 2011b; 2012a; 2012b; 2013; 2014).

28. **The implementation of the structural reform agenda under the 2010 program was mixed.** Most benchmarks were met, albeit often with delay, but the implementation of the structural reform agenda was limited in important areas. Progress was achieved on public sector management, including public finance management and human resource management. There were also improvements in public expenditure efficiency, specifically in planning of investments. However, at the end of the arrangement much work remained to be done, reflecting both implementation slippages but also the extensive nature of the reforms required. Pending tasks included the implementation of a new approach to customs reform and the initiation of comprehensive tax administration reform (which were corrective measures announced during reviews following significant delays and unsuccessful efforts in customs reforms); addressing an increase in nonperforming loans of the banking system observed since 2012; and implementing significant reforms to improve the business environment, including by developing a new framework for the cotton sector with more private sector participation.

29. **Performance under the 2017 ECF was strong.**¹⁶ All quantitative performance criteria (set through end-2019) were met as were almost all SBs. The SB on adopting a comprehensive and high-level regulatory text for public investment, as agreed under the PIMA evaluation, suffered a two-month delay (met in November 2018, as opposed to September 2018). The continuous QPC on non-accumulation of new domestic arrears was not observed over March–June 2018 due to an institutional oversight, which led to a small accumulation of domestic arrears. In addition, the indicative target (IT) on priority social expenditure was met consistently, except at end-June 2017.

30. **The fiscal deficit declined below the program targets.** The deficit targets before grants and after grants were met during 2017–19, with a particularly large margin in 2019. These results were achieved through higher fiscal revenues than expected under the original program,¹⁷ resulting from a successful implementation of tax administration reforms. This allowed considerably increased public investment levels during 2017–18. The large deficit margin in 2019, however, is explained by a significant drop in public investment primarily due to deficiencies in public financial management (PFM).

31. **Nonetheless, the public debt-to-GDP ratio exceeded the 2017 program projection despite the fiscal deficit targets being observed.** The public debt ratio broadly stabilized in 2019 after five years of continuous increases as envisaged under the program. However, with inflation significantly below program assumptions more than offsetting the higher-than-projected real GDP, the debt ratio stood some 5 percent of GDP by end-2019 above the initial program projections (3.6 percent of new GDP). Moreover, in the 6th review of May 2020 the debt was projected to increase in 2020 in the context of higher spending to address the COVID-19 pandemic, before beginning to decline in 2021.

¹⁶ IMF (2017; 2018a; 2018b; 2018c; 2019a; 2019b; 2020).

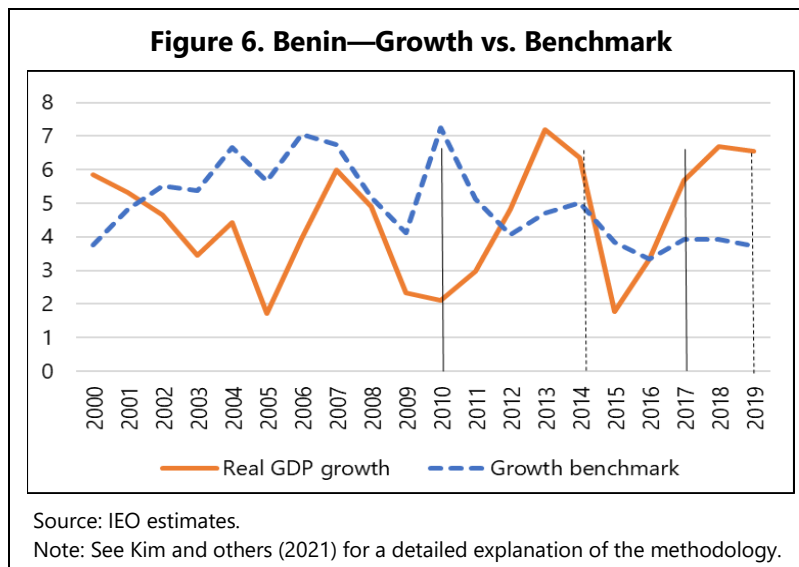
¹⁷ Government revenue, excluding grants, increased from 14.7 percent of GDP in 2016 to about 17.7 percent of GDP in 2018–19, compared to a goal of 16.7 percent of GDP under the original program.

32. **Implementation of the structural reform agenda under the 2017 ECF was generally strong.** Important progress was made on the elimination of tax expenditures, SOE performance contracts, social spending, and electricity generation. The business environment was also improved by the establishment of a credit bureau and the completion of an audit of government arrears to domestic suppliers. All of these point at progress in addressing some of the governance factors, including in the electricity and investment management frameworks, that hampered economic performance prior to the 2017 program.

33. **However, progress was limited in certain areas, including some identified in the course of program reviews.** The IMF's 2019 PIMA found that Benin's institutional framework for public investment was being poorly implemented leading to declining quality of infrastructure spending. Other unresolved issues such as persistent banking sector vulnerabilities (including still high NPLs), continued weak governance, and low attractiveness for foreign investors continue to pose structural impediments for Benin to achieve a high and sustained expansion over the medium term.

B. Growth Outcomes

34. **Growth during the 2010 ECF arrangement fell moderately short of the original program's projections but exceeded the revised projections set at the first review.** Growth initially fell short of the original program projections during 2010–12 (see Figure 3), explained by the slower than expected global recovery and damaging floods. However, it accelerated to well above program projections during 2013 benchmarking, and further in 2014, owing to higher cotton production, after consecutive years with favorable weather conditions, and improved port management. An IEO panel exercise, reflecting shifts in the external environment but not weather-reflected developments, suggests that growth during the 2010 ECF arrangement was only marginally lower than what would have been expected based on external developments alone (Figure 6).



35. **Growth substantially exceeded the program’s objectives during the 2017 ECF arrangement.** Economic activity accelerated consistently during 2017–19, mainly due to strong port activity and agricultural crops, particularly cotton, resulting from the authorities’ reforms but also helped by favorable weather conditions. Growth in 2019 was strong despite the border closure with Nigeria after August supported by continued good weather conditions. The IEO benchmark estimates suggest that growth exceeded the rates that would have been expected during 2017–19 based on external factors by almost 2 percentage points (see Figure 6).

36. **Several indicators point at an improvement in competitiveness, although from a low base and with clear need for further improvement.** The real effective exchange rate depreciated during 2009–2015 by over 15 percent, owing to significantly lower inflation than in trading partners as well as some depreciation of the euro against mid currencies, and has remained broadly stable since then. Productive and export capacity have increased owing to the reforms in the port and cotton sectors and, particularly since 2017, increased spending on infrastructure, notably electricity. Exports increased steadily during 2012–18, with both higher cotton and noncotton volumes contributing significantly. While exports declined in 2019, this was largely explained by lower re-exports in light of the closure of the border with Nigeria, and cotton and other exports still maintained good rates of growth. However, with a large informal sector depending on trade with Nigeria, formal measurements of competitiveness and the calculated real effective exchange rate (REER) miss important developments, including those resulting from oil price fluctuations. More importantly, as noted elsewhere in this report, while Benin has improved, it remains ranked low in international competitiveness indices.

V. AUTHORITIES AND STAFF’S PERSPECTIVES¹⁸

37. **The authorities were generally positive about the Fund arrangements supporting their programs.** While IMF concessional financing was limited as a share of total BOP need, the programs provided an important signal of sound macroeconomic policies to development partners. The three-year duration was generally seen as well-suited for a case where considerable medium-term reforms and investment projects are needed. Some officials, however, called for arrangements of longer duration and a more gradual fiscal adjustment stressing the long-term nature of Benin’s challenges.

38. **During negotiations, country officials called for higher government spending before accepting the low fiscal deficits sought under the Fund program.** In their view, given the country’s massive infrastructure gaps, substantially higher and sustained public investment levels were needed. They also believed that the financing of higher deficits would not be problematic and that the convergence to low deficits should be more gradual than envisaged under the program after 2017.

¹⁸ Based on interviews conducted before the COVID-19 pandemic.

39. **The authorities anticipated a more dynamic growth outlook than assumed under the 2017 program.** They believe that staff's forecasts did not fully capture the structural break set in motion by the new policies of the government and that the higher-than-programmed growth is a reflection of that omission. They explained that the new dynamism was explained to an important extent by the revamping of the cotton sector and the port, as well as the expansion in infrastructure, notably electricity.

40. **In the authorities' interpretation, the overall program objectives were consistent across the 2010 and 2017 ECFs but the strategy to achieve them has been adjusted.** In particular, the previous downward trend in revenue has been reversed in recent years through significant adjustments to the strategy to strengthen tax administration as well as a more forceful implementation. Social indicators have received greater emphasis, with social expenditures consistently increasing faster than overall expenditures, particularly during the 2017 program.

41. **Staff members stressed that Benin had made important progress but also that further efforts to sustain and extend it would be important.** The large informal sector still limits tax administration efforts; the economy remains susceptible to weather and commodity prices developments; and complex relations and substantial linkages with Nigeria make the country vulnerable to developments in its larger neighbor.

42. **Staff stressed that further reducing informality and addressing corruption and smuggling would be essential.** Progress has been achieved but the process has been difficult owing to deeply entrenched vested interests. For example, in the context of the 2010 arrangement the authorities at some point had to use the army to clear boats clogging the port owing to mismanagement and governance issues, but they also had to back down in their anti-smuggling plans. The recent success under the 2017 arrangement in improving tax administration is explained, in part, by measures aimed to address governance issues, although inefficiency and governance concerns persist.

43. **Staff noted that negotiations of the 2017 program were delayed because of the authorities' ambitious spending plans.** A December 2016 mission could not reach an agreement because the authorities wanted higher investment levels than judged appropriate by staff. At the time, there was also a FAD mission about a law for PPPs as a way to help them achieve more investment with less public resources. In the event, the agreed program built in a temporary increase in public investment in 2017, which would be gradually scaled back over the medium term. However, the new PPP law so far has not led to new signed projects.

44. **In the staff's view, the Fund's advice has helped increase fiscal transparency and expenditure.** In the period between the 2010 and 2017 ECFs, large spending increases were financed by a number of non-transparent schemes, including off-budget pre-financing schemes, which led to large increases in public debt. Staff also noted that under the 2017 program, the authorities initially emphasized only the need for large levels of public investment but have

become more appreciative of the importance of social spending. Fund advice and technical assistance have been instrumental in increasing transparency particularly during the 2017 arrangement.

VI. ASSESSMENT AND LESSONS

Assessment

45. **The original 2010 ECF sought a balance between the need for adjustment and protecting/enhancing growth but the significant changes made implied a less growth-friendly composition of adjustment.** A more negative impact from the global crisis and severe floods explain a weak performance at the start of the program, particularly in terms of revenue collections, and the changes to the medium-term targets suggest that some of the initial goals may have been too optimistic. However, the degree of accommodation of the revenue underperformance after the first review, and the positive assessments under the following reviews, do not appear to have sufficiently prioritized the need to protect growth. Fiscal performance was deemed broadly positive as measured by the fiscal deficit and debt. However, continued subpar revenue performance even compared to the lowered targets, led to even lower public investment. The deficit targets were consistently met via cuts in infrastructure spending, which may have been easier to carry out, but implied abandoning a central objective of the program.

46. **Overall, the 2017 ECF seems to have struck a reasonable balance between necessary adjustment and protecting/promoting growth.** The strong and successful emphasis on raising revenues was validated by the substantial upward revision to the GDP estimates following its rebasing in 2019, which suggested that tax revenue to GDP was low, hence placing considerable constraints on sustaining appropriate levels of infrastructure spending. The program allowed a large increase in investment and the deficit in 2017, before gradually scaling them back over time. Moreover, in addition to increased infrastructure spending, the arrangement placed a significant emphasis on structural reforms to improve the quality of public spending and SOE efficiency, and to create conditions for improving the business environment. The increased emphasis on social spending during the last few years has been particularly appropriate. These objectives were attained to varying degrees, with important improvements still needed in several areas as detailed below.

47. **Growth does not appear to have been unduly hurt by fiscal adjustment and the programs seem to have contributed to increased medium-term growth.** After an initial shock-related setback, growth accelerated during the 2010 program considerably even while the deficit ceilings were being observed and the debt-to-GDP ratio was contained. Similarly, growth accelerated in 2017–19, while a sizable reduction in the fiscal deficit was being achieved. While weather developments certainly contributed to this favorable growth performance, reforms under the program to strengthen the operation of the port and the cotton sector have also been important contributors. The success in sustaining high levels of public investment under the 2017 program also played important roles. As previously discussed, while much more is needed, there

has been some improvement in competitiveness and the business environment, and lower inflation than in partner countries contributed to a sizable depreciation of the REER, particularly prior to 2015.

48. **That said, achieving even higher growth appears to have been hampered by the continued low quality of public investment and the need to confront more forcefully poor governance.** The increased public investment under the 2017 program led to an expansion and coverage of infrastructure but less so in its terms of its quality. The 2019 PIMA, highlighted that, despite public investment being a larger share of GDP compared to other WAEMU countries, the quality of the infrastructure is inferior and has declined. There has been progress in terms of fiscal transparency and the business environment, but considerable improvements are still needed.

49. **In addition, Benin's growth developments are still significantly tied to exogenous factors.** Weather, commodity prices, and developments in Nigeria continue to have an outsize impact in Benin. For example, the growth acceleration during 2010–14 benefitted from a recovery in Nigeria owing to higher oil prices, as well as positive weather developments. A sharp deceleration in 2015 was associated with a drop in oil prices. The sharp pickup in growth during the 2017 program follows three-consecutive years of good weather and strong crops.

50. **IMF and WB technical assistance appropriately targeted key reform areas, but implementation sometimes lagged because of weak infrastructural capacity.** The technical assistance provided to Benin by the IMF has been directed strategically at the consolidation of the macroeconomic framework and the implementation of structural reforms, emphasizing tax and customs administration and budget execution, while working closely with other institutions, such as the World Bank, on social programs, expenditure and investment quality, and energy regulation. However, the fact that the need for TA in these areas turned out to be recurrent over the years illustrate that implementation of recommendations has been uneven.

51. **There are questions as to whether the adjustments made early in the 2010 program and the subsequent further accommodation of lower revenues were appropriate.** As discussed above, the significant revenue shortfall in the context of floods clearly justified a downward revision lowering the revenue targets over the short run, but significantly lowering the targets over the medium term may have reduced the sense of urgency to tackle tax administration and associated governance concerns. The fact that revenues continued to fall short, even compared with the revised targets, could have been a red flag about more profound changes needed in tax administration.

52. **Developments after the 2010 program ended raise questions about the authorities' ownership and commitment to that program, while developments under the 2017 program appear to suggest stronger ownership.** The decision to not pursue a successor arrangement after the end of the 2010 program, and the rapid and substantial ramp up in public spending

suggests a different vision than that followed during the program. By contrast, the strong policy implementation during the 2017 program signaled strong commitment and ownership, perhaps reflecting lessons learned from the programs implemented by previous administrations.

Lessons

53. **Benin has been a relatively strong performer in recent years, but questions remain about growth prospects over the longer horizon.** During the 2010–14 program, there were some notable achievements, but important areas were left to be addressed later on. Policies weakened significantly during the 2015–16 period without a program leading to considerable macroeconomic imbalances, including the near doubling of public debt. The 2017 arrangement marked a significant improvement, with both strong program implementation and outcomes, but Benin faces a more difficult external environment post-COVID-19 pandemic and continues to face business environment and governance issues and remains susceptible to supply side shocks.

54. **Significantly wider ranging reforms are necessary if Benin is to make the transition to a higher level of income.** Implementing wide-ranging reforms will take more than a few Fund program cycles. In this context, IMF staff seems to have learned lessons from the 2010 program in designing and implementing a more fully articulated reform strategy in the 2017 arrangement. More specifically, the significant strengthening and more forceful implementation of measures to revamp tax administration under the 2017 arrangement, compared to the 2010 arrangement, was an important step in the right direction and impressive progress already has been made. However, difficult, and far reaching reforms lie ahead if resilience and private sector activity are to be buttressed. Improving considerably the business environment, including by addressing head-on informality, smuggling and governance, could lay the basis for sustained high growth rates. Application of the Framework on Enhanced Engagement on Governance adopted by the Executive Board in 2018 could help in the diagnosis of these vulnerabilities and setting relevant conditionality in future programs.

55. **Program deviations could have been subject to further and more systematic scrutiny and a reassessment of the strategy under the 2010 program could have been useful.** With the benefit of hindsight, a pause mid-way to reassess and reinforce the 2010 program would have been warranted. This was particularly the case after continued weak performance over key aspects of the program, including on revenue targets, despite reiterated assurances during program reviews that the problems were being dealt with. Given the importance of maintaining adequate investment levels to protect and enhance growth prospects, the strategy could have been overhauled, including by requiring a more vigorous implementation of the tax administration reforms. The adoption of refocused efforts to strengthen customs was flagged toward the end of the program, but these did not bear fruit after the program.

56. **The authorities' desire for higher investment via borrowing is understandable but the experience suggests the need for a more detailed and systematic assessment of the growth returns from higher investment and the risks from the growth reforms for greater indebtedness.** Borrowing on reasonable terms to fund carefully selected and efficiently executed projects can clearly be an important contributor to growth and development, which can support somewhat greater debt without raising vulnerabilities excessively. However, hasty execution of expensive or insufficiently productive projects can lead to a build-up to high cost indebtedness that raises vulnerabilities to a weakening of the external environment. To optimize these trade-offs, there is a need for:

- A framework to provide a more explicit analysis of infrastructure gaps, costing of needed investments, and a schedule of implementation. This would provide clarity about the consistency, cost, and expected outcomes of the investment strategy as a whole. It would also help deal openly with the high expectations and costs created by the sustainable development goals (SDG). This would also supplement the IMF's PIMA, which assesses a country's infrastructure governance; and the World Bank's PERs, which analyzes the consistency of public expenditures with policy priorities.
- A more formalized, systematic, and publicly disclosed methodological framework for cost-benefit analysis of all large projects; a more transparent and systematically applied selection process; and increased implementation appraisal capacity. This approach would subject the projects to greater scrutiny, requiring significant documentation on their need, costs, and expected outputs. The latter would also help assess their implementation and make adjustments, as necessary.

REFERENCES

- Arizala, Francisco, and others, 2020. "The Impact of Fiscal Consolidations on Growth in Sub-Saharan Africa," *Empirical Economics*, June.
- International Monetary Fund, 2010, "2010 ECF – Request and 2010 Article IV" (Washington).
- _____, 2011a, "2010 ECF - 1st Review and Request for Extension" (Washington).
- _____, 2011b, "2010 ECF - 2nd Review" (Washington).
- _____, 2012a, "2010 ECF - 3rd Review" (Washington).
- _____, 2012b, "2010 ECF - 4th Review and 2012 Article IV" (Washington).
- _____, 2013, "2010 ECF - 5th Review and Request for Extension" (Washington).
- _____, 2014, "2010 ECF - 6th Review" (Washington).
- _____, 2017, "2017 ECF – Request" (Washington).
- _____, 2018a, "2017 ECF - 1st Review and 2017 Article IV" (Washington).
- _____, 2018b, "2017 ECF - 2nd Review" (Washington).
- _____, 2018c, "2017 ECF - 3rd Review" (Washington).
- _____, 2018d, "Evaluation de la Gestion des Investissements Publics – PIMA," *Departement des Finances Publiques, Rapport Technique*, January.
- _____, 2019a, "2017 ECF - 4th Review and 2019 Article IV" (Washington).
- _____, 2019b, "2017 ECF - 5th Review" (Washington).
- _____, 2019c, "Benin-Consolider et Poursuivre le Renforcement de la Gestion des Investissements Publics," *Departement des Finances Publiques, Rapport Technique*, April.
- _____, 2020, "ECF - 6th Review and Request for Augmentation of Access" (Washington).
- Kim, Jun, and others, 2021, "Cross-Country Analysis of Program Design and Growth Outcomes: 2008–19," *IEO Background Paper*, BP/21-01/01 (Washington: International Monetary Fund).
- Kim, Jung Yeon, and Kwang Yeon Lee, 2021, "Structural Conditions, Structural Reforms and Growth in IMF-Supported Programs," *IEO Background Paper*, BP/21-01/04 (Washington: International Monetary Fund).
- Presidency of the Republic of Benin, 2016, "Government Action Plan 2016-21 Summary," 2016, Benin.

CHAPTER 2. CAMEROON

MARCO PINON-FARAH^{*}

^{*} Consultant, Independent Evaluation Office of the IMF.

EXECUTIVE SUMMARY

This report presents an evaluation of the IMF-supported programs in Cameroon during 2008–19, in terms of how well growth was supported while delivering the necessary adjustment. Cameroon is a low-income country, which is a member of the Central African Economic and Monetary Union (CEMAC). The region is heavily dependent on oil exports and, during 2015–16, faced a severe balance of payments crisis, owing in part to lower oil prices. Cameroon is the largest and most diversified economy in CEMAC. It was the first to conclude an agreement with the Fund in mid-2017, before the other members reached similar agreements during 2017–19.

The design of the program for Cameroon placed appropriate emphasis on achieving the necessary adjustment while taking steps to protect growth. The envisaged reduction of the fiscal deficit was considerable, but even so the debt ratio would increase further, even while being rated in high risk of distress under the Debt Sustainability Analysis (DSA). Moreover, even after considerable expected balance of payments financing, including from the Fund, regional reserve coverage would still remain at a vulnerable level. Hence, less adjustment would likely have entailed undue risks. At the same time, growth was protected by pursuing high-quality fiscal adjustment, including by raising revenues and cutting nonpriority current spending, so as to create space for increased social spending and high public investment by historical standards.

The program design incorporated structural reforms aimed to foster high and participatory growth over the medium term. To help boost private sector investment, job creation and further diversification, ongoing large infrastructure projects were to be completed and the efficiency of public spending improved. Measures to improve business conditions included the elimination of domestic arrears, strengthening the financial system, and creating conditions for increased access to credit and financial services.

In the event, growth fell somewhat short of the objectives during the program period, but fiscal adjustment does not appear to have been a contributor. In particular, a deterioration of the conflict in the two English-speaking regions had a detrimental effect on economic activity. Also, both the fiscal deficit and government debt increased above program projections. Important progress was made in the implementation of the medium-term pro-growth agenda, but the benefits were limited by incomplete or not completely effective implementation in some key areas. Public spending remains inefficient, weak banks have not been addressed, and domestic arrears have not been eliminated. In addition, weak performance by state-owned enterprises (SOEs), the need to replace fuel subsidies with targeted subsidies, and transparency and governance concerns, have come to the fore as constraints on economic performance.

Cameroon’s experience suggests that there is a significant need to strengthen the impact of public investment on growth, while limiting further indebtedness more effectively. Recent lackluster growth record, the high risk of debt distress, and apparent low impact of public investment projects point to the strong need to raise public investment’s “bang for the buck.”

The 2020 Public Investment Management Assessment (PIMA) concluded that there is a need to translate government policies into feasible and efficient investment projects. In this connection, more attention should be paid to explicit analysis of infrastructure gaps, cost of needed investments, and a schedule of implementation, together with more transparent, detailed, and coordinated cost-benefit analysis for all projects and use of competitive tenders for all large government projects with few, if any, exceptions. At the same, the substantial debt increases during the last decade (well above the targets under the 2017 program) and the current DSA rating of high risk of debt distress make it a priority to limit further debt increases.

A broader and comprehensive roadmap to improve governance and transparency would likely have been beneficial for growth, including through its positive impact on the business environment. Cameroon and the rest of the CEMAC region remain near the bottom in world rankings on competitiveness. In line with the Framework on Enhanced Engagement on Governance adopted by the Executive Board in 2018, program conditionality could appropriately build on a diagnosis of these vulnerabilities. The national AML/CFT risk assessment for Cameroon launched with World Bank support in 2018, and the ongoing emphasis on improving transparency and performance of SOEs, are moves in the right direction.

A thorough examination of the sustainability of the exchange rate regime and its trade-offs vis-à-vis growth would be useful. While staff's current assessment of the exchange rate's level suggest that it is broadly appropriately valued, the suitability of a fixed exchange rate cannot be seen, without careful analysis, as a forgone conclusion. Continuing low competitiveness, relatively low growth and, for most of the region, small non-oil sectors point at the need for, at the very least, a careful analysis of the trade-offs for more informed decision making. However, such an exercise would need to reflect regional dimensions.

I. INTRODUCTION

1. **Several factors make Cameroon an interesting case study.** Unlike most Fund-supported programs, the 2017 program for Cameroon was part of a strategy to deal with a shared balance of payments (BOP) crisis in the Central African Economic and Monetary Union (CEMAC). Given that saving the integrity of a monetary union with a fixed exchange rate was a central objective, individual country programs could not be seen in isolation of those of other members of the union. Moreover, for the first time the Fund strategy involved the formal adoption of policy assurances by regional bodies. It is also a useful case study of a country that followed an economic growth strategy based on high public investment, financed in large part by debt.
2. **This evaluation focuses on programs and outcomes through 2019, while providing updated factual information on key developments in 2020.** As has been the case elsewhere, the COVID-19 pandemic has changed substantially Cameroon's economic outlook, but the associated challenges are beyond the scope of this case study. The evaluation draws on program documents and interviews with country officials and staff held prior to the COVID-19 Pandemic.

II. CONTEXT

3. **Cameroon is a relatively low-income country with a diversified economy compared to its regional peers.** It has a per capita income estimated at US\$1,550 and a population of about 25 million. Poverty remains high at about 37 percent of the population. Despite being an oil exporter, it has a large structural balance of payment deficit and a need to implement extensive reforms to foster an environment conducive to more vigorous private sector-led growth. At the same time, growth in the years ahead should benefit from completion of large infrastructure projects and ongoing investments in agri-business.
4. **While Cameroon ranks better than other CEMAC members, generating private sector led and inclusive growth is seriously hampered by business climate and governance concerns.** The Global Competitiveness Report in 2019 ranked CEMAC countries 123–141 out of 141 countries. Cameroon was ranked 123, and its weakest identified areas were information and communication technology adoption (132), health (130), financial system (128), and infrastructure (128).
5. **The country has a challenging social-political and security environment.** In 2008, rising domestic prices fueled domestic unrest. This led to exempting some necessities from custom duties, freezing fuel prices, and raising civil service salaries. On the security front, there are continuing attacks by Boko Haram in the North. In addition, protests that began as a peaceful strike of lawyers and teachers in 2016 have escalated dramatically in the English-speaking regions and have been met with government security forces intervention.

6. **Cameroon is the largest economy in the region, with about 40 percent of the CEMAC regional GDP.** It currently contributes over 50 percent of the regional central bank (BEAC) pooled reserves. Member countries are dependent on oil exports, although oil exports play a smaller role in Cameroon. The regional currency arrangement is generally seen as having served well the region as a whole in maintaining low rates of inflation. However, it also implies that the countries do not have an independent monetary policy or a flexible exchange rate to act as shock absorber.¹ This has at times raised concerns about competitiveness and growth. In addition, unsustainable fiscal policies and use of central bank funds by member countries have sometimes jeopardized the stability of the arrangement. Most recently, high levels of public investment by most country members, followed by oil prices drops during 2015–16, led to a decline in reserves to critically low levels. This decline in reserves was explained to an important extent by use of credit or withdrawals of deposits from the central bank by member countries.

7. **Following the global financial crisis, growth in Cameroon picked up considerably (Figure 1).**² Having dropped to near 2 percent in 2009, growth gradually increased to 4.5 percent by 2012 (Figure 1). It further increased to an average annual growth rate of 5.7 percent during 2013–15, in the context of large public investment, rising debt and, until 2014, high oil prices. Public investment doubled during 2010–14 to about 8 percent of GDP (7.6 percent of new GDP³).

8. **A three-year “Economic Emergency Plan (PLANUT)” was launched in 2015.**⁴ Under the plan, Cameroon was to reach emerging market status by 2035, by prioritizing large public infrastructure projects that would promote private investment and growth. In connection with this, public investment increased further to over 9 percent of GDP by 2017 (8.6 percent of new GDP), even though some large infrastructure projects suffered delays in implementation.

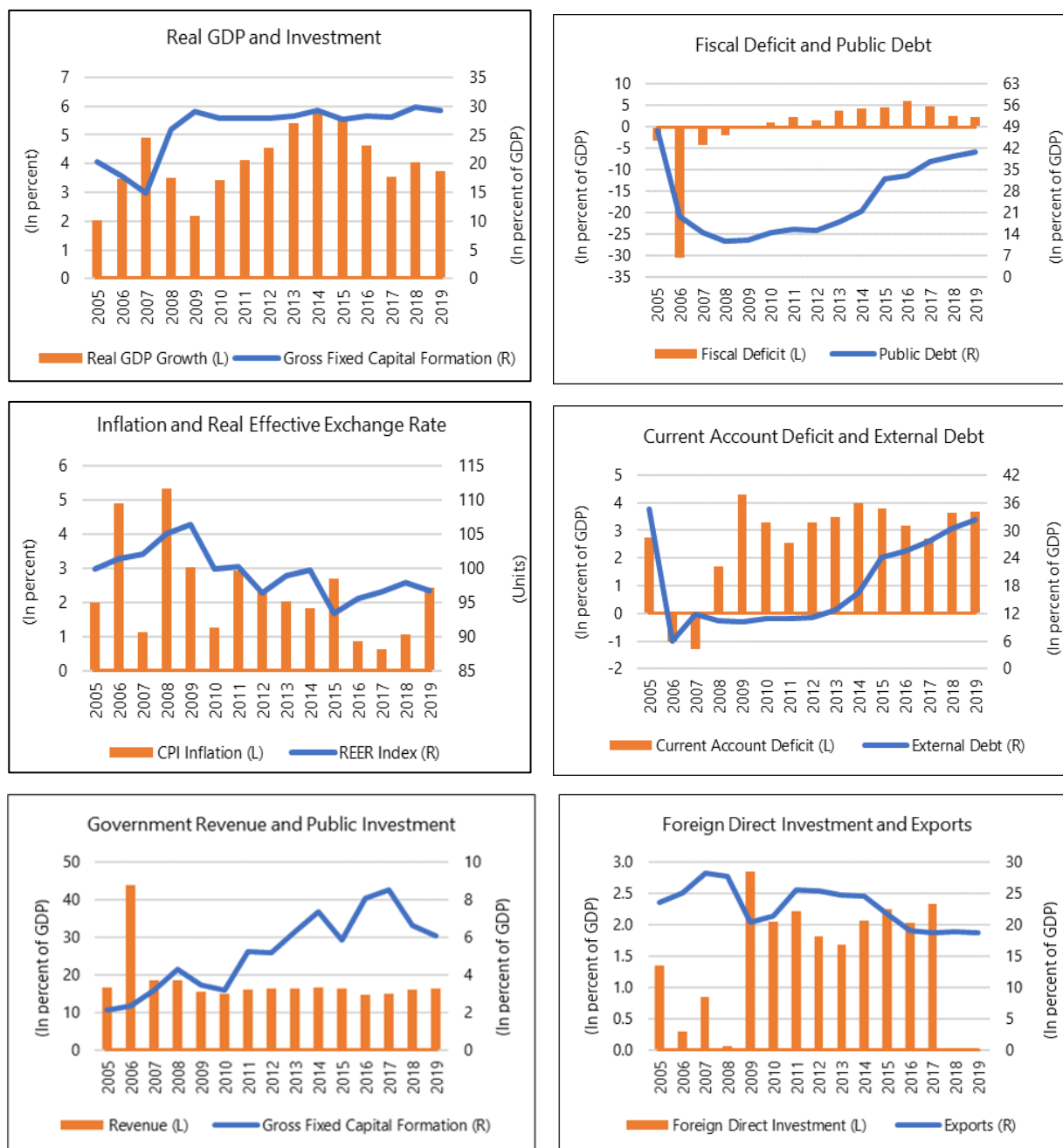
9. **While Cameroon coped better with lower oil prices than other members of CEMAC, the economic situation became increasingly untenable by 2016.** Large infrastructure projects and budget deficits were financed with non-concessional loans. With a drop in oil prices and sustained high levels of spending, public finances and current account deficits deteriorated across the CEMAC region. This led to heavy use of central bank financing by member countries, seriously jeopardizing the sustainability of the regional monetary arrangement. By the end of 2016, (pooled) international BEAC reserves declined by more than two-thirds to about two months of imports.

¹ The peg was last adjusted in January 1994 from 50 CFA to 100 CFA per French Franc. The subsequent peg with respect to the Euro was adopted at the implicit rate of 100 CFA per French Franc.

² IMF (2008), IMF (2009a), IMF (2009b), IMF (2010), IMF (2011), IMF (2012), IMF (2013), IMF (2014), IMF (2015).

³ In late-2017, the GDP was rebased resulting in an 8.2 percent increase in its estimated level.

⁴ IMF (2016b), IMF (2017a), IMF (2017b).

Figure 1. Cameroon—Selected Economic Indicators

Sources: April 2020 WEO database; INS database; FFA database.

10. **In December 2016, CEMAC heads of state set in motion a regionally coordinated effort to protect the integrity of their monetary arrangement.** An agreement was reached among its members to implement a joint strategy, which included seeking IMF-supported programs by all members. Policies at the national level would be based on sustained fiscal adjustment and substantial structural reforms to support economic diversification. At the

regional level, BEAC would stop new monetary deficit financing, tighten credit conditions, and address structural issues in banks and the financial system. Cameroon, as the largest member of CEMAC, was expected to be a major contributor in these efforts.

11. **Cameroon's program helped stabilize conditions, but growth decelerated to 3.8 percent during 2017–19, as security issues became a drag on economic activity.** In the context of IMF-supported programs, regional financial conditions improved. Cameroon began to set the basis for a sustained economic expansion through several reforms. However, with a significant deterioration in the security situation, particularly in the English-speaking regions, economic activity suffered. Economic conditions have been further damaged by the impact of the COVID-19 pandemic.

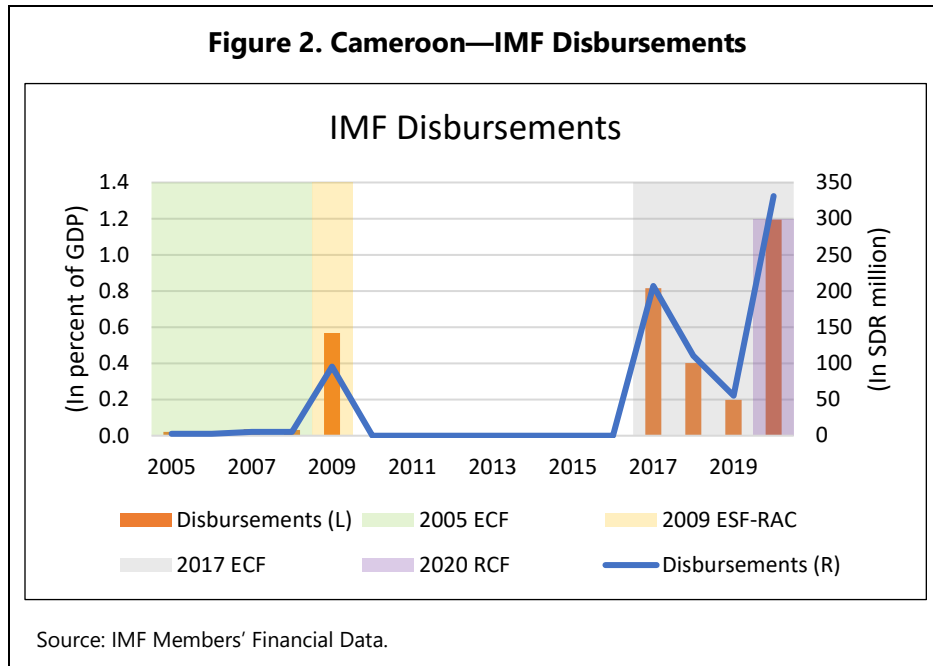
12. **The most recent Debt Sustainability Analysis (DSA) exercise in 2020 judges that Cameroon is at high risk of both external and overall debt distress.** This has been the result of a substantial buildup of public debt, following its sharp reduction in the mid 2000's in the context of the Heavily Indebted Poor Countries Initiative (HIPC) and Multilateral Debt Relief Initiative (MDRI). Public debt rose from about 12 percent of GDP in 2009 to some 45 percent of GDP (41 percent of new GDP) by 2019.

History of Fund Engagement

13. **Prior to the current program, Cameroon had an extended period without an IMF-supported program.** A three-year PRGF-supported program was approved by the Executive Board in October 2005 and in 2009 there was a disbursement under the Exogenous Shocks Facility (Figure 2). The latter aimed to help Cameroon weather the deeper-than-anticipated effects of the global crisis, including a severe drop in its commodity export prices. From then until mid-2017, Cameroon pursued an economic program based on a substantial increase in public investment financed largely with non-concessional debt, without the support of an IMF arrangement.

14. **A three-year Extended Credit Facility (ECF)⁵ arrangement was approved by the Executive Board in June 2017.** The arrangement had access set at 175 percent of quota (SDR 483 million) to support the country's economic and financial reform program, which sought to restore external and fiscal sustainability and lay the foundations for sustainable, private sector-led growth. The Executive Board completed the fifth review in January 2020, bringing total disbursements under the arrangement to SDR 427.8 million. The program lapsed in September 2020 without completing the sixth review or the last disbursement taking place, as the authorities indicated interest in a successor arrangement.

⁵ The ECF supports countries' economic programs aimed at moving toward a stable and sustainable macroeconomic position consistent with strong and durable poverty reduction and growth. The ECF may also help catalyze additional foreign aid. The ECF is available to all PRGT-eligible countries that face a protracted BOP problem, i.e., when the resolution of the underlying macroeconomic imbalances would be expected to extend over the medium or longer term.



15. The 2017 ECF arrangement for Cameroon was approved in the context of programs for all CEMAC members and the development of a regional policy assurances policy.

Fund-supported programs were approved for all CEMAC countries, although for some after considerable delays. The initial programs were supported by policy assurances letters from the regional central bank, which included tightening monetary policy and limiting central bank financing to national governments, while committing to modernize monetary policy and banking supervision over time. In March 2018, the Executive Board approved a paper on Program Design for Currency Unions, which formalized the conditions for regional policy assurances consistent with the approach taken with CEMAC members. Under this policy, regional authorities' policy assurances would be required when those policies were deemed macro critical, monitorable, and time bound. The regional assurances remained in the form of a letter of policy support, with reviews every six months.

16. In May 2020, the Executive Board approved a request under the "Exogenous Shocks Window" of the Rapid Credit Facility (RCF) to help address the COVID-19 pandemic. A first disbursement equivalent to 60 percent of quota (SDR 165.6 million) was made available immediately, while a second disbursement equivalent to 40 percent of quota was approved and disbursed in October 2020. Cameroon also received relief from the Debt Service Suspension Initiative (DSSI) covering some SDR 145 million of debt service due on bilateral official debt during May–December 2020.

III. PROGRAM DESIGN

A. Program Growth and Adjustment Objectives

17. **The IMF-supported program for Cameroon was part of a coordinated effort by member countries as well as regional authorities to arrest rapidly deteriorating economic and financial conditions in the CEMAC region.** In connection with this, each member country requested individual IMF-supported national programs which, in aggregate, would be consistent with the broader regional needs. At the same time, the regional central bank and supervisory authorities would provide appropriate policy assurances at the regional level in the monetary and financial supervision areas.

18. **The stated objectives of the program for Cameroon were to restore external and fiscal sustainability, contribute to CEMAC reserves, and generate high-sustained growth.**⁶ Against the background of a fixed exchange rate and a regional central bank, national commitments would target adjustment through fiscal policies, while protecting investment levels and the poor. Table 1 and Figure 3 show several of the key program targets for Cameroon at the time of approval and as adjusted in the context of program reviews. New monetary financing from BEAC was to be eliminated while borrowing on non-concessional terms was intended to be strictly limited, given high risk of debt distress status under the DSA. There was also significant structural conditionality aimed to promote sustained growth and social protection (see paragraphs 20–22). Specific components of the program included:

- After public debt almost doubled during 2013–16, fiscal policies sought to stabilize public debt at about 35 percent of GDP over the medium term. To this end, the fiscal deficit after grants would be reduced to 1.9 percent of GDP by 2019, some 4½ percent of GDP below 2016, two-thirds of which was to be accomplished in 2017 alone (see Table 1). The adjustment would be achieved roughly in equal parts by tax administration measures, mainly by expanding the non-oil revenues tax base,⁷ non-wage current spending cuts, and capital expenditures prioritization.
- The program sought a careful balance between the authorities' desire to maintain high levels of public investment and the need to not exacerbate the already strained debt situation. To this end, public investment would remain well above historical levels, prior to its surge during 2014–16. At the same time, while a prudent borrowing plan would be followed, the program allowed some one-third of project financing for priority sectors to be on non-concessional terms, given limited availability of concessional financing. However, with significant projects approved in the preceding years, and a substantial

⁶ IMF (2017a).

⁷ While the 2017 budget included an increase in some excise tax on petroleum products and selected additional levies, the improvement in fiscal revenues under the program was largely based on broadening the non-oil tax base through the elimination of exemptions and reforms to enhance tax and customs administration.

stock of contracted but undisbursed loans, the program ceilings entailed a careful prioritization of the projects to be implemented.

- Staff encouraged the authorities to reinstate the automatic fuel pricing mechanism that had protected public finances from fuel subsidies until 2008. The authorities deemed the area as too sensitive and agreed instead to a more general commitment to prepare a strategy to ensure the sustainability of the fuel pricing structure as well as preserving the financial viability of the oil company.
- Steps to increase space for credit to the private sector would be taken. The gradual elimination of the sizable government arrears to domestic contractors would be a major task to reduce banks' non-performing loans (NPLs) and to unlock bank credit to the private sector.
- Significant IMF technical assistance (TA) would support key reforms, including on tax policy and administration; strengthening Cameroon's public financial management systems in line with findings of a 2017 Public Expenditure and Financial Accountability update; raising the efficiency of government investment; and improving debt management. In addition, TA to the regional central bank was to be given on improving the monetary policy framework and instruments and, to the regional supervisory authorities, as needed, on plans for the resolution of banks in difficulty. World Bank technical and policy support would include the electricity sector, social protection, and public expenditure.
- The external current account deficit, which reached about 4 percent of GDP in 2016, would gradually decline to some 2½ percent of GDP by 2019. IEO calculations suggest that the annual BOP need would be 6 percent of GDP and current account adjustment would contribute 1 percent of GDP annually to meet this need during 2017–20 (Figure 4). IMF financing would contribute 0.6 percent of GDP annually, and other multilateral and Bilateral BOP support 1.2 percent of GDP. The remaining need of 3.2 percent of GDP would be met by other official and commercial loans, particularly for infrastructure.
- Growth was projected to decline from 4.7 percent in 2016 to 4 percent in 2017 in the context of upfront fiscal adjustment, and then gradually increase to 5 percent by 2019 as the benefits of growth-friendly policies began to be felt.

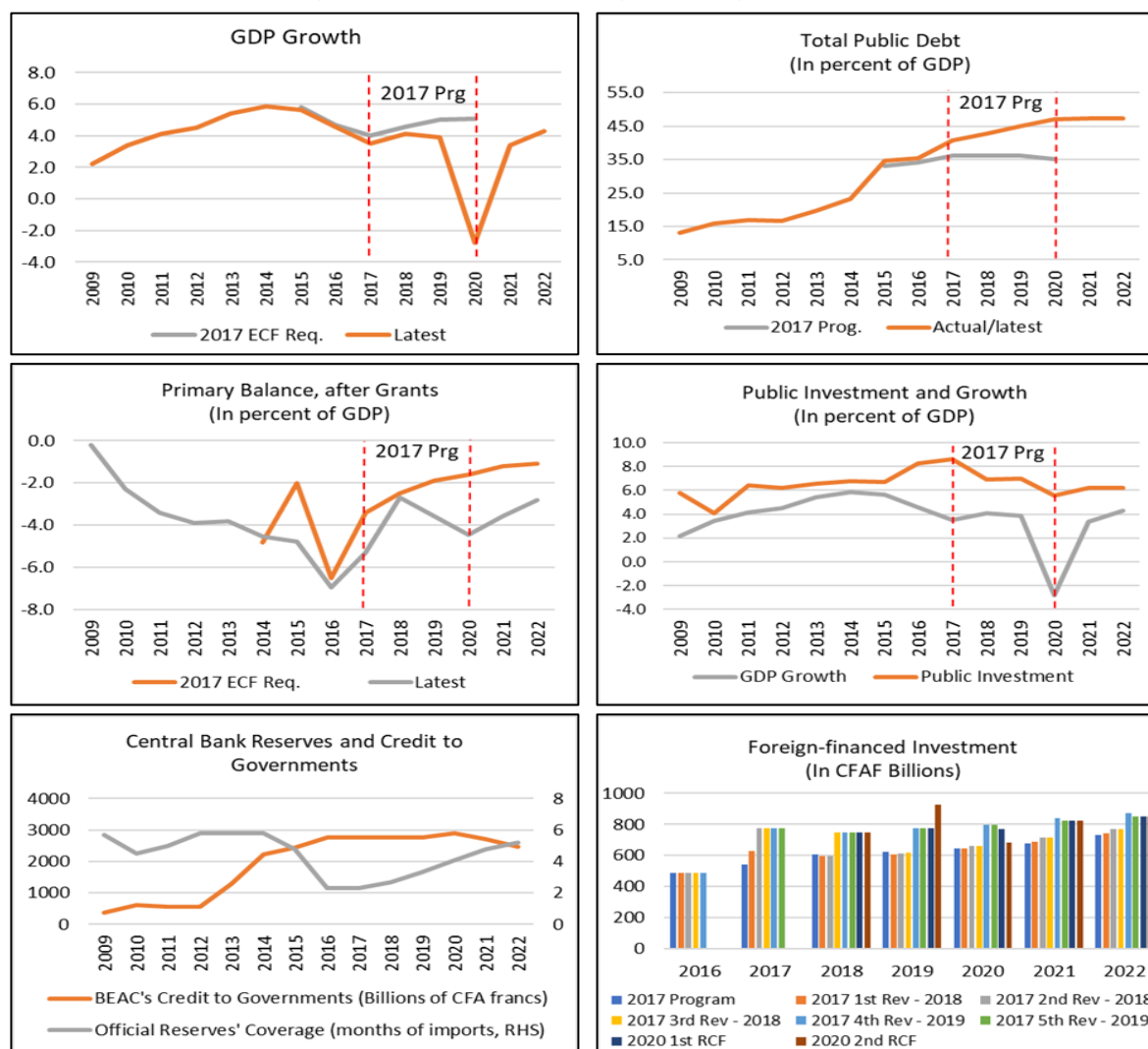
Table 1. Cameroon—Overall Fiscal Balance, After Grants¹
(In percent of GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
Request - July 2017	-4.8	-2.0	-6.5	-3.4	-2.5	-1.9	-1.6	-1.2	-1.1
Request (rebased to new GDP)				-3.1	-2.3				
1st Review-December 2017	-4.2	-4.4	-6.2	-3.1	-2.3	-1.8	-1.4	-1.1	-1.0
2nd Review - July 2018	--	--	--	-5.0	-2.6	-2.0	-1.5	-1.5	--
4th Review - July 2019	--	--	-6.1	-4.9	-2.5	-2.0	-1.5	-1.5	-1.5
5th Review - January 2020	--	--	-6.4	-4.9	-2.5	-2.3	-2.1	-1.7	-1.5
Extension and RCF Request-May 2020	--	--	--	--	-2.5	-2.3	-4.5	-2.7	-2.2
Actual/Latest projection	-4.2	-4.4	-6.4	-4.9	-2.5	-2.3	-4.5	-2.7	-2.2

Source: IMF Staff Reports.

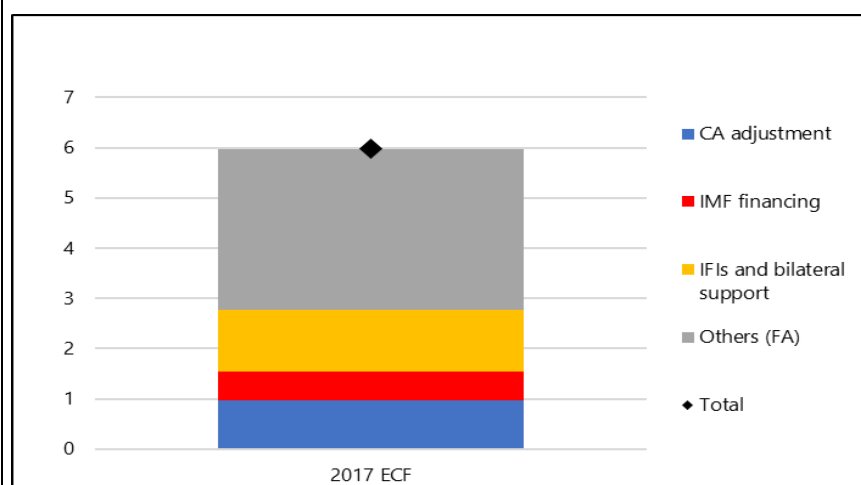
¹ Figures presented at time of approval and selected reviews. It contains historical and program targets as presented in program documents at the time.

Figure 3. Cameroon—Program Targets and Indicators



Sources: WEO database; INS database; FFA database; IMF Members' Financial Data.

**Figure 4. Cameroon—Balance of Payments Need Decomposition
(In percent of GDP, Annual)**



Sources: IEO calculations and Kim and others (2021).

Note: See Kim and others (2021) for a detailed explanation of the methodology.

19. **Even before the approval of the program, the national authorities of the CEMAC region agreed to enhance their regional economic and financial surveillance framework.** In particular, starting in 2017 the surveillance framework would include criteria that would apply at the national level for all members on a floor on the overall budget balances and ceilings on average annual inflation, total public and publicly guaranteed debt, and arrears accumulation. Deviations from targets were to be addressed through adoption and implementation of an adjustment program requested by the regional ministerial council.

20. **In addition, regional understandings under the programs were initially aimed at stopping the drain of reserves and gradually increasing reserve coverage, while improving monetary policy transmission and the functioning of the financing system.**⁸ New central bank financing for governments would be eliminated and monetary policy tightened, including by raising the policy rate. In addition, the BEAC would modernize its liquidity management framework, simplify its monetary policy instruments, and eliminate the persistent excess liquidity. These measures envisaged deposits from national governments made possible by fiscal adjustment. Additional external financing, including from the IMF, would raise regional central bank (pooled) reserves from about two to three months of imports during 2017–19. Moreover, the regional authorities would take measures to strengthen banking supervision over the medium term and ensure better implementation of the existing supervisory framework.

21. **The exchange rate was not an important part of program discussions, despite concerns about competitiveness and the need for sizable adjustment, particularly at the regional level.** Concerns about competitiveness became acute in 2016 as falling commodity

⁸ IMF (2016b, 2017b).

prices worsened Cameroon's and the region's terms of trade significantly and, more generally, put the sustainability of the regional peg in question. However, staff assessment suggested that the real effective exchange rate was at worst moderately overvalued and, with non-oil export volumes growing relatively fast until 2015, obstacles to competitiveness were deemed to be more structural than price related, implying a need for decisive improvements in the business climate. That said, the lack of a thorough discussion is likely to be largely explained by the authorities' strong opposition to a change in the exchange rate. In their view, a depreciation would be unlikely to result in a significant supply response for most countries in the region, given the small size of the non-oil economy.

B. Strategies to Support Growth and Inclusiveness

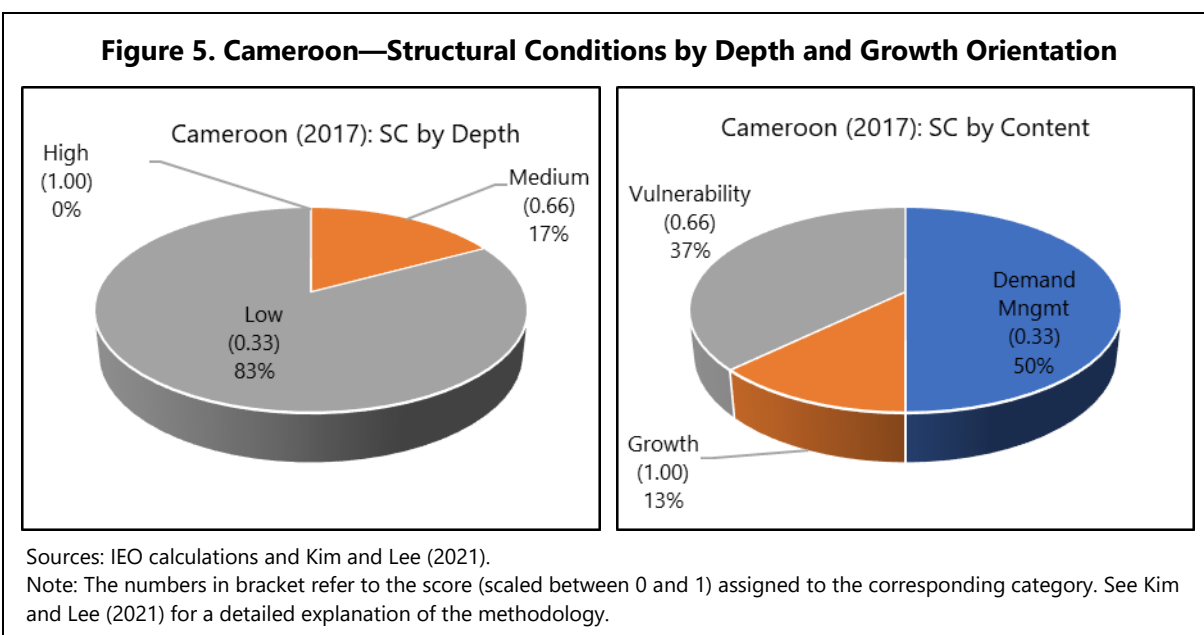
22. **The government strategy included several elements to support growth and improve social conditions, while delivering needed fiscal adjustment.** The composition of the fiscal adjustment was intended to be growth friendly by creating space for priority investment and social spending. To this end, the program targeted an expansion of the non-oil revenue base and sought to limit nonproductive spending, including so-called "direct interventions" by the National Oil Company (SNH).⁹ It also sought to enhance the transparency of state-owned enterprises (SOEs) so as to protect the allocation of resources to priority sectors and the efficient provision of services by public enterprises. Public investment would remain relatively high, while its efficiency was expected to be improved through more effective prioritizing (with IMF and World Bank TA). At the same time, social spending and safety nets were to be increased, and a national social protection strategy prepared.¹⁰

23. **Given the continuing commitment to the exchange rate peg, high and participatory medium-term growth would be encouraged by structural measures to improve competitiveness and increase access to financial services.** To help boost private sector investment, job creation and further diversification, the program envisaged addressing structural barriers to competitiveness, including by completing large energy and transport public infrastructure projects, with World Bank and other development partners' technical and financial assistance, supported by complementary reforms to expand access to financial services and improve the business environment. Increased availability of credit for private sector and, more generally, access to financial services would be buttressed by IMF TA-supported reforms, including the resolution of weak banks, creation of a credit bureau, and establishing specialized financial courts and a legal framework for mobile banking.

⁹ SNH's funds used to respond to vital, mostly security-related emergencies, which in 2016 had accounted for 60 percent of total petroleum royalties.

¹⁰ Later in the program in early 2019, the authorities agreed to request a World Bank in-depth study of the fuel price structure aimed at replacing current subsidies by better targeted subsidies to the poor and vulnerable.

24. **The depth and growth orientation of structural conditions in Cameroon's 2017 ECF arrangement are shown in Figure 5.**¹¹ The large majority (83 percent) of structural conditions (SCs) had low depth, resulting in the average depth score of 0.39 which is below the median for other PRGT countries. For the growth orientation, 13 percent of SCs had strong growth orientation with the average growth orientation score of 0.54, which is above the 75th quartile for PRGT countries in the evaluation sample.



C. Realism of the Macro Framework

25. **Fiscal adjustment seems to have been factored in reasonably carefully in the growth projections.** The program request does not provide precise point estimates for the fiscal multipliers, citing the lack of adequate data for a rigorous estimate. Instead, it notes that it is consistent with multipliers obtained under different approaches and similar to the multiplier assumed in the bucket approach in the literature of between 0.3 and 0.6 in 2017. More recent studies have reaffirmed the relatively low multipliers in low income countries, in part in recognition of the low efficiency of spending.¹²

¹¹ Based on 70 SCs in total before implementation because implementation status was not fully known at the time of writing.

¹² Arizala and others (2020) find that the negative impact of fiscal consolidations in Sub-Saharan Africa on growth can be mitigated through the design of the adjustment. Multipliers for spending-based fiscal consolidations range between 0.3–0.4 in the short run to 0.4–0.7 over three years. Multipliers for public investment are larger than for consumption spending or for consolidations based on revenue mobilization. Also, they show that multipliers are lower where public expenditure management and revenue administration are more inefficient.

D. Contingencies and Program Adjustments

26. **There were no explicit contingencies included in the arrangement, but fiscal targets were adapted flexibly during program reviews.** There was a large slippage in the fiscal program for 2017 observed during the second review, related to higher than envisaged public investment, but the higher debt levels were accommodated as the fiscal deficit targets for 2018 were kept broadly unchanged.¹³ During the fifth review, the overall budget deficit target for 2019 was raised by 0.3 percent of GDP, to accommodate the impact of a fire at the Sonara oil refinery plant. Government investment was also increased in 2019 (by 0.7 percent of GDP) to accommodate increased a faster pace in execution of foreign-financed projects but was offset by an equivalent increase in revenues.

27. **Several structural benchmarks (SB) were added over time to address weaknesses identified during the program.** New SBs were aimed at enhancing budget and SOE transparency, limiting the contracting of non-concessional financing and reducing financial risks from state-owned enterprises. In this connection, the program was adjusted to mitigate risks from contingent liabilities, including though SB requiring accounting statements on cross-debts with public utility companies; a project-by-project plan on the implementation of the signed but undisbursed project loans; and a list of agreed projects to be financed with non-concessional financing.

IV. PROGRAM IMPLEMENTATION AND OUTCOMES

A. Program Implementation

28. **Program implementation was mixed.** Table 1 and Figure 3 show key program outcomes versus targets and indicators at the time of approval and during reviews.¹⁴ After initial slippage in 2017, deficit targets in 2018 and 2019 were met broadly. However, public debt accumulated at a significantly faster pace than programmed and, while most SBs were met, several important measures aimed to improve the business environment and, more generally, support medium-term growth have not been implemented. Also, several new SBs had to be added to deal with weaknesses identified during the program. International reserves at the regional level increased in line with the program, although their level was still relatively low.

29. **Following a large deviation in 2017, the deficit targets were broadly met in 2018–19.** In 2017, the first year of the program, the deficit after grants was almost 2 percent of GDP higher than envisaged under the program. This was explained largely by higher public investment, which exceeded the historical high reached the previous year, and which included large outlays related to the construction of a soccer stadium. The larger-than-programmed

¹³ Much of the fiscal deviation occurred toward the end of the year, including a significant part implemented through February 2018. At the time, in Cameroon there was a two-month period after the end of the fiscal year ending in December where spending that had been committed could still be executed.

¹⁴ IMF (2017c, 2018b, 2018d, 2019a, 2020a, and 2020b).

increase in the government debt in 2017 was accommodated at the time of the review by maintaining the deficit target broadly unchanged for 2018 (which was met). The deficit in 2019 was observed after it was revised upward mid-year to accommodate the impact of a fire at the Sonara refinery. Other areas of weakness in the implementation of the program, at different points in time, included shortfalls in non-oil revenues, higher-than-programmed direct SNH interventions, and persistence of domestic arrears.

30. **Public debt increased significantly higher than projected under the program.** At the end of 2019, public debt stood at 41 percent of new GDP, 7½ percent of GDP higher than programmed and 8 percent of GDP higher than in 2016. This deviation is largely explained by the higher fiscal deficits and lower growth compared with the initial projections (see outcomes below), increases in debt coverage to include domestic arrears and all of the refinery's debts, and the deterioration of public enterprises, notably Sonara after a fire. That said, the 2020 DSA shows an unexplained residual of about 3 percent of GDP during 2018–19 pointing at a somewhat higher debt accumulation than suggested by the fiscal accounts.¹⁵ In addition, the financial condition of several large enterprises deteriorated or remained fragile, entailing large contingent government liabilities.

31. **Consistent with the higher than programmed fiscal deficit and public debt, the external current account deficit remained well above programmed levels.** After some adjustment in 2017, the deficit began to increase in 2018 and 2019 to levels comparable to those prior to the program.

32. **On the reform front, despite some progress there have been important areas where performance fell well short of the program.** Some progress was achieved with measures aimed to support access to financial services, including developing a movable collateral database and establishing specialized financial courts. However, the restructuring of the two ailing banks and the adoption of a business model of the SME bank remain to be carried out. More generally, the strategy to address NPLs has not borne fruit. Other reforms intended to facilitate growth which were not implemented include some the previously discussed fiscal measures, such as the elimination of domestic arrears, which would have freed resources for private sector credit; and limiting direct SNH interventions, which was meant to prevent crowding out of more productive government expenditures. In addition, there appears little movement toward a revision of the existing fuel price structure.

33. **The regional authorities supported the program's objectives well.**¹⁶ The strengthened regional framework and the changes to monetary policy introduced as part of the program were important. Despite shortfalls in external support, owing to delays in approving some of the national programs, overall CEMAC reserve targets were observed through end-2019. This has been in part

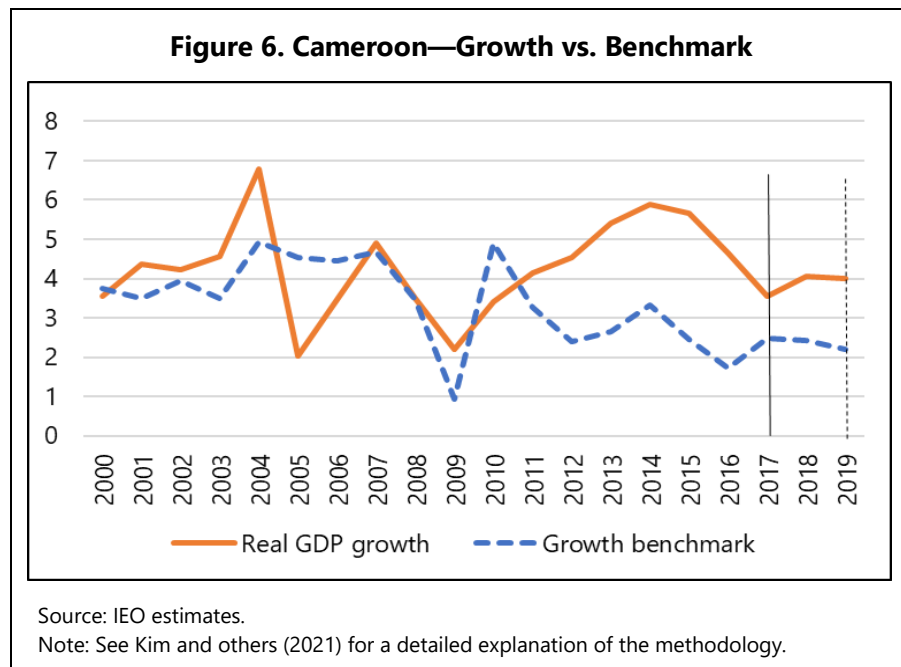
¹⁵ The IMF team is studying possible explanatory factors including payments to correspondent accounts, which had not been accounted for in the DSA.

¹⁶ IMF (2017b, 2018c, and 2019b).

the result of tightened foreign exchange surrender requirements. Banking supervision has been strengthened. To boost financial intermediation, the regional central bank is working on measures to reduce the fragmentation of the interbank market. That said, excess liquidity at the regional level has persisted, reflecting in part a more gradual approach to avoid the potentially high costs of sterilization.

B. Growth Outcomes

34. **Growth fell somewhat short of the program objectives.** The decline in growth in 2017 was somewhat steeper and the recovery in 2018–19 weaker than assumed under the program. With growth beginning to decelerate since 2016 despite expansionary fiscal policies and with the regional financial crisis looming, it could be argued that the steeper deceleration could have been anticipated. Nonetheless, the degree of the deterioration of the security situation, which could not have been foreseen, appears to have been the main factor behind the economic slowdown. Moreover, the overall fiscal deficit during 2017 in particular was considerably higher than envisaged under the program, while the significantly larger than programmed increase of public debt suggests that, from a broader public sector perspective, the adjustment was even smaller than suggested by the fiscal deficit alone. This notion appears confirmed by IEO's benchmark estimates of 2.5 percent during 2017–19, suggesting that growth during the program as a whole was substantially higher than would have been expected based on external factors alone (including the impact of weak international oil prices on terms of trade) (Figure 6).



V. AUTHORITIES AND STAFF'S PERSPECTIVES¹⁷

35. **The authorities stressed that the program's initial emphasis on regional stability had been appropriate, while staff noted that the program was designed from the start to be as growth friendly as possible.** The authorities explained that at the time when the program was approved there was consensus among CEMAC members that the integrity of the regional monetary arrangement was at risk and that a Fund-supported program for the region was needed. However, since CEMAC is not an IMF member, having bilateral programs with its members was seen as the closest equivalent. To further support these efforts, the Fund developed a regional policy assurances mechanism that, for the first time, included understandings with the regional central bank. At the same time in Cameroon, and the other CEMAC countries, programs included substantial measures at the national level, supported by agreements with the regional authorities, aimed to support economic growth.

36. **IMF staff noted that the strategy adopted by the Fund for Cameroon and the CEMAC region as a whole involved taking risks.** The staff acknowledged that the fact that the regional monetary arrangement was guaranteed by the French Treasury, with the IMF expected to provide program financing to these programs, posed serious burden sharing issues. These issues were compounded by the high level of access given to these programs. In addition, the fact that the approach required programs with all CEMAC members, including some oil-rich cases with serious governance problems, further raised the stakes. Against this background, at the time some departments would have preferred for the IMF role to have been limited to a catalytic role rather than providing external financing.

37. **Staff emphasized the importance of having developed a policy of regional policy assurances in the context of currency unions.** The region was facing a severe BOP crisis which, in addition to fiscal measures, warranted monetary and financial measures. The issue was that a Fund arrangement with a member could not impose conditionality on policies that were out of the country's control, while at the same time it could not disburse funds without appropriate policy assurances. In the event, the IMF adopted a new policy by which it received regional policy assurances from CEMAC in the form of a letter. Such assurance is only required when the regional policies are deemed macro critical, monitorable, and time bound. A key component of this policy assurance included commitments by the regional authorities, such as eliminating direct financing to governments and a number of financial reforms. The approach adopted was consistent with the new policy for program design for currency unions approved by the Board in 2018.

38. **Some country officials considered that a more gradual fiscal adjustment with higher use of non-concessional external borrowing, as well as more flexibility in the execution of the ongoing projects, would have been preferable.** In their view, allowing a higher use of external non-concessional borrowing for investment at the beginning of the

¹⁷ Based on interviews conducted before the COVID-19 pandemic.

program would have led to higher growth in Cameroon. In addition, with several large projects approved and their financing contracted before the program's approval, the program's debt ceilings imposed unnecessary delays in the pace of implementation of major projects. They believe that, in the future, the fiscal program should follow the projects' implementation and not the other way around. The problem has been compounded as the increased security spending needs have put further downward pressure on the available resources for productive purposes.

39. **Other officials and Fund staff, however, viewed the agreed deficit targets and debt limits as reasonable given debt sustainability concerns and unrelated to the lower than programed growth.** They did not see space for more non-concessional financing for investment given growing debt distress risks. They noted that, while there may be examples when investment may be critical, it also remains essential to be careful about debt sustainability. Staff explained that another key factor weighing against more gradual adjustment was the level of reserves at the regional level which, even now, remain low. Moreover, the lower than programmed economic growth can be attributed to the increasing security risks and lower oil prices and not to fiscal adjustment or low debt limits.

40. **Staff noted that the program design recognized the importance of implementing critical projects but expressed concerns about the low efficiency and quality of investment.** At the time of the program, Cameroon was one of only two countries at high risk of debt distress that had a non-zero non-concessional borrowing limit. A March 2020 Public Investment Management Assessment (PIMA) mission generally reiterated the findings of very low efficiency and quality of investment found in the previous PIMA mission in 2016. It indicated that, despite progress in investment planning and budgeting, in its present form the management system does not appear to be able to deliver on the government's ambitious plans with the required due diligence, noting the low completion rates and very high management costs and delays. Staff also noted that several major projects have not been subject to competitive tendering and that the authorities' designation of a soccer stadium as a critical project to be financed with non-concessional resources crowded out other large projects with substantial growth payoffs.

41. **The authorities emphasized that, while there is room to raise the quality of investment, there have been considerable improvements in recent years.** They emphasized that the process has improved significantly and that each year a list of conditions has to be met for projects to be included in the annual budget. They agreed that there should be further work on having a stronger system to assess, select and monitor implementation of investment projects. Some saw a need to do more in terms of private sector participation, including through Public-Private Partnerships, to reduce the need for public borrowing.

42. **Some staff from reviewing departments indicated that, with the benefit of hindsight, the Fund could have been more involved on addressing governance and transparency issues.** While this applied to Cameroon, they acknowledged that there were other CEMAC members with significantly more severe concerns. In this connection, since 2017–18 after the program for Cameroon was approved, the IMF has become more involved in systematically

assessing member countries' governance weaknesses, including in the context of Article IV consultations. There are also now governance diagnostic missions led by FAD/LEG with input from MCM and the World Bank (WB), with about a dozen completed so far. In the CEMAC region, diagnostic missions have taken place for Congo and Equatorial Guinea, but not Cameroon. An example of related measures being pushed by staff in some countries' is the publication of oil contracts.

43. **Country officials generally felt that the IMF program played an important positive role in Cameroon.** It ensured coordinated actions by all of CEMAC's members and supported the national economic authorities in exercising expenditure discipline. It also had a strong catalytic effect with developing partners, resulting in much needed direct budget support. This was essential to increase social safety nets. In agreement with the IMF, they believe that, to enhance the impact of donors' funds, there is still a need to further channel counterpart funds through the single account to increase fungibility of the funds' use.

44. **Officials also indicated that collaboration between IMF and other development institutions has been good, although there was still room for improvement.** The structural reforms supported by the IMF and other development partners are helping to lay the basis for sustained growth. However, there are still discrepancies in the positions taken by the institutions. For example, they felt that at times other development partners were more sympathetic than Fund staff to the need to maintain higher levels of investment.

45. **The authorities and most staff agreed that, on balance, maintaining the exchange rate peg and its level had been appropriate given the trade-offs.** In particular, the system had been effective in maintaining inflation in check and imposing an important level of fiscal discipline. The level of the exchange rate was seen as broadly appropriate and, while added flexibility would have some benefits in terms of resilience to shocks, they were outweighed by loss of the nominal anchor. Some staff from reviewing department, however, saw an important missed opportunity in 2017, when it appeared clear that the exchange was overvalued, as evidenced by the small and largely unresponsive non-oil sectors. In their view, a step adjustment would have been warranted or, at the very least, the pros and cons of such a move should have been carefully assessed.

VI. ASSESSMENT AND LESSONS

A. Assessment

46. **The program design for Cameroon placed significant emphasis on protecting growth, while achieving the necessary adjustment.** The reduction of the fiscal deficit envisaged under the program was considerable, particularly in 2017. However, the deficit levels would still remain relatively high, as evidenced by the projected further increase in the debt ratio. Moreover, the adjustment envisaged for Cameroon, together with the rest of the CEMAC region, would result in only a moderate increase in regional reserves, leaving reserve coverage at a still

vulnerable level. Targeting a milder fiscal adjustment at the regional level may not have been consistent with the overall goal of preserving the integrity of the regional arrangement.

47. **The IMF insistence on strictly limiting the use of non-concessional financing while emphasizing efforts to better prioritize spending was well placed.** The authorities' belief that further debt can finance investment safely appears overly optimistic in light of high debt vulnerabilities and continued low investment efficiency. Despite vast public investment for several years, the outcome in terms of growth so far has been somewhat disappointing. Growth accelerated during 2013–15 but in the context of unsustainably high public spending. Moreover, as documented in the recently completed 2020 PIMA mission,¹⁸ despite progress, the efficiency and quality of public investment remains low, with frequent delays and low project completion rates and high management costs.

48. **While problems persist, conditionality increasingly sought to tackle problems related to fiscal transparency and contingent risks, particularly from SOEs.** The limits on so-called direct interventions are likely to have played a role in limiting these expenses, but they were often missed, and the outlays remained off-budget. True capital spending is likely to be overestimated according to the World Bank's Public Expenditure Review (2018). While the reporting on SOEs improved by some metrics, further transparency is needed and the financial condition as well as efficiency of several large enterprises remain important concerns to be tackled. Introduction of conditionality at a program review requiring the transparent accounting of cross-debts between the central government and SOEs. In collaboration with the World Bank, an audit of four SOEs should also bring more clarity about the SOEs operations. More generally, transparency and governance concerns remain an important obstacle to growth prospects.

49. **IMF and WB technical assistance have appropriately targeted key reform areas, but progress was mixed in some areas.** The TA provided by the IMF has been directed strategically at the consolidation of the macroeconomic framework and enhancing investment efficiency, although implementation was sometimes uneven, as evidenced by the continued low efficiency of public investment. Similarly, the World Bank's projects and TA targeted improvements in the social and energy sectors, while seeking to improve the quality and composition of public expenditure.

50. **Regional burden sharing issues between Cameroon and other CEMAC members appear to have been appropriately weighed.** It could be argued that Cameroon took on a larger-than-necessary burden both in terms of adjustment and contribution to the regional reserve buildup. For example, even though the drop in reserves preceding the crisis was by and large not attributable to Cameroon's actions, under the program it was expected to contribute significantly to their subsequent buildup (including through borrowing from the IMF). However,

¹⁸ IMF (2016a, 2020c).

given the large size of the Cameroonian economy, its leadership and decisive participation was likely to have been essential to catalyze the needed regional response.

51. **The adoption of a regional policy assurances policy contributed to a better-founded joint monetary and financial framework for the region.** Monetary and financial policy actions at the regional level were seen as instrumental in supporting the reversing of the reserve drain and improving credit conditions for the private sector. In particular, stopping central bank credit to national governments, and tightening monetary conditions were seen as critical elements of the strategy. Financial sector reforms were also correctly intended to improve credit conditions for the private sector.

52. **While the strategy entailed significant risks and key vulnerabilities remain, in retrospect the approach did succeed in bringing needed stability.** In particular, what appeared to be an imminent regional crisis as recent as 2016, was staved off. To an extent, this was helped by a recovery in oil prices during 2017–18 but policy actions both at the national and regional level were also essential. This was the case though some of the programs took far longer than expected to be brought to the Board. However, the recent collapse in oil prices and the broader disruptions from the COVID-19 pandemic will provide a difficult test to the approach taken and the risks taken by the IMF.

53. **It remains an open question whether more far-reaching adjustments to the monetary and exchange rate arrangements could have produced stronger results and increased resilience to shocks.** To be sure, the authorities in the region were not open to any possible changes as part of the program. However, remaining vulnerabilities and the worsening risks point at a possible missed opportunity at the time of the program design in terms of adopting a scheme that allow the exchange rate to act as a shock absorber and that could have served the region well in current conditions. Moreover, while the fixed exchange proved to be an effective anchor for inflation, it may also have hampered improvements in competitiveness to support growth over time, as evidenced by the persistently lackluster performance of the non-oil sector.

B. Lessons

54. **While the 2017 program arrested a rapidly deteriorating regional financial situation, important vulnerabilities remain.** Moreover, the recent COVID-related deterioration in global conditions, including sharply lower oil prices, is testing whether the adjustment and reforms adopted under the program went far enough, both in terms of developing resilience and creating conditions for growth. The region remains as dependent on oil revenues as before with little significant growth in the non-oil sectors and reserves are still relatively low. Moreover, lack of transparency and low efficiency of public spending and SOEs remain serious concerns. In this connection, a deeper reform to strengthen the growth dividends from public investment, and to genuinely enhance the business environment, transparency and quality of public spending and the performance of public enterprises, would be essential.

55. **Cameroon's experience suggests that there is a significant need to strengthen the links between public investment and growth.** Cameroon's recent lackluster growth record, high risk of debt distress under the DSA, and relatively high but insufficiently efficient public investment, point at a strong need to limit further indebtedness while improving considerably public investment's "bang for the buck." In this connection, while borrowing at reasonable terms to fund productive investments can provide an important contribution to growth and development, insufficiently productive spending can lead to dangerous increases in debt and, ultimately, hamper growth prospects. Against this background, there is a need for:

- **A more comprehensive and transparent growth strategy, with an explicit analysis of infrastructure gaps, cost of needed investments, and prioritization.** Given recent experience, it would be important to ensure coherence in the implementation of the diverse components of major projects, even if executed by different agencies or development partners. This would provide a crucial link between the authorities' development goals and concrete implementation plans. It would also bring about clarity and consistency on the expected outcomes of the investment strategy as a whole.
- **More detailed and coordinated cost-benefit analysis, especially for all large projects.** As suggested in the 2020 PIMA, there is a need to translate government policies into feasible and efficient investment projects, adopt projects based on needs (and not on offers), avoid unscheduled investments and expenditure, and establish an effective, transparent, and accessible evaluation and selection process. This approach would subject projects to greater scrutiny, requiring significant documentation on their need, costs, and expected outputs. The latter would also help assess their implementation and make adjustments over time, as necessary.
- **Subjecting all large government projects to public competitive tenders, with few if any exceptions.** In the case of specific projects fully implemented and financed by individual development partners, or resulting from unsolicited offers, in addition to careful cost-benefit analysis, a detailed comparison with projects potentially offered by other providers would be useful.

56. **Given the pernicious effect of weak governance on growth, greater emphasis on addressing concerns on governance and transparency, including state-owned enterprises, would be desirable.** The program achieved improvements in several important areas. However, Cameroon and the rest of the CEMAC region remain near the bottom in world rankings on competitiveness. In line with the Framework on Enhanced Engagement on Governance adopted by the Executive Board in 2018, programs conditionality could be based on a diagnosis of these vulnerabilities. The national AML/CFT risk assessment for Cameroon launched with World Bank support in 2018 goes in this direction.

57. **There is a need to better balance attention to country ownership with achieving critical program objectives.** The authorities seem to have missed an opportunity early in the program to reinstate the flexible oil price mechanism when oil prices were low. In addition, while it may be understandable to proceed cautiously, particularly in the short term, the lack of a commitment to reinstating the automatic fuel pricing mechanism (and replacing fuel subsidies, which would arise if oil prices were to increase, with more targeted subsidies) even over the medium term was less justified. In this connection, the recent announcement in 2020 of the intention to develop a time-bound plan to phase out fuel subsidies with WB support is a welcome step. Similarly, following the substantial deviation in the fiscal program and the resulting higher-than-programmed debt for 2017, it is unclear whether maintaining largely unchanged the fiscal deficit targets for the 2018–19 was warranted, particularly in light of the high-risk debt situation.

58. **Requiring further transparency and more granular data, or a clear plan to improve them at the onset of the program, including in the case of SOEs, would be useful to better assess the authorities' fiscal and growth plans.** During the program period, reporting improved considerably, and conditionality increasingly dealt with risks, including those posed by SOEs. However, this approach was relatively piecemeal and slow. As shown by the case of Sonara (before and after the fire), SOEs entail fiscal risks. The currently planned audits of four SOEs with World Bank cooperation should be an important step in the right direction. In connection with this, program design should adopt, or define a clear timeline for the adoption of:

- Broad fiscal targets that seek to capture all possible sources of outlays and risks, including from SOEs.
- Sufficient disclosure from SOEs and performance targets for key parastatals.
- Greater granularity and improved quality of fiscal data, including on the non-security current and capital spending.

59. **Finally, more consideration could be given to include a more thorough examination of the sustainability of the exchange rate level and regime and its implications for growth.** Current staff's assessment of the exchange rate suggest that it is appropriately valued, and staff accepted the region's collective commitment to the peg. However, especially in light of the limited growth achieved in Cameroon and its neighbors, especially in the non-oil sector, the suitability of a fixed and unchanged exchange rate could benefit from further careful analysis. Continuing small non-oil sectors point at the need for, at the very least, a careful analysis of the trade-offs for more informed decision making.

REFERENCES

- Arizala, Francisco, and others, 2020. "The Impact of Fiscal Consolidations on Growth in Sub-Saharan Africa," *Empirical Economics*, June.
- International Monetary Fund, 2007, "2007 PRGF - 4th Review," December (Washington).
- _____, 2008, "PRGF - 5th Review and Request for Extension," June (Washington).
- _____, 2009a, "PRGF - 6th Review," January (Washington).
- _____, 2009b, "Article IV and Request for Disbursement Under the Rapid-Access Component of the ESF," July (Washington).
- _____, 2010a, "Article IV," (Washington).
- _____, 2010b, "Poverty Reduction Strategy Paper," (Washington).
- _____, 2011, "Article IV," June (Washington).
- _____, 2012, "Article IV," July (Washington).
- _____, 2013, "Article IV," June (Washington).
- _____, 2014, "Article IV," June (Washington).
- _____, 2015, "Article IV," November (Washington).
- _____, 2016a, "Reinforcer la Gestion des Investissements Publics (PIMA)," *Rapport Technique*, January 2016.
- _____, 2016b, "CEMAC-Staff Report of Common Policies of Member Countries," July (Washington).
- _____, 2017a, "ECF – Request," June (Washington).
- _____, 2017b, "CEMAC-Staff Report of Common Policies in Support of Member Countries Reform Program," December, (Washington).
- _____, 2017c, "ECF - 1st Review," December (Washington).
- _____, 2018a, "Review of 1997 Guidance Note on Governance-Policy Paper," April (Washington).
- _____, 2018b, "ECF - 2nd Review and 2018 Article IV," July (Washington).
- _____, 2018c, "CEMAC-Staff Report of Common Policies in Support of Member Countries Reform Program," December (Washington).

- _____, 2018d, "ECF - 3rd Review," December (Washington).
- _____, 2019a, "ECF - 4th Review," July (Washington).
- _____, 2019b, "CEMAC-Staff Report of Common Policies in Support of Member Countries Reform Program," December (Washington).
- _____, 2020a, "ECF - 5th Review," January (Washington).
- _____, 2020b, "RCF – Request and 2017 ECF Extension," May (Washington).
- _____, 2020c, "Cameroon-Poursuivre le Renforcement de la Gestion des Investissements Publics," Rapport Technique, April 2020.
- Kim, Jun, and others, 2021, "Cross-Country Analysis of Program Design and Growth Outcomes: 2008–19," IEO Background Paper, BP/21-01/01 (Washington: International Monetary Fund).
- Kim, Jung Yeon, and Kwang Yeon Lee, 2021, "Structural Conditions, Structural Reforms and Growth in IMF-Supported Programs," IEO Background Paper, BP/21-01/04 (Washington: International Monetary Fund).
- World Bank, 2018, "Cameroon-Public Expenditure Review," (Washington), 2018.

CHAPTER 3. GHANA

AJAI CHOPRA *

*Consultant, Independent Evaluation Office of the IMF.

EXECUTIVE SUMMARY

Policy implementation was uneven under Ghana's Extended Credit Facility (ECF) arrangements in 2009 and 2015. In particular, fiscal slippage was large, partly due to spikes in spending before elections. Nevertheless, both IMF-supported programs helped reduce macroeconomic imbalances by lowering twin fiscal and current account deficits, cutting inflation, stabilizing the currency, and strengthening international reserves. A high proportion of balance of payments needs were met by current account adjustment.

Progress was also made on structural reform. Expenditure management was strengthened and a framework for transparent and prudent management of Ghana's oil income was put in place. Repair of bank balance sheets helped improve financial sector stability.

But deep-rooted challenges remain. Low revenue mobilization and losses in the energy sector raise government borrowing needs and the risk of public debt distress remains high. Access to credit has been constrained by deficiencies in financial intermediation, as clean-up of the banking sector is not yet complete. External buffers are low, raising the vulnerability to external shocks. And, it is unclear if fiscal control, especially around election periods, is sufficiently entrenched despite improvements in the policy framework.

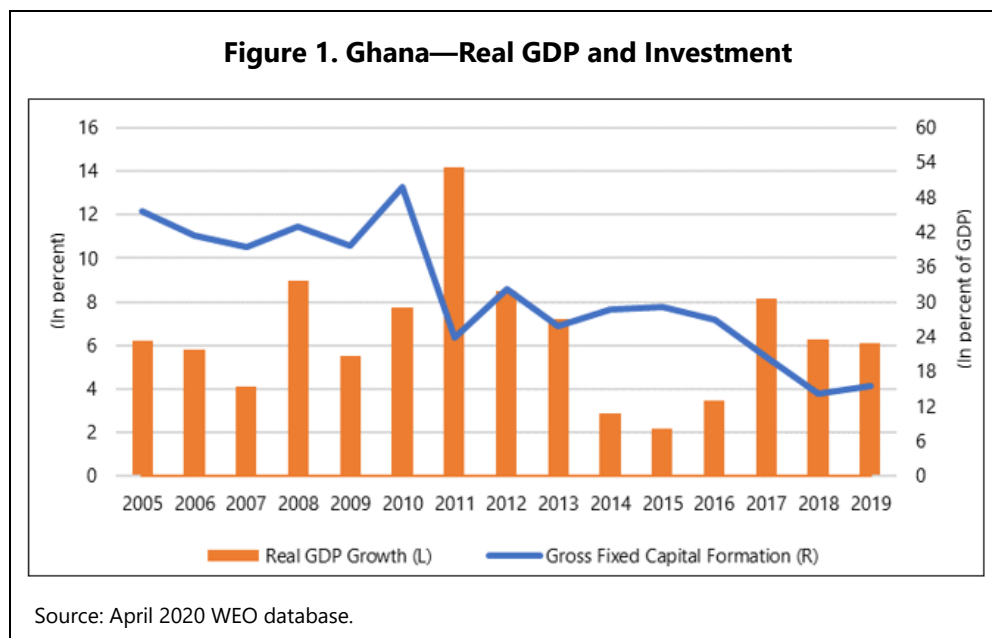
Both arrangements recognized that fiscal tightening would dampen near-term growth, but frontloaded adjustment was appropriately seen as essential to arrest the deterioration in macroeconomic conditions and create a more stable environment to support future growth. In the event, fast growth was sustained under both ECF arrangements, but this was primarily due to fortuitous exogenous supply-side developments. Notably, growth outcomes were driven largely by factors such as rising oil, gold and cocoa production; favorable rainfall; construction and service activity related to the oil sector; and increasing power availability.

Key lessons include:

- (a) The choice made in the balance between adjustment and financing is a critical element of program design and needs stronger justification in program documents.
- (b) Energy sector issues and losses of state-owned enterprises have large macroeconomic consequences, including to restrain growth, but their problems were given insufficient attention because of limited staff expertise. Obtaining stronger commitments from partners with relevant expertise is therefore essential.
- (c) Attention to a growth strategy was cursory because of staff resource constraints and other pressing policy priorities. Notably, emphasis on "inclusive growth" was largely a slogan and not backed by necessary policies. Better analysis and data are needed to back up the emphasis on greater equity in incomes. In addition, although country ownership was buttressed by adapting programs to shifting government priorities, more could have been done to build national consensus around the government's growth agenda.
- (d) Detailed discussion of policy contingencies if risks to growth were to materialize would be beneficial. Recommendations for procyclical policies need better justification.

I. INTRODUCTION

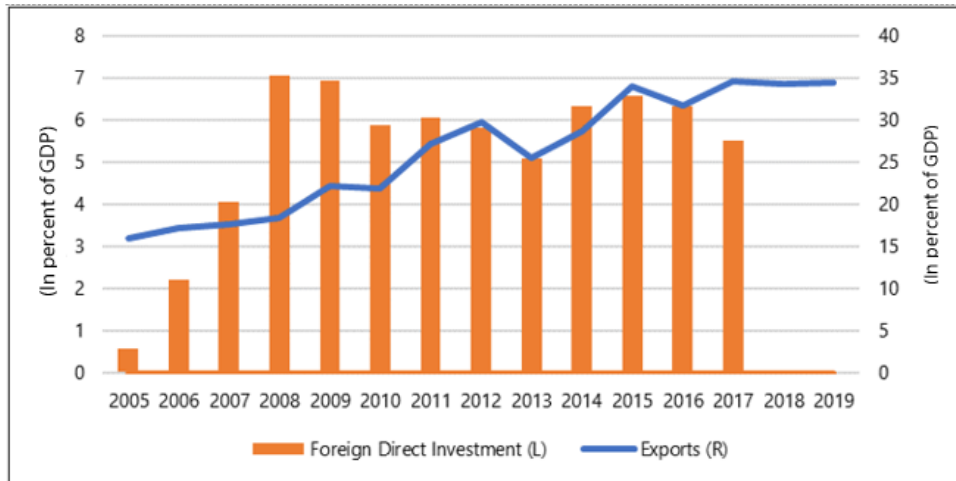
1. **Country overview.** Ghana was the first sub-Saharan country in colonial Africa to gain independence in 1957. Multiparty politics was restored in 1992 when a new constitution was approved. Ghana is well endowed with natural resources. Gold, oil, and cocoa exports, together with individual remittances, are major sources of foreign exchange. Commercial oil production began in December 2010 and the expansion of the oil and gas industry over the last decade has boosted economic growth. Agriculture still accounts for 20 percent of GDP and employs more than half the workforce. The country's age structure is young, with about 57 percent of the population under the age of 25. Ghana's economy has experienced considerable cyclical variation but has still grown on average by 6.3 percent per year since 2000, equivalent to 3.9 percent per year per person (Figure 1). Real GDP per person doubled between 2000 and 2019, and Ghana reached lower middle-income status in 2011. This growth momentum has placed Ghana at the forefront of poverty reduction in Africa, with the poverty rate (national poverty line definition) falling to 23½ percent in 2016 from 39½ percent in 1998. Ghana has attracted substantial foreign direct investment, aided by a good business environment and democratic credentials (Figure 2).



2. **IMF engagement.** Ghana is eligible for concessional financial support from the IMF under the Poverty Reduction and Growth Trust (PRGT). It is also considered to be a “frontier” market by foreign investors. This case study covers two arrangements under the Extended Credit Facility (ECF), the first approved in July 2009 and the second approved in April 2015, about three years after the first arrangement ended (Figure 3). Both arrangements were fully disbursed. They aimed for sustained medium-term engagement to address balance of payments problems and support policies to promote growth and reduce poverty. Prior to these two arrangements, Ghana had an ECF arrangement in place from May 2003 to October 2006. In all, Ghana has had 16 IMF

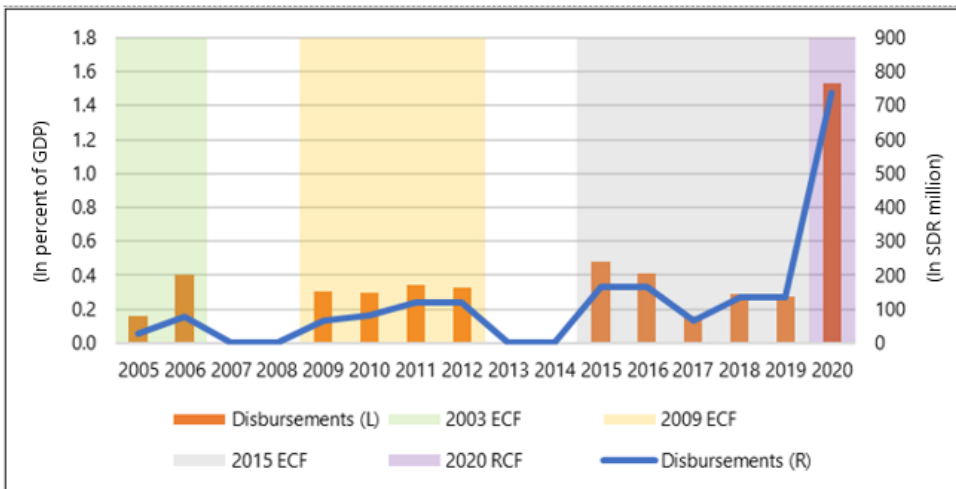
arrangements since 1966. In April 2020, Ghana received a disbursement of SDR 738 million (100 percent of quota, about US\$1 billion) under the Rapid Credit Facility to address the budgetary and external financing gaps arising from the economic impact of the COVID-19 pandemic and related mitigation efforts.

Figure 2. Ghana—Foreign Direct Investment and Exports



Sources: April 2020 WEO database; FFA database.

Figure 3. Ghana—IMF Disbursements



Source: IMF Members' Financial Data.

3. **Political developments during 2008–20.** Ghana has two main political parties, the New Patriotic Party (NPP) and the National Democratic Congress (NDC). The country has a presidential system of government with elections every four years. The NDC won the 2008 presidential election, replacing the previous NPP administration, and it also won the 2012 presidential

election. About 18 months into the 2015 ECF arrangement, the NPP won the 2016 election, marking the third time that Ghana's presidency has changed parties since the return to democracy. Election periods have coincided with substantial fiscal slippage because of election-related spending pressure.

4. **Organization.** This case study first provides a review of the 2009 ECF arrangement, covering the program's objectives, design and outcomes. Emphasis is put on the legacy of the program. This is followed by a more detailed review of the 2015 ECF arrangement, which was influenced by the experience and results of the previous program.

II. THE 2009 ECF ARRANGEMENT

A. Context

5. **Fast growth and rising imbalances.** Growth averaged 6.2 percent a year (3.7 percent in per person terms) in the five years before the program, about the same as the long-term average. The main drivers were supportive global conditions, good cocoa harvests, new gold mines coming on stream, large remittance inflows that fueled consumption and private investment in housing, and increased service and construction activity in response to improvements in the business environment. But imbalances were rising because of demand pressure from high public spending, fueled by investment to address growth bottlenecks and policy slippage in the run up to the 2008 elections. In addition, the external environment deteriorated because of the global financial crisis. Spurred by loose fiscal policy and fast credit expansion, growth shot up to an unsustainable 9.3 percent in 2008, a two-decade high. Risks to external stability increased as the current account deficit widened to 19 percent of GDP in 2008 from 12 percent the year before.¹ The currency depreciated by about 50 percent against the dollar during 2008 and the first half of 2009, and gross reserve cover fell from 2.7 to 2.2 months of prospective imports. The 2008 Article IV consultation recommended urgent policy adjustment to reduce excess demand pressure and reduce external vulnerability.

B. Program Design

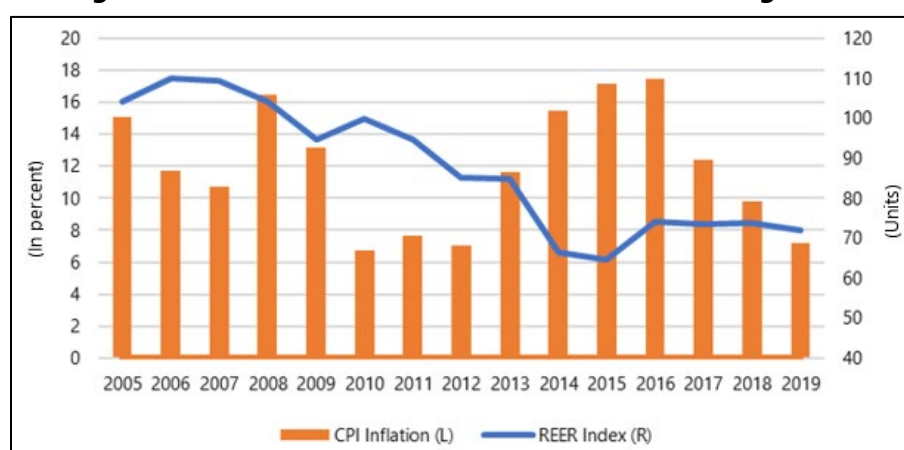
6. **Program objectives and political situation.** The 2009 ECF arrangement was approved in July, about six months after a new NDC-led government took office. With the next election due in December 2012, the same administration was in place for the duration of the three-year ECF arrangement. The primary objective of the ECF was to tackle macroeconomic instability, which was viewed to be the main obstacle to sustained strong growth and poverty reduction. An additional objective was to strengthen fiscal institutions ahead of the expected start of oil production in 2011.

¹ These are the estimates that were available to the authorities and staff at the time the ECF was requested. Subsequent data show smaller current account deficits in large part because Ghana's national accounts were rebased in 2010, resulting in a substantial increase in the level of GDP for earlier years.

7. **Macroeconomic policies.** Tightening fiscal and monetary policy was central to restoring macroeconomic stability under the program.

- **Fiscal policy.** Fiscal tightening was seen as essential not only to restore stability, but also to create the necessary room for maneuver so that when oil revenues came on stream in 2011 they could be dedicated to new growth-promoting and poverty-reducing investment that would benefit future generations. The budget deficit surged to 14½ percent of GDP in 2008 largely because of a one-off blowout in spending before the elections, financed in large part by a Eurobond issue, proceeds from the sale of Ghana Telecom, and central bank credit. The 2009 budget deficit target of 9½ percent of GDP, set before the program was agreed, was not changed but additional measures were identified to preserve this target and avoid an overrun. The program aimed for further tightening to bring the deficit down to 4½ percent of GDP by 2011, frontloaded with a 3½ percentage points of GDP reduction planned for 2010. This fiscal path was projected to stabilize government debt at about 66 percent of GDP; debt sustainability analysis indicated that external debt dynamics would be subject to moderate risk of debt distress. The fiscal consolidation strategy relied primarily on spending restraint, especially a reduction in the public wage bill and a shift to cost recovery for utility tariffs. Capital spending was reduced by 3 percent of GDP in 2009, but this mainly reflected the completion of investment projects in the power sector and other areas. Revenue mobilization was also on the agenda but was given less priority.
- **Monetary and exchange rate policy.** In response to rising inflation, monetary policy had been tightened before the program commenced and exchange rate flexibility was also increased in the second half of 2008.² As a result of Ghana's macroeconomic imbalances and declining foreign exchange inflows, the currency depreciated by about 50 percent against the dollar during 2008 and the first half of 2009. However, the large depreciation against the dollar translated into only a modest correction of the real exchange rate because of high inflation (Figure 4). The authorities saw the currency as appropriately valued as the program got underway, while staff saw risks of continuing modest overvaluation. The program called for maintaining the tight monetary stance and exchange rate flexibility to reduce inflation and rebuild external reserves. The inflation-targeting framework was also enhanced, especially through improved communications. With a reduction in fiscal dominance, the Bank of Ghana's tools for monetary management were viewed as adequate to control inflation.

² In May 2007, the Bank of Ghana had announced a formal inflation targeting (IT) regime, which IMF staff characterized as "IT lite" because exchange rate stability (in the context of a managed float) was an important intermediate objective.

Figure 4. Ghana—Inflation and Real Effective Exchange Rate

Sources: April 2020 WEO database; INS database.

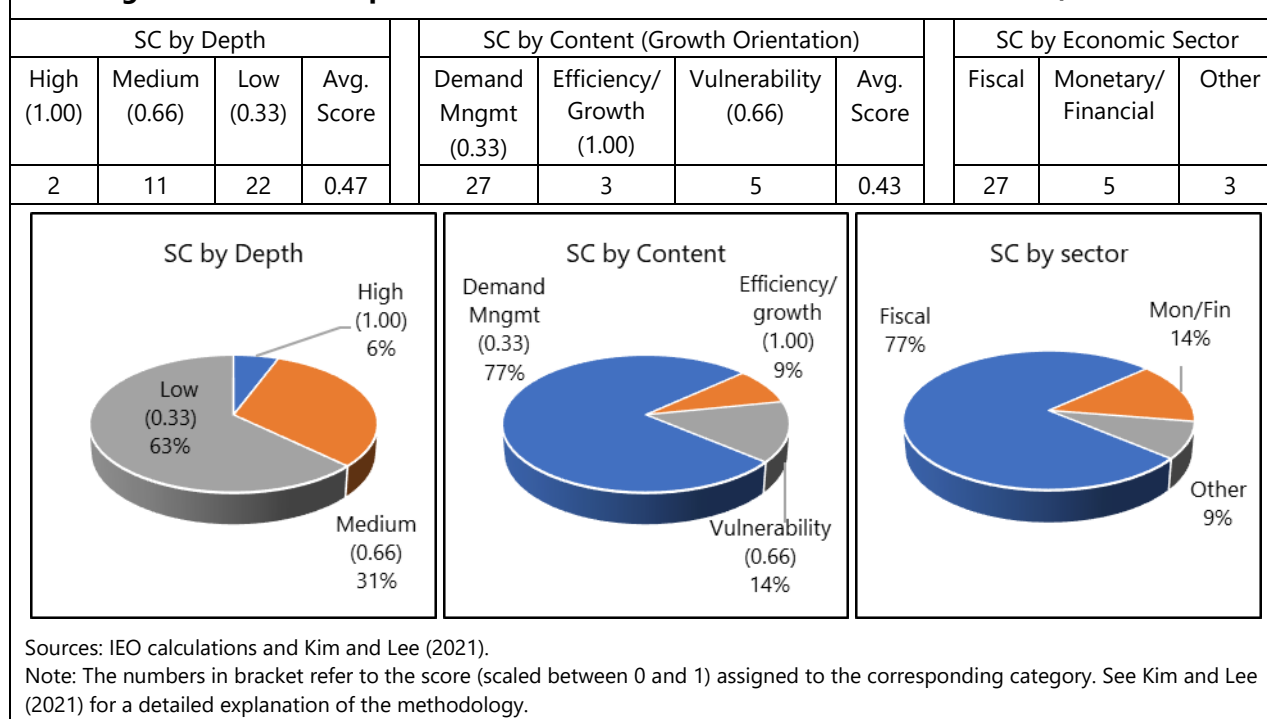
8. **Structural policies.** Structural conditionality focused on strengthening fiscal institutions (tax policy, revenue administration, PFM) and addressing recurrent sources of spending pressure (particularly energy subsidies and the public sector wage bill, including by freezing net hiring except in education and health). Work was also begun to develop a framework to manage oil and gas revenues. When the arrangement was approved, the financial sector was seen as resilient to the initial impact of the global financial crisis, but there was a concern that vulnerabilities had accumulated in an environment of rapid banking expansion, strong competition, and increased risk taking. These vulnerabilities increased during the course of the program, but a thorough diagnosis had to await the 2011 update of Ghana's FSAP. Developing a strategy to address problems in weak banks took additional time after that update and was included as a structural benchmark at the time of the combined third and fourth review in June 2011 (almost two years after program approval), with the strategy to be delivered by the end of 2011. The depth, growth orientation and sectorial content of structural conditions in Ghana's 2009 ECF arrangement are shown in Figure 5. Ghana's average score of 0.47 for the depth of structural conditions is modestly below the median of 0.52 for all PRGT arrangements; for growth orientation of structural conditions, the average score is in line with the median, although mainly through improved demand management rather than efficiency improving reforms (0.43 versus 0.44).³

9. **Technical assistance.** These policy efforts were supported by extensive technical assistance (TA) from the IMF and other partners. The IMF provided TA in areas including tax policy, revenue administration, petroleum regulation and a fiscal regime for natural resources, public financial management (in collaboration with the World Bank), expenditure control and the regularization of arrears, public debt management (jointly with the World Bank), banking supervision (in collaboration with Canada's Office of the Superintendent of Financial Institutions),

³ For technical details regarding the analysis of the depth, content, and implementation of structural conditionality see Kim and Lee (2021).

anti-money laundering, problem bank resolution, statistical methods (national accounts, money and banking, government finance, and balance of payments). In addition, Ghana received TA from the United Nations Development Program and the International Labor Organization for the design and compilation of labor statistics.

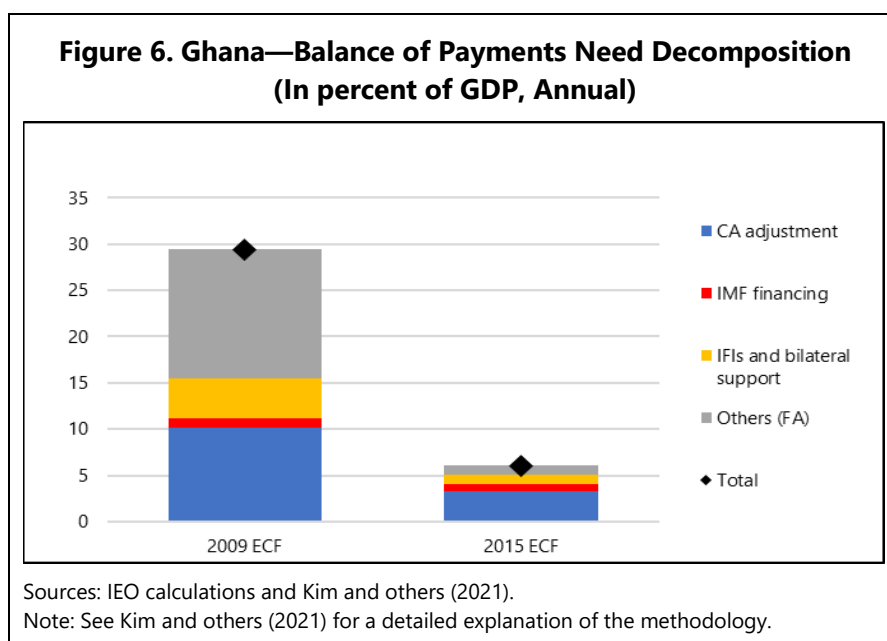
Figure 5. Ghana—Depth and Growth Orientation of Structural Conditions, 2009 ECF



10. **Program modalities and financing.** Access of SDR 387.5 million (105 percent of quota, or \$576 million) was somewhat above the norm of 70 percent of quota for a fifth-time PRGT user, reflecting program strength and balance of payments needs. Almost 70 percent of access was frontloaded to 2009 and 2010 when the adjustment effort and balance of payments needs were strongest. Total financing requirements for 2009–2012 were estimated to be \$13 billion, with the bulk coming from FDI (\$6.8 billion) and bilateral creditors (\$5.2 billion), while the contribution from other IFIs was small (\$375 million). Thus, as with other PRGT cases, the IMF arrangement aimed at playing a catalytic role to attract FDI and financing from bilateral donors.

11. **Balance between adjustment and financing.** At the time the program was designed, the current account deficit for 2009 was projected to be 13 percent of GDP, a reduction of 6 percentage points of GDP from the estimated deficit in the previous year. The current account deficit was projected to fall further to about 8½ percent of GDP by 2012. Overall, to meet balance of payments financing needs, Ghana's 2009 ECF arrangement called for a substantially higher proportion of planned current account adjustment than the average for other PRGT countries. Specifically, Figure 6 shows annual current account adjustment of 10 percent of GDP. This adjustment covered about one-third of total balance of payments needs, with the other

two-thirds covered by financing.⁴ By contrast, for PRGT case studies in this evaluation, on average about 17½ percent of total balance of payments needs were envisaged to be met via current account adjustment, with the remainder covered by financing. This substantial current account adjustment planned under Ghana's 2009 ECF arrangement in large part reflected the projected increase in natural resource exports, including an exportable surplus of oil.



12. **Program design and the growth outlook.** Staff anticipated fiscal tightening to be a significant drag on growth in 2009, although this was expected to be tempered somewhat by the strength of domestic demand in the previous year. In addition, credit growth was projected to decline, and the global recession was dampening remittances. Accordingly, growth was forecast to slow to 4½ percent in 2009 and then rise to 5 percent in 2010 as the external environment improved. The medium-term outlook under the program incorporated the start of oil production in 2011, projecting growth of 24 percent for that year. Non-oil growth over the medium term was forecast to be 6.2 percent.

13. **Attention to inclusive growth.** Steps to foster inclusive growth focused on two areas. First, Ghana's poverty reduction strategy, drawing on the *Ghana Shared Growth and Development Agenda* (GSGDA) for 2010–13, included efforts to enhance private sector competitiveness and sectoral priorities such as agricultural reforms, human development, water and sanitation, and transport. And second, the Petroleum Revenue Management Act, adopted by parliament in 2011, dedicated at least 70 percent of benchmark oil revenue to investments in identified priority areas, including road and infrastructure improvements, agricultural modernization, and capacity building.

⁴ See IEO (2021a) for details on the methodology to estimate the decomposition of balance of payments needs.

14. **Risk assessments and contingencies.** Risk assessments generally focused on policy implementation risks, especially in the fiscal area. The assessment of the consequences of downside risks to growth was limited. Although the authorities had a more optimistic view of the growth outlook, they agreed to base fiscal plans on the staff's more conservative growth projections. Notably, the program advocated additional procyclical fiscal tightening in the event of negative growth shocks. Specifically, the staff report for the request for the 2009 ECF stated: *"The authorities have intensified cash management, and in the event of an even larger slowdown in economic growth and revenue collections, are ready to maintain the deficit target through cuts in discretionary spending"* (paragraph 19). No rationale was provided for this stance, but implicitly the priority was to ensure fiscal discipline and avoid overruns of the deficit.

C. Outcomes

15. **Evolution of the program.** Reviews were completed with delays between two and eight months. Six out of seven reviews were combined in pairs, with only one conducted on its own. Delays provided time for the authorities to take corrective policy action and comply with structural benchmarks. All disbursements under the program were made, with the program extended by about a month to allow the final disbursement upon completion of the sixth and seventh reviews.

16. **Fiscal slippage.** Fiscal performance fell substantially short of program goals in 2009. The end-year performance criterion for the fiscal deficit on a cash basis was met, but the deficit on a commitment basis was about 3 percentage points of GDP larger than programmed, financed by new domestic spending arrears. The program's original goal to limit the 2010 fiscal deficit to 6 percent of GDP was unattainable and was revised to 8 percent of GDP. But even this looser target was missed because of spending overruns, which contributed to a further accumulation of arrears. Fiscal performance was much stronger in 2011, with good revenue performance (especially non-oil tax revenue as tax administration improved) and a reduction in cash expenditure (especially non-wage current spending and capital expenditure). The clearance of old arrears exceeded the accumulation of new arrears. Overall, the fiscal adjustment in 2011 on a commitment basis was 5¼ percentage points of non-oil GDP, but this large adjustment was still about 1 percentage point less than envisaged at the time of the fifth review. Additional spending pressure materialized in early 2012 with higher-than-budgeted public wage increases and the reemergence of energy subsidies.

17. **Evolution of fiscal balance.** Table 1 below compares the program projection of the overall fiscal balance (cash basis, including grants) at start of the ECF arrangement with the estimated outturn at each review of the arrangement based on information available at the time. Due to the rebasing of Ghana's national accounts in 2010, which resulted in a substantial increase in the level of nominal GDP in earlier years as mentioned in paragraph 5, consistency requires comparing the program projections at the time of the third and fourth review in May 2011 with the estimated outturns at the time of the final reviews of the arrangement in July 2012. The table shows that fiscal adjustment achieved in the initial years of the ECF was substantially reversed in the last year of the arrangement. Nevertheless, the sixth and seventh reviews of the arrangement

were completed as a pair based on the staff's assessment that *"program objectives remained within reach under an appropriately tight policy stance"* (IMF 2012b, page 3). In the event, the programmed 2012 cash deficit of 6.7 percent of GDP, set at the time of the final reviews in July, was exceeded by a wide margin (see paragraph 23).

**Table 1. Ghana—Overall Fiscal Balance (Cash): 2009 ECF Program vs. Estimated Outturn
(In percent of non-oil GDP)**

	2008 (Pre-program)	2009	2010	2011	2012
ECF Request (July 2009)	-14.5	-9.4	-6.0	-4.5	-2.8
1 st & 2 nd Review (June 2010)	-14.5	-9.7	-8.0	-4.5	-3.5
3 rd & 4 th Review (May 2011) <i>After revision of GDP series</i>	-8.5	-5.8	-7.7	-4.7	-2.5
5 th Review (December 2011)	-8.5	-5.8	-7.4	-5.1	-5.2
6 th & 7 th Review (July 2012)	-8.5	-5.8	-7.2	-4.4	-6.7

Source: IMF program documents.

18. **Monetary policy implementation.** Following the sharp tightening of monetary policy before the start of the program, the Bank of Ghana (BoG) started to ease in the last quarter of 2009 as inflation fell and the exchange rate stabilized. The policy rate was reduced gradually from 18 percent to 12½ percent by the end of 2011. But with the reemergence of inflation and exchange rate pressures, the BoG raised its policy rate in three steps to 15 percent from January to June 2012. The tightening aimed to preserve the inflation target, reduce the need for intervention to arrest the slide of the cedi, and slow the acceleration in private credit growth. Continued central bank lending to the government complicated the BoG's efforts to mop up excess liquidity.

19. **Reduced imbalances.** Notwithstanding the slippage in fiscal policy compared to program objectives, overall macroeconomic policies were more restrictive, which helped to reduce domestic and external imbalances. Inflation fell from a peak of 20 percent in June 2009 to close to 9 percent in mid-2010 and remained at that level till about the end of 2011 when pressures began to reemerge. The current account deficit fell from a peak of 9 percent of GDP in 2008 to 4 percent of GDP in 2009, and then stabilized at about 6½ of GDP for the next two years.⁵ The cedi strengthened against the dollar and gross reserves increased from \$2 billion in 2008 (2.2 months of prospective imports) to \$5.5 billion in 2012 (2.9 months of imports), supported by foreign borrowing.

20. **Lags in structural reform implementation.** There was generally good compliance with the structural benchmarks in the fiscal area, but with some delays especially in areas such as expenditure management, public sector reform and payroll management, and revenue

⁵ As noted in footnote 1, the national accounts were rebased in 2010 resulting in a substantial increase in the level of GDP used in the denominator for these ratios, affecting comparisons based on information available at the start of the program.

administration. The adoption of the Petroleum Revenue Management Act in April 2011 was a notable first step toward establishing a framework for transparent and prudent management of Ghana's oil income. Conditionality in the financial sector was stepped up in mid-2011, but there were delays in conducting an independent audit of problem banks and developing a strategy to deal with these banks. Overall, 77 percent of structural conditions were met on schedule, with the remainder being met with delays, putting Ghana's compliance rate somewhat below the median for other PRGT cases.

21. **Growth forecast and actual performance.** Growth over the program period was broadly in line with initial projections (Table 2). Cumulative growth in 2009 and 2010 was 13.8 percent, exceeding the program's more conservative forecast of 9.7 percent. Growth was expected to spike in 2011 and 2012 with the start of oil production, with the program projecting cumulative growth of 33 percent for the two years. Actual cumulative growth for the two years together was a bit lower at 28 percent. Taking the four years spanned by the program (2009–12), the ex-ante cumulative growth projection and ex post actual growth were virtually identical at 46 percent versus 45.7 percent. Program documents also projected non-oil growth separately: actual cumulative non-oil growth of 28.7 percent for the four years exceeded the forecast of 23.8 percent. Ghana's growth performance during the 2009 ECF arrangement significantly exceeded the IEO growth benchmark estimated by using external factors alone (Figure 10 below).⁶ Overall, in addition to the boost to growth from the start of oil production in 2011, non-oil growth benefitted from buoyant commodity exports, favorable rainfall, and strong construction and service activity related to the oil sector.

22. **Rising risks.** In July 2012, at the time of the final reviews of the 2009 ECF arrangement, it was evident that risks to macroeconomic stability were beginning to rise. The cedi depreciated as high domestic demand and delays in tightening monetary policy put upward pressure on inflation. A larger-than-budgeted public sector wage increase and the reemergence of energy subsidies began to raise concerns about fiscal discipline ahead of the December 2012 elections. The potential for slower global growth was also a concern. Nevertheless, as noted in paragraph 17, the final reviews of the arrangement were completed based on the staff's assessment that program objectives remained within reach if the authorities adopted and maintained a tight policy stance. However, the hoped-for tight policy stance did not happen.

23. **Risks materialize.** Fiscal policy was highly expansionary in 2012, with a tripling of the cash deficit to 12 percent of GDP, well above what was projected at the time of the final reviews of the program as shown in Table 1. The loss of fiscal control occurred in the months before the December 2012 elections. With the expansionary policies, growth momentum remained strong in

⁶ To construct the growth benchmark, a panel growth regression is estimated for a sample of 174 countries over the period of 1990–2019 based on external factors alone. The external factors in the panel regression include terms of trade changes, trading partner's growth, US interest rates, regional growth and a dummy for the global financial crisis. For technical details regarding the econometric analysis used to estimate the growth benchmarks see Kim and others (2021).

2013 but imbalances reemerged and there was a marked slowdown in growth in 2014. Monetary policy was tightened with some delay to halt the rapid depreciation of the cedi and address rising inflation. The resulting double-digit real interest rates weakened private sector activity, as did electricity shortages.⁷ Fiscal consolidation targets for 2013 and 2014 were missed and the deficit remained high. Public debt was rising and financing needs were large. There was increasing resort to short-term domestic debt and also sizeable monetary financing of the deficit. Reliance on foreign investors was also significant. A new US\$1 billion Eurobond was issued in September 2014, but at a higher spread than for regional peers. The current account deficit widened and the international reserve position weakened.

Table 2. Ghana—Growth: 2009 ECF Program vs. Outturn (In percent)					
	2009	2010	2011	2012	Cumulative
Program projection					
Total	4.5	5.0	24.2	7.1	46.0
Non-oil	4.5	5.0	6.2	6.2	23.8
Outturn					
Total	5.5	7.9	17.4	9.0	45.7
Non-oil	4.0	6.4	8.4	7.3	28.7

Source: IMF program documents and World Economic Outlook.

III. THE 2015 ECF ARRANGEMENT

A. Program Design

24. **Request for IMF support.** Although it was evident in 2013 that Ghana would need a new IMF arrangement, the authorities resisted and delayed making a request. Eventually in August 2014, the authorities requested an IMF arrangement as risks began to mount that Ghana would be unable to roll over maturing debt. The ECF arrangement was approved in April 2015.

25. **Program objectives.** In view of the policy slippage since the previous IMF arrangement, a key objective of the new arrangement was to help support stronger policy adjustment to arrest the macroeconomic deterioration and restore market confidence. In addition, the arrangement aimed to support the government's transformation agenda for the country, which was put forward in the second *Ghana Shared Growth and Development Agenda* (GSGDA II, 2014–17). The transformation agenda focused on economic diversification, social inclusion, and sustained macroeconomic stability. To achieve these goals, the agenda aimed to gradually shift public expenditure from current to capital spending, supported by channeling new oil and gas revenue

⁷ Power shortages were a recurring problem in Ghana for many years, imposing a toll on growth. Management inefficiencies in the state-owned enterprises in the energy sector, lack of timely utility tariff adjustment, and accumulation of cross arrears contributed to these shortages. Demand had outpaced added new capacity, with electricity-intensive sectors like manufacturing and mining being particularly affected.

into productive investment to develop infrastructure and reliable power generation, as well as reform of state-owned enterprises.

26. **Country ownership and political economy.** An NDC-led government was in place when the 2015 ECF arrangement was requested and launched, the same party that oversaw the 2009 ECF arrangement. The opposition won the next election in December 2016 and an NPP-led government was installed in early 2017. When the program was designed, it was recognized that there was a significant risk of fiscal slippage around the election based on past experience. But, in the event, this risk was underestimated. The program was modified to reflect the new NPP-led government's priorities as discussed in greater detail in paragraphs 34 and 35 below.

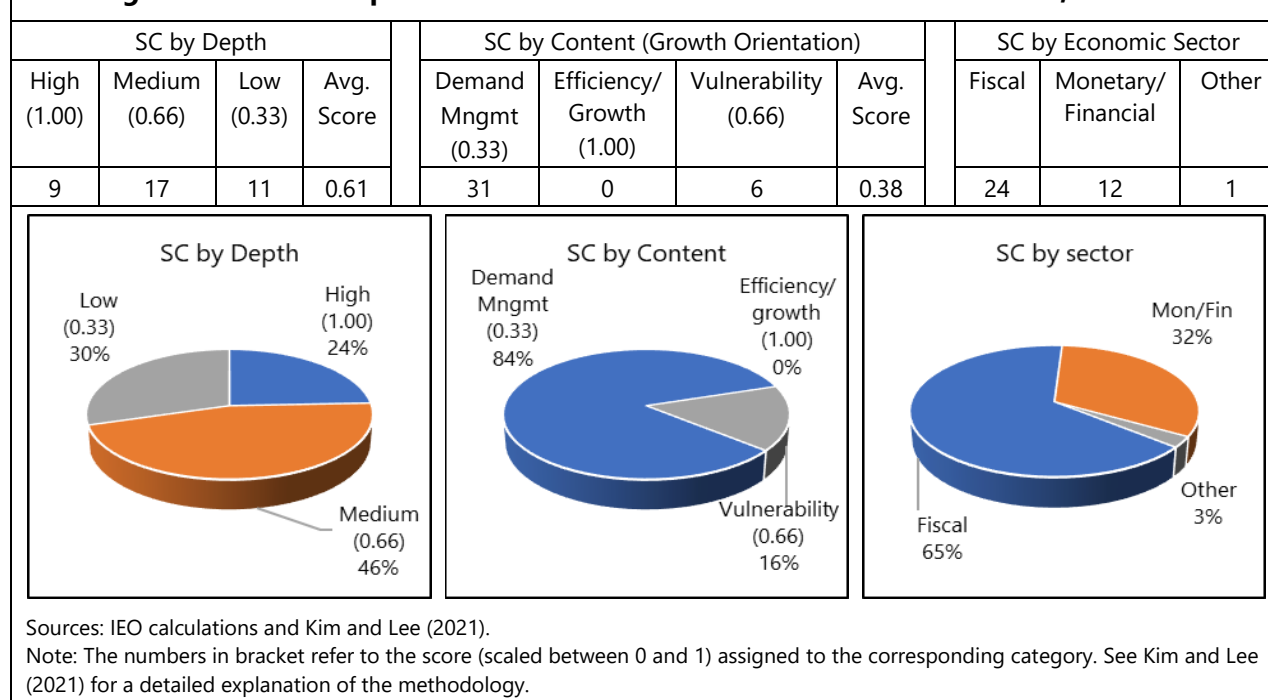
27. **Policy strategy.** The program centered on ambitious frontloaded and sustained fiscal adjustment to restore macroeconomic stability and debt sustainability, rebuild external buffers, and eliminate fiscal dominance of monetary policy. The policy strategy also sought to preserve financial stability and put greater emphasis on promoting growth and social protection than the 2009 ECF-supported program.

- **Fiscal adjustment.** The program aimed to turn the primary balance (on a commitment basis) from a deficit of 3½ percent of GDP in 2014 to a surplus of 0.9 percent of GDP in 2015 and 3.2 percent of GDP in 2017. Taking into account lower than previously projected oil revenue over the program period, the program sought to expand revenue collection, restrain the wage bill and other primary expenditure, and make space for priority spending and clearing domestic arrears. Combined with the expected expansion in hydrocarbon production, fiscal consolidation was projected to lower total public debt from 72 percent of GDP in 2015 to a more sustainable level of about 50 percent of GDP within a decade.
- **Fiscal reforms.** To strengthen public finances and fiscal discipline, the program included a wide-ranging set of fiscal reforms. The areas covered were: (i) improving public financial management; (ii) strengthening budget transparency; (iii) cleaning up the payroll and enhancing wage bill control; (iv) reforming the civil service; (v) restructuring statutory funds; (vi) broadening the tax base by reducing various discretionary tax treatments; (vii) accelerating tax administration reforms; and (viii) amending the Petroleum Revenue Management Act to address operational issues that had emerged since the Act was adopted.
- **Monetary and exchange rate policy.** A medium-term inflation target of 8 percent was announced to help anchor inflation expectations. To this end, the program included steps to restore the effectiveness of the inflation targeting regime including (i) progressively eliminating central bank financing of the central government and state-owned enterprises; (ii) strengthening the foreign currency interbank market and adopting a

market-based daily reference exchange rate;⁸ and (iii) legislating a new Bank of Ghana Act to strengthen functional autonomy, governance and the ability to respond to banking sector stress. The Bank of Ghana committed to adjust its policy rate to achieve the inflation and reserve targets and to limit foreign exchange intervention to manage disorderly market conditions.

- **Financial sector.** To address concerns about bank balance sheets and preserve financial stability, a special diagnostic audit of loan classification, provisioning, and restructured loans was conducted by the Bank of Ghana and an external audit firm. This was to be followed by a prompt policy response to address any shortcomings, including intensive supervision, enforcement actions, and, if needed, resolving banks that failed to meet their targets. Deposit insurance and bank resolution laws were adopted to strengthen the Bank of Ghana's supervisory and crisis management powers.
- **Growth and social protection agenda.** Plans in this area drew on *Ghana Shared Growth and Development Agenda 2014–17*. These plans centered on improving electricity generation and distribution and supporting small and medium-scale industries. In addition, investment in the agricultural sector was to be prioritized to promote job creation for a rapidly growing workforce. The agenda also included a variety of social protection and safety net interventions, including the establishment of a National Household Registry to improve the targeting of these interventions and protect the most vulnerable. Other reforms aimed to improve service delivery in areas such as sanitation, health and education. The program included a floor on poverty-reducing government expenditures as an indicative target.
- **Thrust of structural reform conditionality.** The depth, growth orientation and sectoral content of structural conditions in Ghana's 2015 ECF arrangement are shown in Figure 7. The sectoral composition and lack of growth orientation was similar to the 2009 ECF arrangement, but the depth was greater with 70 percent of conditions classified as being of medium and high in the 2015 arrangement versus 37 percent in the 2009 arrangement. Ghana's average score of 0.61 for the depth of structural conditions is above the median of 0.52 for all PRGT arrangements. But for growth orientation of structural conditions, Ghana's average score of 0.38 was somewhat below the median (0.44), and entirely through demand management rather than efficiency enhancing reforms.

⁸ Apart from noting that there was a sharp depreciation of the nominal and real effective exchange rate in the first eight months of 2014, followed by greater stability after the issuance of a euro bond and external borrowing by the Cocoa Board, the issue of competitiveness was not discussed in the request for the ECF arrangement.

Figure 7. Ghana—Depth and Growth Orientation of Structural Conditions, 2015 ECF

28. **Technical assistance.** The IMF continued to provide technical assistance in the period between the end of the 2009 ECF and the start of the 2015 ECF, after which TA was ramped up to support the new arrangement. Areas covered were wider and deeper than the 2009 ECF (see paragraph 9), with particular emphasis on fiscal and financial stability issues. Specifically, 56 individual TA items from 2014 to mid-2017 were listed in the “Relations with the Fund” appendix of the staff report for the fourth review of the arrangement in September 2017. To provide an indication of the enormous scale of TA provided by AFRITAC West 2 (AFW2), FAD, ICD, LEG, MCM, and STA, these individual TA items are listed in Annex I of this case study. The items listed in the annex understate TA during the ECF arrangement because assistance in the listed areas continued in 2018 and 2019. This extensive support resulted in a backlog of TA recommendations and complicated follow up. After the arrangement ended, the 2019 Article IV staff report took a step back to review the capacity development strategy.⁹ In addition to IMF TA, the World Bank was involved in improving the governance of state-owned enterprises and the transformation of the energy sector.

29. **Program modalities and financing.** Access was the equivalent of 180 percent of quota (SDR 664.2 million or \$915 million). Internal IMF documents noted that this was higher than the norm of 75 percent of quota for such arrangements for countries with outstanding loans to the

⁹ See Annex V, “Capacity Development Strategy” in the 2019 Article IV staff report. A key conclusion was that progress in capacity development under the program was uneven. For example, progress in revenue administration was assessed to be particularly slow despite extensive support. In addition, TA recommendations were judged to be largely outstanding for risk-based supervision and financial stability.

IMF in excess of 100 percent of quota.¹⁰ In addition, the high risk of debt distress precluded blending with GRA resources. Published program documents stated that the case for higher-than-usual access was based on (i) protracted balance of payments needs—notably, elevated current account deficits, limited access to international capital markets due to high public debt and bond spreads, and the need to build larger reserves, including to buffer against commodity price shocks; (ii) the strength of medium-term adjustment (including frontloaded fiscal measures); and (iii) the commitment of the World Bank, the African Development Bank and bilateral donors to provide significant support of about \$900 million over 2015–2017. Notwithstanding constrained international market access at the start of the program, IMF disbursements were not frontloaded and instead eight equal disbursements were envisaged over the course of the program. Donor and IFI support, however, was frontloaded, with \$500 committed for 2015 conditional on approval of the IMF arrangement. This frontloading was due to the bunched disbursement of bilateral support that had been held back in the previous couple of years because of rising macroeconomic imbalances.

30. **Balance between financing and adjustment.** As in the case of Ghana’s 2009 ECF arrangement, the 2015 arrangement called for a substantially higher proportion of planned current account adjustment to meet balance of payments financing needs than the average for other PRGT countries (see Figure 5 and paragraph 11 above). At the time the program was designed, the current account deficit for 2015 was projected to be 7 percent of GDP, a reduction of about 2 percentage points of GDP from the estimated deficit in the previous year. The current account deficit was projected to fall to about 5 percent of GDP by 2017. These current account developments were premised on an increase in oil exports and compressed aggregate demand. Gross international reserves were projected to rise to \$7.5 billion (4.2 months of prospective imports) by 2017, up from \$4.3 billion in 2014 (3 months of imports).

31. **Program design and the growth outlook.** It was recognized that the programmed frontloading of fiscal adjustment would further dampen non-oil economic growth in 2015, but there was no explicit analysis of fiscal multipliers. Growth was expected to rebound in the following years. Specifically, non-oil growth was projected to decelerate further to 2¼ percent in 2015 from about 4 percent in the previous year, before picking up and reaching 5½ percent in 2017. Large increases in hydrocarbon production were expected to boost the economy, resulting in higher and rising total GDP growth of 3½ percent in 2015 and 9¼ percent in 2017. Lower inflation and interest rates together with a more competitive and stable exchange rate were expected to support growing private sector activity.

32. **Risk assessment.** A number of downside risks to the near and medium-term outlook were identified, including (i) a more prolonged electricity crisis that would lower growth and weaken the financial sector, creating a negative feedback loop because banks would be less able

¹⁰ Ghana had outstanding obligations of 111 percent of quota at the time the 2015 ECF arrangement was approved. Subsequent to the approval of the ECF, PRGT access limits were increased and are currently 100 percent of quota per year with total outstanding concessional credit limited to 300 percent of quota.

to support private sector activity and provide budget financing; (ii) social tensions and policy reversals in the run up to elections in 2016 in view of the experience with fiscal overruns during previous election cycles; (iii) exposure to terms of trade shocks with exports dominated by commodities, and especially a further decline in oil prices that would have a substantial negative fiscal impact in the medium term; (iv) increased financing costs because of changes in global financing conditions as concessional resources diminish for Ghana; and (v) risks related to the recent Ebola outbreak in Africa, which could impact trade and budget spending. On the upside, there was potential to quickly regain policy credibility leading to a more rapid decline in domestic interest rates and restoration of investors' confidence. In addition, a stronger rebound in commodity prices, including oil, would facilitate accelerating some development projects.

33. **Policy contingencies.** The Risk Assessment Matrix prepared for the first review in August 2015 contained the most explicit statement of policy contingencies if downside risks to growth were to materialize. In particular, it indicated that because of high debt and inflation there was no space for expansionary policy to offset an adverse shock to growth; the matrix did not call for procyclical fiscal tightening in these circumstances. Furthermore, in the event of a deterioration in market confidence affecting the availability of financing, it was stated that economic growth and imports would have to decline to bring about the required adjustment in the current account deficit.

B. Implementation and Outcomes

34. **Evolution of the program.** Implementation of 2015 ECF program went through two distinct phases:

- Program performance and implementation were broadly satisfactory for the first three reviews, but the environment was becoming increasingly challenging. In particular, the electricity crisis remained unresolved, there were disruptions in oil production, the cocoa harvest was poor, gold production declined, and there was a drop in the price of key exports. In addition, inflation remained stubbornly high, requiring continued tight monetary policy. As a result, growth remained weak. Furthermore, state-owned enterprises faced increasing financial pressure and bank asset quality worsened. After the third review was completed, the situation took a dramatic turn for the worse in the run up to the December 2016 election when there was a loss of fiscal control. The fiscal cash deficit for 2016 hit 9.3 percent of GDP versus a third review target of 5.2 percent of GDP.
- With the change in government after the election and the absence of fiscal adjustment under the program, there was a debate about whether to cancel the ECF arrangement and put a new arrangement in place. After several months of discussions with the new NPP-led government, the fourth review under the program was completed in August 2017 and it was decided to extend the existing arrangement by one year until March 2019 and re-phase remaining disbursements. In many respects, including the added attention given to the new government's policy priorities, this second phase was

equivalent to a new program but with unchanged access. Four reviews remained (a new one had been added to the original seven), and they were completed in pairs.

35. **Program revisions.** The new NPP government had a strong mandate to pursue macroeconomic stability and “create prosperity and opportunity for all.” But it faced significant challenges as policy slippage before the 2016 election amplified the impact of external and domestic shocks, resulting in persistent imbalances, high inflation, exchange rate volatility, unfavorable debt dynamics, and tightening market access. New understandings were reached on fiscal adjustment, structural reforms, measures to improve the financial viability of state-owned enterprises, and better monitoring and oversight of the program.

- **Fiscal tightening and reforms.** To reverse adverse debt dynamics, the program aimed for primary adjustment of 4½ percent of GDP over 2017–18 to bring the overall deficit down to 3.8 percent of GDP in 2018. The adjustment was frontloaded to 2017, when growth was expected to receive a boost from increased oil and gas production. The adjustment was premised primarily on expenditure containment, with improved tax compliance and mobilization of non-tax revenue also contributing. The program found room for free high school education, a key election promise by the NPP. The budget also included tax relief estimated to cost about 0.4 percent of GDP to spur private sector growth. The fiscal reform agenda was similar to the original program.
- **Fiscal program, revisions, and outcomes.** Table 3 compares the program projection of the overall fiscal balance (cash basis, including grants) at the start of the ECF arrangement with the estimated outturn at each review based on information available at the time. The updated estimates of the deficit for the 2019 Article IV consultation are also shown, including and excluding the costs related to the restructuring of the financial and energy sectors. Following the loss of fiscal control before the 2016 election, the deficit was reduced from 9.3 percent of GDP in 2016 to 4.7 percent of GDP in 2019 (excluding restructuring costs).
- **State-owned enterprises.** As noted in paragraph 23, energy sector enterprises posed significant fiscal risks and power shortages imposed a toll on growth. These enterprises faced financial pressure stemming from management inefficiencies, weak governance, and inadequate tariff structure. Under the ECF-supported arrangement, additional efforts were made to strengthen monitoring, transparency and governance. For example, submission of legislation to create a single oversight authority (the State Interest and Government Authority, SIGA) was a prior action for the final review of the ECF arrangement. In addition to relying on the World Bank, IMF teams made efforts to develop basic internal expertise. Overall, however, reforms in this area were hampered by limited political will and weak implementation, resulting in continued fiscal risks and growth impediments.

- **Monetary policy.** The authorities committed to abstain from central bank financing of the government under the program as laid out in the March 2015 memorandum of understanding between the Ministry of Finance and the Bank of Ghana. To further reduce the risk of fiscal dominance, amendments to the Bank of Ghana Act were planned to bolster central bank independence.
- **Financial sector.** The 2016 Asset Quality Review (AQR), completed in March 2017, highlighted substantial provisioning shortfalls in a subset of banks and capital needs of about 1.6 percent of GDP. The revised program called for the implementation of remedial actions in response to the AQR, including ongoing recapitalization of undercapitalized banks using public funds if needed and resolution of banks that cannot be rehabilitated. Steps were also to be taken to operationalize the framework for crisis management and bank resolution, including an action plan to implement the Deposit Protection Act.

Table 3. Ghana—Overall Fiscal Balance (Cash): 2015 ECF Program vs. Estimated Outturn (In percent of GDP)

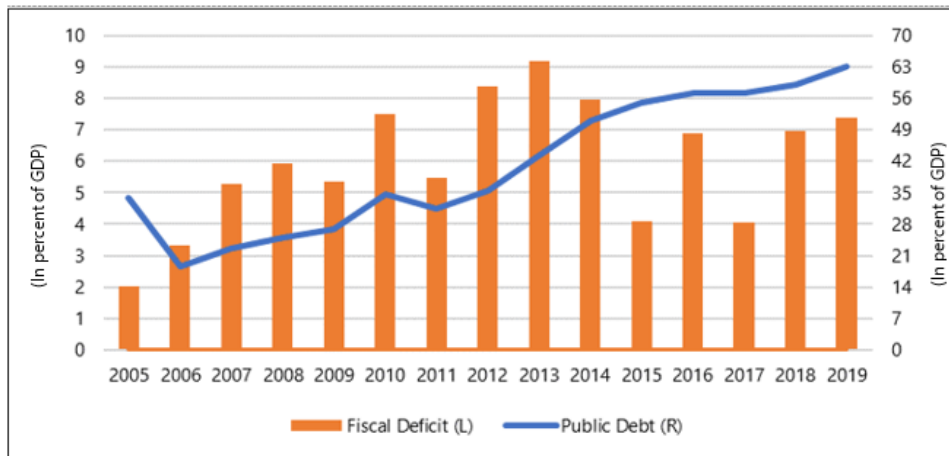
	2014	2015	2016	2017	2018	2019
ECF Request (April 2015)	−9.4	−7.5	−5.8	−3.7	...	...
1 st Review (August 2015)	−10.2	−7.3	−5.8	−3.7	...	...
2 nd Review (January 2016)	−10.2	−7.2	−5.3	−3.7	...	...
3 rd Review (September 2016)	−10.1	−6.9	−5.2	−3.5	−3.0	...
4 th Review (August 2017)	...	−7.0	−9.3	−6.3	−3.8	−3.2
5 th & 6 th Reviews (April 2018)	...	...	−9.3	−6.0	−6.4	−4.5
7 th & 8 th Reviews (March 2019)	...	...	...	−4.7	−7.0	−5.6
2019 Article IV (December 2019)				−4.7	−7.0	−7.0
(Excluding costs related to financial and energy sector restructuring)	...	...	...	(−4.7)	(−3.7)	(−4.7)

Sources: IMF program documents and staff report for the 2019 Article IV consultation.

36. **Improved economic performance.** Macroeconomic performance strengthened in 2017 and 2018 (Figures 4, 8, and 9). Growth increased with expanded oil production. Inflation declined, falling to 9 percent in January 2019, within the Bank of Ghana's band around the inflation target. As noted earlier, the fiscal position (excluding financial sector-related costs) improved significantly, leading to primary surpluses for the first time in 15 years and public debt stabilized relative to GDP. The quality of adjustment, however, was poor as revenue mobilization targets were missed and the burden fell on expenditure reduction. The exchange rate stabilized at a competitive level and the external position improved with a lower-than-anticipated current account deficit. There was a sizable increase in foreign reserves in 2017, but this was followed by a fall in 2018. The Bank of Ghana resolved nine insolvent banks over a period of 18 months. Structural reforms to strengthen public financial management and oversight of the state-owned enterprises continued. A fiscal rule capping the budget deficit at 5 percent of GDP was adopted and a Fiscal Council was established to oversee its enforcement. For the full 4-year program

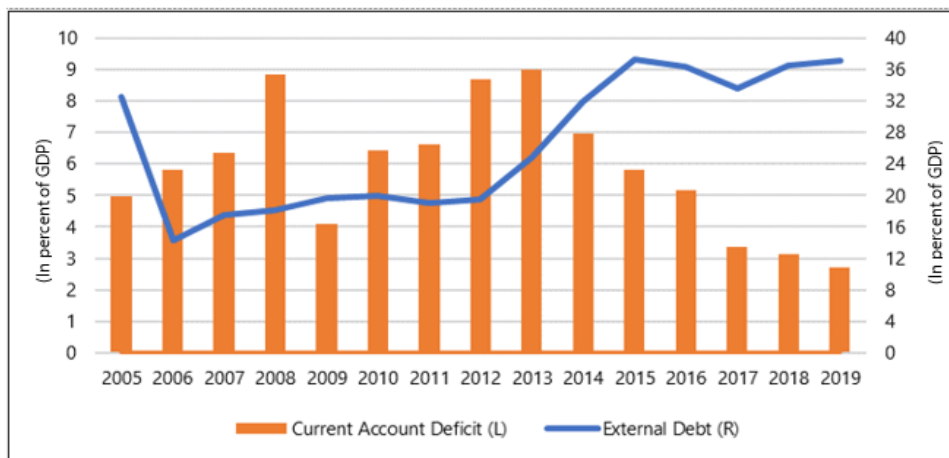
period, 59 percent of structural conditions were met as scheduled, 14 percent were met with delays, and the remaining 27 percent were not met. This implementation record was below the mean and median for PRGT programs.

Figure 8. Ghana—Fiscal Deficit and Public Debt



Source: April 2020 WEO database.

Figure 9. Ghana—Current Account Deficit and External Debt



Source: April 2020 WEO database.

37. **Growth forecast and actual performance.** Actual cumulative growth over the program period (2015–18) was 21.4 percent compared to 30.4 percent projected at the start of the program (Table 4). This shortfall was due to unanticipated disruptions in oil production in 2015–2016, as non-oil growth came in somewhat above program forecasts. Specifically, cumulative non-oil growth over the program period was 19.9 percent, versus a forecast of 18.6 percent at the start of the program. Ghana’s growth performance during the 2015 ECF arrangement was slightly above the growth benchmark derived from the IEO panel regression (see footnote 6), with average actual and benchmark growth rates of 5.5 percent and 5.3 percent, respectively. Supply factors such as oil,

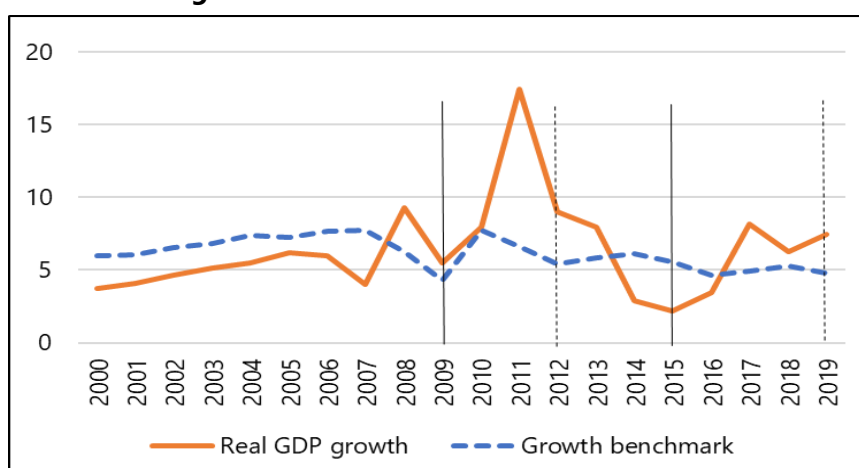
gold and cocoa production, and power availability played a larger role in growth outcomes than demand factors. Figure 10 shows the evolution of actual real GDP growth and benchmark growth over the period 2000 to 2019; the solid and dashed lines in this figure denote the starting and ending date of the ECF arrangement.

**Table 4. Ghana—Growth: 2015 ECF Program vs. Outturn
(In percent)**

	2015	2016	2017	2018	Cumulative
Program projection					
Total	3.5	6.4	9.2	8.4	30.4
Non-oil	2.3	4.7	5.5	5.0	18.6
Outturn					
Total	2.2	3.4	8.1	6.3	21.4
Non-oil	4.0	5.0	4.6	5.0	19.9

Sources: IMF program documents and World Economic Outlook.

Figure 10. Ghana—Growth vs. Benchmark



Source: IEO estimates.

Note: See Kim and others (2021) for a detailed explanation of the methodology.

38. **Post-program challenges.** Six areas on the macroeconomic front stand out:

- First, although Ghana's growth strategy has delivered fast GDP growth, the improvement in other welfare indicators (e.g., poverty, income inequality, gender equality, and health) has been more modest. Limited progress may in part reflect the growth strategy's heavy reliance on extractive industries and external borrowing.
- Second, the clean-up of the financial sector continues to be a drain on public funds. The cumulative fiscal cost of 4.6 percentage points of GDP in 2018–19, estimated at the time of the 2019 Article IV consultation, is already unexpectedly high. This cost is likely to increase. As the clean-up proceeds, credit to the private sector remains restrained and is yet to fully recover.

- Third, domestic revenue mobilization has remained low compared to peers. The limited achievements on revenue mobilization are due to policy missteps and insufficient political will. The tax relief granted by the new government in 2017 (see paragraph 35 above), which included the widening of exemptions and removal of some taxes, was not accompanied by adequate impact analysis and has resulted in a smaller tax base and lower revenue intake. The government has also been slow to implement the recommendations from the extensive technical assistance focused on widening the tax base and improving compliance. Special interests and electoral promises to keep taxes low to promote the private sector have hindered bolder action. As a result, government borrowing needs remain large and are crowding out credit to the private sector.
- Fourth, problems of power shortages and losses in the energy sector persist, increase government financing needs and fiscal risks. After the end of the ECF arrangement, a multiyear Energy Sector Recovery Plan (ESRP), developed with assistance from the World Bank, was launched in May 2019. Rigorous implementation of the plan will be critical to mitigate risks.
- Fifth, net international reserves are still low and Ghana remains exposed to shifting investors' sentiment and external shocks, amplified by elevated public debt and government financing needs.¹¹
- Finally, Ghana has a legacy of political budget cycles around elections. It will be important for the new fiscal rule and Fiscal Council to provide a strong and sustainable brake and prevent a repeat of previous damaging episodes.

IV. AUTHORITIES AND STAFF'S PERSPECTIVES

39. **Program design and growth.** Although the authorities tended to be more optimistic than staff about the growth outlook, there was no significant difference of view regarding program design and the growth implications of tightening macroeconomic policies. It was recognized that unless macroeconomic stability was restored, sustained high growth would remain elusive. It was agreed, therefore, that restoring stability needed to be the priority. Ghanaian representatives noted that this order of priorities was appropriate as it was a recognition of the reality facing Ghana when IMF support was requested. The authorities also agreed that it was prudent to base their fiscal plans on the staff's more conservative growth projections. The program mentioned planned reforms to help support growth, such as steps to improve governance and accelerate private investment in the energy sector to improve power generation and distribution, but these received less attention in conditionality.

¹¹ As noted in paragraph 2, in April 2020 Ghana received a disbursement under the Rapid Credit Facility to help address the economic impact of the COVID-19 pandemic.

40. **Role of GSGDA.** The IMF-supported programs coincided with the preparation of an important government document—the *Ghana Shared Growth and Development Agenda (GSGDA)*, the first covering 2010 to 2013 and the second covering 2014 to 2017. As these documents put forward an agenda focused on economic diversification, social inclusion, and sustained macroeconomic stability, they had the potential to generate strong ownership of policies under the IMF-supported programs. But both staff and Ghanaian representatives noted that the GSGDA was primarily a statement of aspiration rather than an operational policy plan with identified costs, financing or links to the public investment program. Moreover, it was not used sufficiently to build consensus and mobilize support. One senior Ghanaian representative noted that even relevant line ministries did not know what the GSGDA contained. Thus, although it could be claimed by both sides that this agenda was a part of the program, its role was at best tangential.

41. **Ghanaian views about other elements of the program.** In addition to the points above, the following points made by Ghanaian representatives about the program’s design and its support for growth in the medium-to long run are salient:

- **Broader benefits of IMF support.** Ghanaian representatives found IMF policy advice to be beneficial, and were appreciative of high-quality technical assistance which the authorities viewed as an essential support for IMF programs. They noted that the experience under IMF-supported programs has helped to better embed policy discipline and fostered greater accountability. Limits on central bank financing of the fiscal deficit, together with the establishment of a Fiscal Council, Financial Stability Council, and an Economic Policy Coordinating Committee, all initiated under the 2015 ECF, should help Ghana maintain policy discipline in the future. In addition, Ghana has been going to international capital markets since 2007 and rating agencies and investors rely heavily on IMF analysis and views. The IMF arrangements have helped the country regain credibility with investors by supporting the implementation of necessary policies to restore stability. Ghanaian representatives pointed out that improved investor confidence allows Ghana to borrow more for less, another way in which the IMF provides considerable value added.
- **Appropriate attention to government priorities.** The authorities appreciated that they had flexibility on the choice of fiscal measures as long as the program’s fiscal anchor was not jeopardized. For example, free high school education was a signature priority for the new NPP government in 2017, which they were able to implement consistent with the deficit target by reprioritizing spending. The new government’s proposals for tax relief to help spur growth were also accommodated within the program. Ghanaian representatives emphasized that such flexibility on the part of the IMF helped enhance ownership. As noted in paragraph 38, however, the authorities’ tax relief policies have compromised the goal of strengthening revenue mobilization with longer-term consequences.
- **Strong assistance for financial sector cleanup.** The authorities were particularly appreciative of focused IMF technical assistance and policy advice to cleanup bank balance sheets and strengthen the financial sector, an essential element of program

discussions. They noted that Ghana faced systemic bank failures but without the necessary safety net and bank resolution powers. Hence the financial sector component of the program ended up being much larger than anticipated. The authorities valued the push from the IMF to take corrective action in response to the AQR, backed up a modernized resolution framework. Depositors were protected to avoid a social crisis, requiring fiscal funding which was accommodated by the program. The authorities said that they would not have been able to deal with financial sector problems without help from the IMF.

- **Problematic volume and pace of reforms.** Although circumstances required an urgent reform push to ensure financial stability, the authorities noted that in general the volume and pace of reforms stretched their administrative capacity. Advice from extensive technical assistance (summarized in paragraph 28 above) would quickly become conditionality under the program, with a tight implementation timetable. They noted that not everything can be achieved in the three-year horizon of a program, but still the time bound nature of the program created pressure to deliver. This pressure was not always warranted in their view and more realistic timetables that create the conditions for continuity of policies to meet objectives in the medium-to-long term would be preferable. The authorities noted that they would push back on some of the proposed conditionality with some success and there was generally good faith on both sides. Acknowledging that the IMF's Executive Board needs comfort that progress is being made with structural reform, they suggested that decisions on whether or not to complete a review under the program should take a broader look at the situation and review overall progress, rather than focus too narrowly on conditionality.
- **Inadequate attention to social implications.** Ghanaian representatives noted that IMF staff recognized that the significant fiscal tightening would disproportionately hurt the poor. But they observed that although IMF staff were open to mitigating this impact, these issues were not sufficiently integrated into the program because of other priorities and limited expertise. Furthermore, they pointed out that mitigation is not sufficient; more active policies are necessary but were not forthcoming. In interviews, IMF staff acknowledged that other priorities dominated their attention.

42. **Relations with donors and other institutions.** Issues related to poverty and social protection were largely left to the World Bank and donor agencies with relevant expertise. But follow up by IMF staff was limited because of other priorities. The World Bank also took the lead on issues related to the energy sector and state-owned enterprises. Their involvement on this front, however, received mixed reviews because the World Bank was seen as reactive rather than proactive. That said, the authorities and staff both noted that relations and coordination with the World Bank and donors was generally good.

V. ASSESSMENT AND LESSONS

Assessment

43. **Main achievements.** Notwithstanding uneven policy implementation and fiscal slippage, the 2009 and 2015 ECF arrangements helped reduce macroeconomic imbalances. IMF support provided policy credibility and helped improve investor sentiment. Twin fiscal and current account deficits were reduced, inflation fell, the exchange rate stabilized, and international reserves strengthened. The 2015 arrangement also helped avert an external financing crisis. Progress was made on structural reform, including strengthening expenditure management and advancing a framework for transparent and prudent management of Ghana's oil income. Repair of bank balance sheets helped improve financial sector stability and support intermediation, although financial sector cleanup continued to drain public funds after the 2015 ECF.

44. **Growth and adjustment.** In both arrangements, frontloaded fiscal adjustment was seen as imperative to arrest the deterioration in macroeconomic conditions and create a more stable environment to support future growth. It was recognized that fiscal tightening would dampen near-term growth, which was factored into projections for non-oil growth although there was no explicit analysis of fiscal multipliers. Assessing growth outcomes in both programs is complicated by the large role played by the oil sector and other exogenous elements, including developments in the power sector. The following points are salient:

- For the 2009 ECF, actual growth was in line with program expectations and exceeded benchmark growth derived from econometric analysis based on external factors alone by a substantial margin. In addition to the boost to growth from the start of oil production in 2011, non-oil growth benefitted from strong commodity exports, favorable rainfall, and construction and service activity related to the oil sector.
- For the 2015 ECF, unanticipated disruptions in oil production in 2015–2016 dampened overall growth, but non-oil growth was in line with program forecasts. Actual growth exceeded benchmark growth derived from econometric analysis, but by a smaller margin than in the 2009 ECF. Overall, supply factors such as oil, gold and cocoa production, and power availability played a larger role in growth outcomes than demand factors.

In sum, growth was sustained while delivering necessary adjustment for balance of payments viability in both ECF arrangements, but this was in part due to fortuitous exogenous supply-side developments.

45. **Deep-rooted challenges.** Ghana has tremendous potential but still faces deep-rooted challenges. The country has enjoyed political stability, impressive human capital and entrepreneurial talent, and healthy and diversified growth. Policy implementation, however, has waxed and waned.

- The quality of fiscal adjustment has been deficient as revenue mobilization was weak and the burden fell on expenditure reduction. Low revenue mobilization has increased borrowing needs and crowded out credit to the private sector. In this connection, it is noteworthy that difficult tradeoffs arise because steps taken in the short term to enhance policy ownership, for example the accommodation of the authorities' preference for tax relief, can have unfavorable longer-term consequences.
- In addition to crowding-out effects, access to credit has been constrained by deficiencies in financial intermediation as clean-up of the sector remains incomplete.
- Public debt continues to rise. Longstanding losses in the energy sector raise government financing needs and the cost of financial sector repair is accumulating. The risk of debt distress rating in the IMF's debt sustainability analysis remains high.
- External buffers are low for a country subject to significant external shocks.
- It is unclear if fiscal control is sufficiently entrenched despite improvements in the policy framework. Inadequate fiscal control, especially in election years, has led to bouts of macroeconomic instability that have set the country back.

The priority, therefore, is to continue to strengthen institutions and policies to maintain macroeconomic stability, increase resilience, and promote sustained high growth.

Lessons

46. **Balance between adjustment and financing.** In both arrangements the balance was heavily skewed toward current account adjustment to meet balance of payments needs. The choice of how balance of payments needs are met has consequences, including for growth, especially if programs are underfinanced. The choices made in Ghana's IMF-supported arrangements was not adequately justified in program documentation. The constraints on IMF financing imposed by PRGT access rules and limits, including constraints on blending with non-concessional IMF resources, were touched on in internal IMF documents (see paragraph 27 above), but the issues that dictated the IMF's financing decisions did not feature in public program documents. Should the balance of payments financing needs in 2015 have been viewed more as a capital account problem than a current account problem? Was the program treated more as a current account problem than a capital account problem because of the constraints on IMF financing? Questions of this nature should have been faced head on in program design and program documentation to justify the choice made and its potential economic consequences. It is noteworthy, however, that PRGT access limits were increased after the approval of Ghana's 2015 ECF. If the higher access limits were in place at the time the 2015 arrangement was approved, it could have resulted in less severe adjustment.

47. **Dealing with state-owned enterprises and energy sector issues.** At the time of the 2015 ECF, there were serious concerns about the balance sheets of the financial sector and also state-owned enterprises. The arrangement dealt decisively with financial sector problems based on well established procedures and deep expertise. But there was no similar protocol that IMF staff could draw upon to deal with state-owned enterprises and hence their problems were given insufficient attention despite World Bank involvement. The macroeconomic consequences of state-owned enterprise losses and weak performance of the power sector were enormous and well understood, but this knowledge is not enough. Tackling problems in state-owned enterprises and power sector requires microeconomic interventions, an area where IMF staff do not have the expertise or comparative advantage. Obtaining stronger and more specific commitments from partners, including the World Bank, with the relevant expertise is therefore essential.

48. **Growth strategy.** Program documentation typically had a section titled “Policies to Support Growth and Poverty Reduction.” This section, however, had little of substance and reported on what other development partners were doing and on the priorities in the GSGDA. In addition, program documentation put considerable emphasis on making growth inclusive. But this was primarily a slogan because the emphasis was not adequately backed by the necessary policies to promote greater equity in incomes. Resource constraints and other pressing policy priorities meant that IMF staff had little time to devote to growth and related issues in a program environment. Thus, there was little IMF staff analysis or input, and the issues identified were not well integrated into the program. By contrast, the 2013 Article IV had an annex on inclusive growth (Appendix II) and the 2019 Article IV consultation included a deeper dive into the relevant issues, resulting in a Selected Issues Paper titled “Growth Strategy for Ghana.” This suggests that the surveillance environment provided more time to analyze a growth strategy. But that the opportunity to do such work between the 2009 and 2015 ECF was missed, limiting the staff’s input on these issues in the 2015 arrangement. Finally, the focus on more inclusive growth should be complimented with better data presentation. For example, a simple approach would be to report not only overall GDP growth, but also growth at the 50th income percentile (that is, median growth). If this simple measure is not available, the priority should be to generate the needed statistics. More generally, although adapting programs to shifting government priorities helped to buttress country ownership, more could have been done to build national consensus around the government’s growth agenda.

49. **Contingency planning for growth shortfalls.** Growth performance during both ECF arrangements was broadly in line with expectations, but as noted earlier this was in part due to fortuitous exogenous supply developments. As this outcome was not assured, a detailed assessment of risks to growth and policy contingencies is essential. The 2015 ECF dealt with these risks and contingencies in more detail than the 2009 ECF (see paragraphs 14, 32 and 33). Nevertheless, the discussion of policy contingencies tended to be cursory entries in a risk assessment matrix. A more detailed discussion of the risks, and especially the policy contingencies if the risks to growth were to materialize, would be beneficial. In particular, if procyclical policies are being recommended, they need to be better justified.

ANNEX I. GHANA: TECHNICAL ASSISTANCE 2014 TO MID-2017

Subject	Department	Year
Diagnostic mission on VAT administration	FAD	2015
Diagnostic mission in indirect taxes	AFW2	2015
Multi-topic fiscal mission	FAD	2015
Risk management in tax and custom administration	FAD	2015
PFM Law	FAD	2015
Wage bill and energy subsidies	FAD	2015
Modeling and forecasting of natural resource revenue	FAD	2015
Strengthening macro-fiscal policy formulation	FAD	2015
Performance monitoring and evaluation	AFW2	2015
Review of the GRA Strategic Plan	FAD	2015
Project management framework	FAD	2015
Resource revenue modeling	FAD	2016
Public investment management assessment (PIMA)	FAD	2016
Ministry of Finance restructuring	FAD	2016
Debt recording and debt servicing	FAD	2016
Treasury Single Account	FAD	2016
Fiscal reporting and budget transparency	AFW2	2016
Debt recording and payment execution	FAD	2016
Resource revenue modeling (follow-up)	FAD	2016
Tax administration	FAD	2016
Government Finance Statistics and fiscal reporting	AFW2	2016
Tax expenditure	FAD	2016
TRIPS implementation and process review	FAD	2016
Data matching exchange project	AFW2/FAD	2017
Advancing TSA and cash management	FAD	2017
Tax Administration Diagnostic Assessment Tool (TADAT)	FAD	2017
Advancing reorganization of the Ministry of Finance	FAD	2017
Basel II/III Part 1	MCM	2014
Deepening domestic debt market and debt management	MCM	2015
Basel II/III Part I	MCM	2015
Enhancing offsite supervision Part I	AFW2	2015
FOREX operations	MCM	2015
Review of prudential reports	MCM	2015

Subject	Department	Year
Capital market development	MCM	2015
Enhancing offsite supervision Part III	MCM	2015
Banking supervision	AFW2	2016
Assessment of banking supervision	MCM	2016
Enhancing risk focused supervision	MCM	2017
Bank restructuring and resolution	MCM	2017
Domestic debt market deepening	MCM	2017
National accounts	AFW2	2014
Balance of payments statistics	STA	2014
Consumer and producer prices	STA	2014
Quarterly national accounts	AFW2	2015
Consumer and producer prices	STA	2016
National accounts	AFW2	2016
Government finance statistics	STA	2016
National accounts	AFW2	2017
AML/CFT structures and tools	LEG	2014
AML/CFT structures and tools	LEG	2015
Public Finance Management Law	LEG	2015
AML/CFT—risk-based supervision	LEG	2016
AML/CFT—risk-based supervision	LEG	2017
Monetary Policy Formulation and Communication	ICD	2016
Managing tax administration reform program	ICD	2016
Monetary policy formulation: forecasting and policy analysis	ICD	2017
Source: IMF Country Report No. 17/26 – Staff Report for the 2017 Article IV Consultation and Fourth Review Under the Extended Credit Facility, Appendix on “Relations with the Fund” (September 2017).		

REFERENCES

- Government of Ghana, 2010, "Ghana Shared Growth and Development Agenda (GSGDA), 2010–2013, Volume I: Policy Framework," National Development Planning Commission (December).
- _____, 2014, "Ghana Shared Growth and Development Agenda (GSGDA) II, 2014–2017, Volume I: Policy Framework," National Development Planning Commission (December).
- International Monetary Fund, 2008, "Ghana: 2008 Article IV Consultation—Staff Report," IMF Country Report No. 08/344, October (Washington).
- _____, 2009, "Ghana: 2009 Article IV Consultation and Request for Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report," IMF Country Report No. 09/256, August (Washington).
- _____, 2010, "Ghana: Combined First and Second Reviews Under the Arrangement Under the Extended Credit Facility, Request for Waiver of Nonobservance of Performance Criteria, Modification of Performance Criteria and Rephasing of Disbursements—Staff Report," IMF Country Report No. 10/178, June (Washington).
- _____, 2011a, "Ghana: 2011 Article IV Consultation and Third and Fourth Reviews Under the Arrangement Under the Extended Credit Facility, Requests for Waiver of Nonobservance of Performance Criteria and Modification of Performance Criteria, and Rephasing of Disbursements—Staff Report," IMF Country Report No. 11/128, June (Washington).
- _____, 2011b, "Ghana: Financial System Stability Assessment Update," IMF Country Report No. 11/131, June (Washington).
- _____, 2012a, "Ghana: Fifth Review Under the Three-Year Arrangement Under the Extended Credit Facility and Request for Modification of Performance Criteria—Staff Report," IMF Country Report No. 12/36, February (Washington).
- _____, 2012b, "Ghana: Sixth and Seventh Reviews Under the Three-Year Arrangement Under the Extended Credit Facility and Requests for Waiver of Nonobservance of Performance Criteria and Extension of the Arrangement—Staff Report," IMF Country Report No. 12/201, July (Washington).
- _____, 2013, "Ghana: Staff Report for the 2013 Article IV Consultation," IMF Country Report No. 13/187, June (Washington).
- _____, 2014, "Ghana: 2014 Article IV Consultation—Staff Report," IMF Country Report No. 14/129, May (Washington).

- _____, 2015a, "Ghana: Request for a Three-Year Arrangement Under the Extended Credit Facility Staff Report," IMF Country Report No. 15/103, April (Washington).
- _____, 2015b, "Ghana: First Review Under the Extended Credit Facility Arrangement and Request for Waiver and Modifications of Performance Criteria," IMF Country Report No. 15/245, September (Washington).
- _____, 2016a, "Ghana: Second Review Under the Extended Credit Facility Arrangement and Request for Waiver for Nonobservance of Performance Criterion," IMF Country Report No. 16/16, January (Washington).
- _____, 2016b, "Ghana: Third Review Under the Extended Credit Facility and Request for Waiver for Nonobservance of Performance Criteria, and Modifications of Performance Criteria," IMF Country Report No. 16/321, October (Washington).
- _____, 2017, "Ghana: Staff Report for the 2017 Article IV Consultation, Fourth Review Under the Extended Credit Facility Arrangement, Request for Waiver for Nonobservance of Performance Criteria, and Request for Extension and Rephasing of the Arrangement," IMF Country Report No. 17/262, September (Washington).
- _____, 2018, "Ghana: Fifth and Sixth Reviews Under the Extended Credit Facility, Request for Waivers for Nonobservance of Performance Criteria, and Request for Modification of Performance Criteria," IMF Country Report No. 18/113, May (Washington).
- _____, 2019a, "Ghana: Seventh and Eighth Reviews Under the Extended Credit Facility Arrangement and Request for Waivers of Nonobservance of Performance Criteria," IMF Country Report No. 19/97, April (Washington).
- _____, 2019b, "Ghana: Staff Report for the 2019 Article IV Consultation," IMF Country Report No. 19/367, December (Washington).
- Kim, Jun, and others, 2021, "Cross-Country Analysis of Program Design and Growth Outcomes: 2008–19," IEO Background Paper, BP/21-01/01 (Washington: International Monetary Fund).
- Kim, Jung Yeon, and Kwang Yeon Lee, 2021, "Structural Conditions, Structural Reforms and Growth in IMF-Supported Programs," IEO Background Paper, BP/21-01/04 (Washington: International Monetary Fund).

CHAPTER 4. MALAWI

PETER F. ALLUM^{*}

^{*} Consultant, Independent Evaluation Office of the IMF.

EXECUTIVE SUMMARY

The study focuses on four programs, supported under the ESF (2008) and ECF (2010, 2012, 2018). Malawi is one of the world's poorest countries, vulnerable to shocks to foreign aid and climatic conditions. Weak program performance in the first three programs reflected uneven ownership, weak governance, and weather shocks.

Program design. The 2008 and 2010 programs focused on introducing greater exchange rate flexibility to eliminate foreign currency shortages and parallel market premia. The 2010, 2012, and 2018 programs also sought to strengthen budget performance in the context of periodic governance-related shortfalls in external grants and weak expenditure control. The 2012 program, in particular, supported a PFM action plan to address large scale theft of public funds. Programs did not feature significant structural conditionality to address institutional growth constraints.

Program performance. Implementation was erratic. The 2008 and 2010 programs went off track without advancing exchange regime reforms. These were achieved at the outset of the 2012 program, but other structural reforms were repeatedly delayed, leading to combined reviews and multiple program extensions. The 2018 program also saw sizeable fiscal slippages.

Growth and poverty outcomes. Strong agricultural performance drove robust growth through 2010. Thereafter, growth slowed, initially reflecting foreign currency shortages (2011), but then reflecting weather-related shocks, a slump in external grants, high inflation, and low public investment. After falling significantly through 2004, the poverty rate stabilized through 2010, and then increased slightly through 2016.

Fiscal outcomes. Weak public finances were a routine challenge, with lax expenditure control and volatile external grants due to poor governance. Fiscal financing needs complicated liquidity management.

Exchange rate and monetary outcomes. Currency shortages were successfully eliminated under the 2012 program, but the currency float was not adequately supported by tight fiscal and monetary policy. As a result, inflation remained high during 2012–16, sapping growth. With improved monetary management, inflation was reduced from 2017, but credit and growth remained subdued.

More attention could have been given to identifying political and institutional constraints to growth and explicitly integrating them into program design. A staff-monitored program may have been better than the 2008 ESF and 2010 ECF, pending agreement on exchange market reforms that were more fully owned by the authorities.

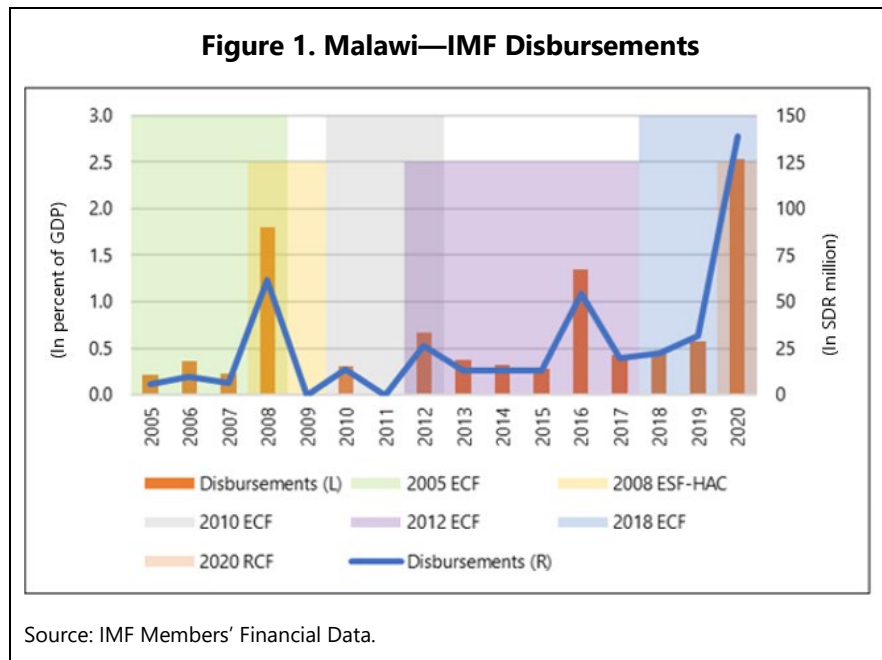
Staff could have engaged more substantively with the World Bank and other agencies on how Fund-supported programs could support longer-term growth prospects. Consultation and coordination practices have weakened in recent years and consideration should be given to developing jointly agreed strategic approaches to engagement on growth issues.

Greater attention could have been given to growth as a core program goal, with policies examined more closely in terms of how they contributed to this goal. Policy issues are often addressed from the perspective of macro stability and efficient resource allocation without considering the complex links between policy levers and growth. Policy design could be improved by earlier and more consistent attention to growth influences.

I. INTRODUCTION

1. **Malawi is one of Africa's poorest countries and highly vulnerable to weather-related shocks.** Per capita income is around \$330, and it ranks around the lowest 10th global percentile on the World Bank's human development index. Malawi's economy lacks diversity, with commercial agriculture (dominated by tobacco) accounting for three-quarters of exports and two-thirds of employment. Maize, the country's staple crop, is dependent on a single rainfed season. As a result, Malawi is one of the world's most vulnerable countries to climate change and natural disasters. Economic diversification and private sector-led growth have been hampered by macroeconomic instability, weak governance, underfunded public infrastructure and weak public services (notably water and electricity), high transport and trade costs, and agricultural market distortions.

2. **In recent decades, Malawi has been supported by almost continuous Fund arrangements (Figure 1).** This study spans arrangements under the Exogenous Shocks Facility (ESF) (approved December 2008) and under the Extended Credit Facility (ECF) (approved February 2010, July 2012, and May 2018).¹ In May 2020, a disbursement of US\$91 million was approved under the Rapid Credit Facility to help Malawi meet urgent balance of payment needs stemming from the COVID-19 pandemic.

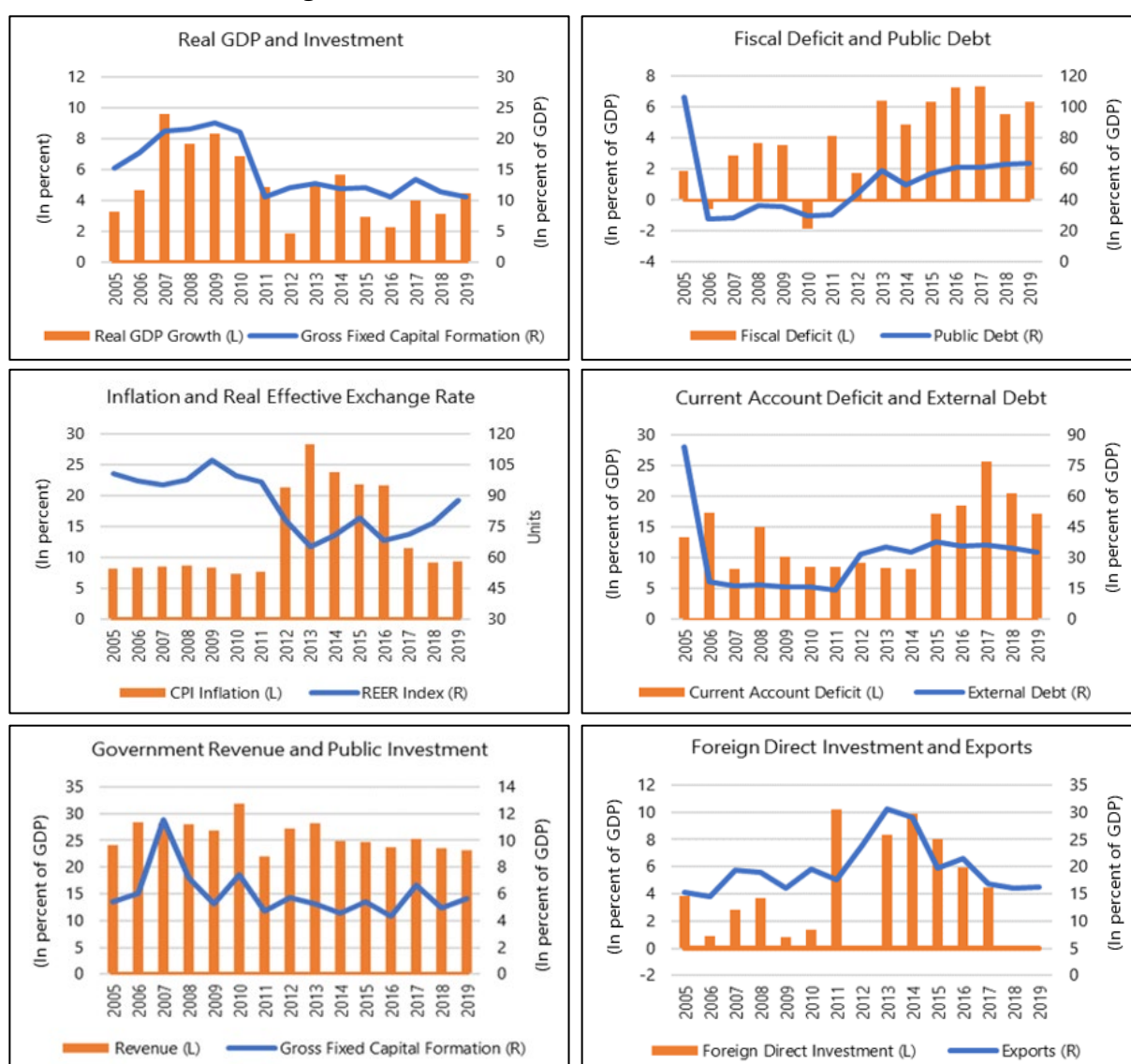


¹ The 2008 ESF expired without the completion of any reviews, while the 2010 ECF went off track after just one review (in December 2010). The 2012 ECF was extended twice and expired after 4½ years at end-2016. The 2018 ECF was cancelled by the authorities in September 2020. This study covers performance under the 2018 ECF only through end-2019 and does not cover the 2020 RCF.

II. COUNTRY CONTEXT

3. **Reflecting its difficult business environment and vulnerability to shocks, growth fluctuated widely in the early 2000s.** After the economy contracted by 6 percent in 2001 due to a one-third drop in the maize harvest, growth averaged 6 percent between 2003 and 2008, reflecting good harvests, a strong non-agricultural economy, generally favorable terms of trade, and strong development partner support. Malawi also weathered the global financial crisis relatively well, reflecting its limited integration into international capital markets and supply chains (Figure 2).

Figure 2. Malawi—Selected Economic Indicators



Sources: April 2020 WEO database; INS database; FFA database.

4. **From 2008, program engagement with the IMF addressed a succession of challenges:**

- **Exchange market distortions.** Malawi's exchange rate was effectively pegged to the U.S. dollar from mid-2006. In the context of strong economic growth, the market could not satisfy foreign currency demand, giving rise from late 2008 to a widening parallel exchange rate premium. Foreign currency shortages and market distortions posed risks to business confidence, and Fund-supported programs during 2008–2012 sought to introduce greater exchange rate flexibility supported by tighter fiscal and monetary policies.
- **"Cashgate" scandal.** In 2013, a major fraud led to the misappropriation of public funds equivalent to almost 1½ percent of GDP. In the wake of the scandal, donors cut budget support by 4½ percent of GDP, leaving the budget off track. Discussions in 2014 and 2015 under the ongoing 2012 ECF focused on designing and implementing an action plan to address weaknesses in public finance management to rebuild donor confidence while adjusting public finances to the tighter financing environment. Reflecting political instability in the wake of the crisis, policy implementation was weak, requiring four extensions of the ECF arrangement (through end-2016).
- **El Niño-induced drought.** Drought conditions in 2016 cut maize production by more than 40 percent and required modification of the fiscal program in the final year of the extended 2012 ECF.
- **Lagging growth performance.** Despite a more flexible and efficient currency market from mid-2012, growth proved sluggish from 2012 through 2017. In response, the 2018 ECF focused on supporting growth by reprioritizing fiscal spending and pursuing structural reforms.

5. **Political context.** The 2008 and 2010 programs were launched under President Bingu wa Mutharika, whose tenure ran from 2004 until his death in office in April 2012. Mutharika was a strong supporter of agricultural subsidies, which benefitted almost 1.7 million smallholder farmers, and was credited with economic reforms, fiscal restraint, and anti-corruption measures.² Relations with development partners became strained in his second term, following purchase of a US\$13 million presidential jet in 2009 and government suppression of 2011 protests against fuel prices, inflation, and unemployment.³ Following Mutharika's death, Vice President Joyce Banda was sworn in as president. Her administration restored relations with the donor community and took bold steps to liberalize the foreign exchange market, but governance

² During President Mutharika's first term (2004–09), Goodall Gondwe, former AFR Director, served as Minister of Finance. Gondwe returned to this position in the 2014 administration of Peter Mutharika.

³ By the last year of Mutharika's presidency, Britain, the US, Germany, Norway, the EU, the World Bank, and the African Development Bank had all suspended financial aid.

concerns re-emerged with the 2013 Cashgate scandal. President Banda lost the 2014 election to Peter Mutharika (younger brother of the former president). President Mutharika's first term was marked by popular discontent about corruption, food shortages, and power cuts. Although Mutharika was sworn in for a second term after a close 2019 presidential election, Malawi's Constitutional Court subsequently called for a rerun of the elections. In the June 2020 re-run, opposition party presidential candidate Lazarus Chakwera defeated Mutharika by a wide margin.

III. PROGRAM DESIGN

6. For most of the period covered by the study, Malawi experienced lax fiscal and monetary policy. This was initially evidenced by mounting foreign currency shortages and, after 2012, by high inflation (see Figure 2). Programs initially focused on fiscal adjustment, gauging that growth and poverty reduction were best served by reining in public spending, rather than by tightening monetary policy and slowing private investment. While a tighter fiscal stance implied adverse multiplier effects, it was envisaged that these would be offset, at least in part, by a more flexible, competitive exchange rate. Fiscal and external imbalances were reduced in 2012 by an upturn in foreign grants, but challenges resurged from 2014 when external budget financing collapsed after the Cashgate crisis. Over time, as inflation became entrenched, more attention was given to monetary tightening.

Growth Outlook

7. **The 2008 and 2010 Fund-supported programs were approved during a period of sustained strong growth.** As noted above, this reflected favorable agricultural conditions and strong development partner support. Although rapid demand growth was contributing to foreign exchange shortages in the context of an increasingly overvalued currency peg, the 2008 and 2010 programs envisaged that, with greater exchange rate flexibility, growth could continue in the 6–7 percent range. The 2012 ECF also projected robust growth of 5½–6½ percent during 2013–15 based on measures to increase exchange rate flexibility.

8. **Greater attention was given to growth concerns in the 2018 program.** Growth prospects were marked down to an average of 4½ percent under the 2018 ECF, consistent with weaker performance during 2015–17 (Table 1). This led to an emphasis in the 2018 program on providing more space for infrastructure spending and other measures to support the economy.

9. **Programs focused increasingly on the importance of economic diversification to boost trade opportunities and reduce vulnerability to shocks.** With the exception of the 2008 program—approved during a period of strong growth—staff consistently flagged the need for higher private investment to broaden the economic base. To establish such incentives, the 2010, 2012, and 2018 programs underlined the importance of a flexible, market-clearing exchange rate (Table 2). Beyond this, the 2010 program noted the need to tackle agricultural market distortions and strengthen the business climate, while the 2012 program highlighted the need for a more reliable and adequate public energy supply. As growth flagged, the 2018 program noted the

constraining role played by generally weak public infrastructure (electricity, roads, telecommunications, water, irrigation), access to credit, and poor governance. As regards public infrastructure, the 2018 program paid increased attention to the appropriate balance between recurrent and capital spending. Wage and interest expenses had reduced room for much needed capital expenditure and the government planned new concessional external borrowing to finance infrastructure projects to diversify the economic base and build resilience.

Table 1. Malawi—Real GDP Growth Rates (In percent)														
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Projections ¹ :														
2008 ESF			6.7	7.1										
2010 ECF				6.0	6.3	6.6	6.8	7.1						
2012 ECF						4.3	5.7	6.1	6.5	6.7	6.7			
March 2015 extension									5.5	5.7	6.0			
June 2016 extension										2.7	4.5	5.0	5.5	
2018 ECF												3.5	4.5	5.1
Outturn	9.6	7.6	8.3	6.9	4.9	1.9	5.2	5.7	3.0	2.3	4.0	3.2	4.5	...

Source: Staff projections in Board papers for the respective ESF and ECF arrangements.

¹ The years covered by the successive Fund arrangements are highlighted in boxes.

Table 2. Malawi—Factors Identified as Important for Economic Diversification				
	2008 ESF	2010 ECF	2012 ECF	2018 ECF
Overvalued or inflexible exchange rate	--	✓	✓	✓
Agricultural policy	--	✓	--	✓
Business climate	--	✓	--	✓
Adequacy of public energy supply	--	--	✓	✓
Public infrastructure and public services generally	--	--	--	✓
Access to credit	--	--	--	✓
Governance	--	--	--	✓

Source: Staff reports for respective program requests.

Fiscal Adjustment

10. **From 2010 onwards, programs sought sizeable fiscal adjustment.** With a relatively modest prior-year fiscal deficit,⁴ the 2008 program accommodated slightly higher spending (Table 3). By contrast, the prior-year fiscal deficit for the 2010, 2012, and 2018 programs averaged 6½ percent of GDP (after grants). To strengthen public debt dynamics and reduce fiscal dominance of monetary policy, these programs sought fiscal adjustment averaging more than

⁴ The overall deficit was estimated at 2.7 percent of GDP in 2007/08, including grants.

4½ percentage points of GDP during the program period.⁵ While much of the deficit reduction in the 2012 program was projected to be achieved through higher budget support grants, the three programs also generally sought to raise revenue mobilization and reduce domestically-financed spending (see Table 3). Much of the adjustment was front-loaded in the first program year with the 2010 and 2018 ECFs targeting higher taxes and/or reduced spending and the 2012 ECF assuming a surge in grant financing.

Table 3. Malawi—Programmed Fiscal Adjustment Under Fund Programs¹
(In percentage points of GDP)

	Change in overall fiscal balance	Change in budget support grants	Overall balance excluding budget support grants	Change in revenues	Change in spending ²
2008 ESF	-0.4	0.5	-0.9	0.3	1.2
2010 ECF	3.9	0.2	3.7	2.0	-1.7
2012 ECF	6.0	3.4	2.6	1.8	-0.9
2018 ECF	4.5	0.4	4.1	0.0	-4.3

Source: Staff projections in Board papers for respective arrangements.

¹ Based on fiscal projections relative to pre-program fiscal year. Fiscal projections are for 2008/09–2009/10 (2008 ESF); 2009/10–2011/12 (2010 ECF); 2012/13–2014/15 (2012 ECF); and 2018/19–2020/21 (2018 ECF).

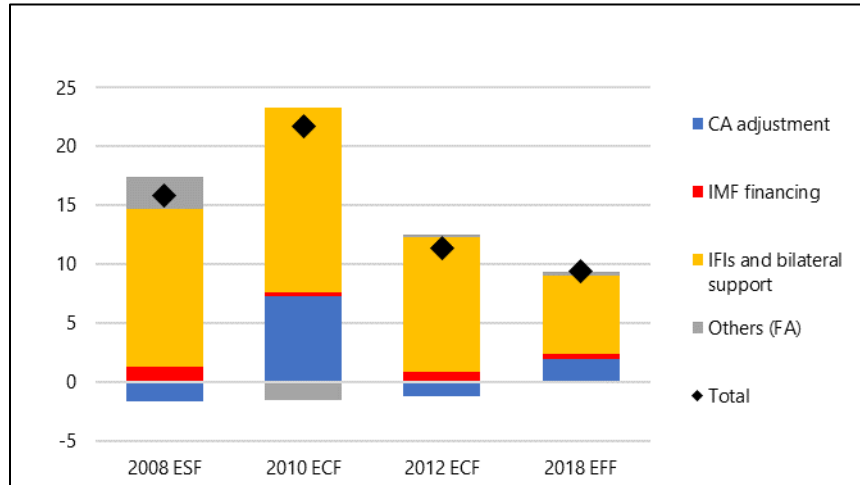
² Domestically financed spending excluding that part financed through project grants and dedicated grants.

11. **Fiscal adjustment provided room for higher private spending.** Fiscal correction was expected to be accompanied by corresponding current account adjustment only under the 2010 program (Figure 3 and IMF, 2021c). Implicitly, planned fiscal adjustment under the 2012 and 2018 programs accommodated higher private spending, including by “crowding in” access to domestic credit. While staff did not specify the assumed multiplier effects of fiscal tightening, these were implicitly small, based on the generally limited pass-through to external adjustment.

12. **Fiscal adjustment was supported by extensive public financial management (PFM) reforms.** Malawi’s weak PFM practices were a regular focus of engagement by the Fund, World Bank, and other development partners (notably the EU, Norway, and UK). These efforts were intensified following the Cashgate scandal, when the Fund helped the authorities develop a PFM reform program and action plan in coordination with key donors to rebuild trust and confidence in the budget process and prevent the misappropriation of public funds. Implementation of the PFM action plan proved uneven and reforms were often significantly delayed. Partly as a result, conditionality relating to PFM reforms eventually expanded to more than half of the total under the 2012 program (Table 4).

⁵ The 2010 program sought to strengthen fiscal performance after policies loosened in 2008/09 in the run up to the May 2009 presidential and parliamentary elections. The 2012 program followed large deficits in 2011/12 as external grants dropped on governance concerns and as revenue performance weakened. The 2018 program was adopted in the context of a rising 2017/18 fiscal deficit related to the impact of slowing growth on revenue yields and a range of spending pressures.

**Figure 3. Malawi—Balance of Payments Need Decomposition
(In percent of GDP, Annual)**



Sources: IEO calculations and Kim and others (2021).

Note: See Kim and others (2021) for a detailed explanation of the methodology.

Table 4. Malawi—Structural Conditionality Under ECF Arrangements

	PFM	SOE reform	Fiscal policy	Financial system	Foreign currency regime	Monetary policy	Social data	Total
Number of benchmarks and prior actions:								
2010 ECF ¹	4	1	...	3	5	1	1	15
2012 ECF	33	...	2	18	...	5	...	58
2018 ECF ¹	30	5	...	3	1	3	...	42

Source: Board papers for ECF requests and reviews.

¹ Covers the 2010 ECF through the first review and the 2018 ECF through the third review.

13. **PFM reforms were supported by technical assistance.** Fund technical assistance (TA) missions in 2014 and 2015 helped the authorities develop and implement their post-Cashgate PFM action plan. These missions were associated with a considerable increase in fiscal-related TA delivery during the 2012 program (Tables 5 and 6). Capacity development assistance was also provided by the World Bank and other development partners on internal and external audit, central government procurement, and the introduction of the Integrated Financial Management Information System (IFMIS), while the World Bank helped develop PFM capacity at the district level.⁶ Progress in implementing TA recommendations improved following the Fund's appointment of a resident advisor in public finance.

⁶ The World Bank supported PFM reforms through a \$19 million TA loan (March 2013) and a \$50 million budget support grant (May 2013).

Table 5. Malawi—Number of Fund Technical Assistance Missions, 2008–2017

	PFM	Revenue	Other fiscal	Monetary & financial	Exchange regime	General macro	Statistics	Total
2008	1	2	1		1	1	1	7
2009	2	4	1	7	1		1	16
2010	7	5		3			5	20
2011	8	6		5	1		4	24
2012	3	2		2			5	12
2013	1						4	5
2014	2						3	5
2015	5	1	1	4			6	17
2016	2	3		7	1		5	18
2017	5	2		9	1	3	5	25

Source: IMF Article IV staff reports.

Table 6. Malawi—Delivery of Fund Technical Assistance (FTEs)

	Central bank and financial	Fiscal	Macro structural	Other	Total
2008 ESF	1.30	0.77	0.02	0.02	2.11
2010 ECF	3.15	1.86	0.23	0.01	5.24
2012 ECF	1.75	7.52	0.89	0.03	10.18

Source: Fund Staff estimates.

14. **Over time, increased attention was given to the adverse impact of domestic government arrears on the business climate.** Efforts to control government spending were partly circumvented by the accumulation of arrears to domestic suppliers, which added to business uncertainty and accumulated as nonperforming loans in the banking sector. Following the validation of arrears claims, creditors were issued promissory notes amounting to a cumulative 9 percent of GDP between 2013 and 2018. The 2012 and 2018 programs included PFM conditionality designed to better limit and track new arrears, and the 2018 ECF introduced an indicative ceiling designed to prevent the emergence of new domestic arrears.⁷

15. **To safeguard vulnerable groups from the adverse impact of fiscal adjustment, ECF programs included an indicative floor on social spending.** The spending floor covered 39 percent of projected overall spending at the start of the 2010 ECF, declining to 37 percent in the 2012 ECF and to 25 percent in the 2018 ECF.⁸ To mitigate the impact of 2012 currency

⁷ Domestic arrears validation and clearance was also supported by the World Bank's May 2013 budget support grant.

⁸ In the 2010 ECF, the floor applied to the sum of spending on health, education, and fertilizer subsidies. In the 2012 ECF, the definition was broadened to also include government social protection, comprising expenditures by the ministry of gender, children and social welfare, the ministry of disability and elderly affairs, and the local development fund. In the 2018 ECF, coverage was narrowed by excluding fertilizer subsidies and the local development fund.

adjustment on the poor, the 2012 ECF included plans to scale up social protection programs, drawing on an increase in grant financing projected at around 5 percentage points of GDP. Programs receiving substantially higher allocations included the Farm Input Subsidy Program (FISP), public works, school feeding, school bursary, and cash transfer programs. World Bank engagement over the same period was designed to harmonize and extend the reach of Malawi's uncoordinated social programs.⁹

16. **The FISP was a key element of social spending.** The provision to farmers of heavily subsidized fertilizers and seeds under the FISP since its launch in 2005 coincided with a substantial increase in the production of maize that helped improve food security in the context of weather-related risks to harvests. From this perspective, the program was considered a success. Subsequently, the program became increasingly costly, without accompanying improvements in maize production or poverty reduction.¹⁰ Starting in 2015/16, the authorities began to assign to the private sector responsibility for retailing subsidized fertilizers while reducing the public subsidy rate. These reforms, supported by the World Bank and other development partners,¹¹ reduced fertilizer and seed subsidy costs from about 3 percent of GDP over 2009–2013 to a post-reform level of less than 1 percent of GDP. Fund staff provided analytical contributions on the potential social and economic impact of FISP reforms (Nsengiyumva et al, 2015),¹² but Fund-supported programs did not seek to advance reforms through conditionality.¹³ Reforms to the FISP are envisaged to continue through 2019/20.

17. **Program design also recognized the importance of public investment for growth.** The 2010 and 2012 ECFs highlighted the need to improve public infrastructures to strengthen the investment climate and promote growth, though neither program established specific goals for public investment spending or conditionality on public investment practices. The 2018 ECF gave

⁹ About half of Malawi's population were classified as vulnerable. Public interventions, mainly donor-financed, included public works programs, social cash transfers, school meals, and savings and loan schemes. Other than public works, most were not implemented nationwide, had limited ability to scale up in times of crises, and used different targeting mechanisms. Reforms were supported under the World Bank's May 2013 budget support grant. The World Bank was also asked by the authorities in early 2012 to explore possible measures to mitigate the impact of prospective currency devaluation on the poor.

¹⁰ The World Bank noted that the FISP had "not been sufficient to push rural households out of poverty trap. This could partly be explained by the huge imbalance in FISP between fertilizer and provision of seeds, especially drought resistant seeds, and limited technical support to farmers through extension services on good farming practices," see IMF (2012).

¹¹ The World bank supported Malawi's FISP reforms as part of a broader agricultural program with a \$100 million grant approved March 2014 and an \$80 million loan approved March 2017. The Bank's engagement was part of an agriculture sector-wide approach that coordinated financial and technical support by the EU, Belgium, Ireland, Norway, UK, and US.

¹² The analysis, in a Selected Issues Paper for the 2015 Article IV, modelled the impact of the FISP on agricultural activity, finding that a reduction in fertilizer subsidies could boost overall agricultural production by encouraging low-productivity farmers to diversify into crops other than maize. Moreover, by dedicating part of the subsidy savings to cash transfers for the poorest farmers, the reforms could also reduce inequality.

¹³ The 2010 ECF required transparent accounting for fertilizer spending in the last two fiscal years as a prior action.

increased prominence to the need to build economic resilience, and included structural benchmarks designed to help improve public investment management, focusing on efficiency and project returns, though again without specific spending goals.¹⁴ These reforms sought to support the authorities' goal of increasing investment in electricity generation, roads, telecommunications, water, and irrigation.

Monetary and Exchange Rate Policy

18. **The 2008 and 2010 programs targeted more flexible, market-clearing exchange rates to resolve foreign currency shortages.** Under the 2008 program, the government planned to study the route to a more flexible foreign exchange rate regime free of the multiple-currency practice, drawing on a recent FSAP, TA on foreign exchange operations in early 2008, and upcoming Article IV discussions. While the goal was to develop plans for implementation in 2009, the program went off track without significant action. Following a 7 percent step currency devaluation (prior action), the 2010 program envisaged further exchange rate flexibility, with the central bank managing a gradual transition to market clearing rates. Thus, indicative targets were established for a progressive one-year reduction of foreign currency queues at commercial banks and for closing the gap between bank and bureau exchange rates and the official rate.¹⁵ A further two prior actions and two structural benchmarks supported exchange regime reforms in this program (see Table 4). In the event, the program went off-track before these indicative targets and benchmarks were met. A one-off 10 percent depreciation in August 2011 also failed to clear the market and, by early 2012, the exchange rate was estimated to be overvalued by more than 30 percent with a parallel market premium of 80 percent.

19. **Market-clearing exchange rates were introduced with the 2012 program.** Ahead of the 2012 ECF request, the new administration in April 2012 depreciated the currency by 33 percent against the dollar, adopted a floating rate regime, liberalized current account transactions, and adjusted petroleum product prices to reflect the new exchange rate.¹⁶ These reforms effectively eliminated the gap between the market and official exchange rates. The new floating rate regime with limited central bank intervention was consistent with Fund TA on the options for liberalizing the exchange rate regime provided in late 2011. In this review, staff recommended against a managed float, given Malawi's limited foreign reserves. At the same time, the TA evaluation underlined the importance of supportive monetary and fiscal policies, with early priority given to removing the substantial excess liquidity that had emerged.

¹⁴ The benchmarks related to implementing the areas of biggest potential for enhancing efficiency, planning and allocation of public investment; piloting ex-post reviews and performance audits of selected major capital projects; and auditing the Public-Sector Investment Program (PSIP) database, including the efficiency and timeliness of its processes, and its coverage.

¹⁵ The foreign currency queues and exchange rate gap were to be reduced by 50 percent relative to pre-program levels by December 2010 and by 75 percent by June 2011.

¹⁶ These measures were implemented without conditionality as prior actions. The only prior action for the 2012 ECF request was parliamentary passage of a 2012/13 budget in line with the program.

20. **Programs envisaged that market-based exchange rates would allow a progressive strengthening of international reserve cover.** Prior to the 2012 float, reserve cover ranged from 2½ to 5 weeks of prospective import cover. The 2008, 2010, and 2012 programs envisaged an increase to around 3½ months of cover, providing a more effective buffer for terms of trade and weather-related shocks and aid volatility. The programmed accumulation was spread over several years, with annual increases equivalent to around 3 weeks of import cover. This required a strengthening of the balance of payments by about 2 to 2½ percentage points of GDP, to be achieved either by restraining domestic demand and/or improved BOP performance (through grants, loans, terms of trade, etc.).

21. **Programs targeted monetary aggregates with a view to restraining inflation while making room for private credit expansion.** Although the central bank targeted reserve money, risks of fiscal dominance led to the adoption of performance criteria (PC) ceilings on central bank credit (NDA) in the 2008, 2010, and 2012 programs.¹⁷ Liquidity was managed using multiple tools, including open market operations, changes in reserve requirements, and adjustments to the official interest rate applicable at the central bank liquidity window. Programs targeted single-digit inflation, with the exception of the 2012 program, where near-term inflation was boosted by the 33 percent step currency depreciation ahead of the program request (Table 7). Private sector credit was projected to rise by more than inflation, except in the 2018 program, after several years of weak credit expansion.

Table 7. Malawi—Monetary Program Objectives, 2009–2020

	2008 program	2010 program	2012 program	2018 program
Program objectives (percent changes) ¹ :				
Broad money	7.9	11.9	19.9	11.9
Reserve money	5.8	...	24.0	12.5 ²
Private sector credit	10.5	20.5	15.8	7.5
CPI inflation	6.7	8.5	14.1	7.7
Source: Staff reports for program requests.				
¹ Averages for year-end 2009 for the 2008 ESF; 2010–12 for the 2010 ECF; 2012–14 for the 2012 ECF; and 2018–20 for the 2018 ECF.				
² For 2018 only.				

22. **Monetary policy design and implementation was complicated by uncertain transmission mechanisms.** The link between interest rates and inflation was not well understood in a cash-based, largely unbanked society where one single item—maize—constituted more than 50 percent of the CPI basket. Accordingly, from the 2008 through the 2018 programs, staff highlighted the need for a better understanding of the monetary policy transmission mechanism. Without clarity on monetary conditions and monetary policy levers, discount window operations and reserve requirement adjustments sometimes appeared to

¹⁷ The 2008, 2010, and 2012 programs also included an indicative ceiling on reserve money. The 2018 program replaced the performance criterion on NDA with one on reserve money.

prioritize support for bank credit over price stability. Policy was also complicated by the costs to the central bank of sterilizing liquidity injections from international reserve accumulation and large government borrowing from the central bank.

23. **Structural conditionality in the financial sector focused on promoting financial stability and strengthening liquidity management.** The majority of structural benchmarks in the financial area in the 2010 and 2012 programs related to financial stability, though the latter program also included five benchmarks designed to reduce fiscal dominance in the area of liquidity management. The 2018 program included a new emphasis on conditionality relating to the clarity of monetary policy communication. Each ECF arrangement included one benchmark on the development or launch of a financial sector development strategy. Fund TA supported reforms to banking supervision and the monetary policy framework, notably in the 2010 program (see Tables 5 and 6). Following the 2012 exchange rate float, Fund staff provided TA on liquidity management and monetary operations (late 2012) and on the interbank money market and monetary policy framework (late 2015 and early 2016). Broader goals of financial sector development were supported by the World Bank under a 2011–18 TA program and a 2018 FSAP development module.

Other Growth-Promoting Reforms

24. **Despite slowing growth performance and vulnerability to weather-related shocks, programs did not include broad-based structural conditionality designed to boost growth.** Staff viewed reforms to enhance the economy’s flexibility, governance, investment climate, and productivity as generally outside the Fund’s core expertise. The strategy was to discuss business climate priorities with the authorities to ensure that they received the necessary attention and to urge the government to work with the World Bank, other donors, and local stakeholders to address these obstacles. These discussions took place during Article IV consultations and during the design and review of Fund-supported programs.

25. **Within the Fund’s areas of expertise, structural conditionality focused on SOE oversight, public sector investment, and access to finance.** To help address the adverse impact of inefficient utility parastatals on the business climate, the 2010 and 2018 ECFs included conditionality designed to strengthen SOE financial reporting, improve fiscal risk analysis, and clarify policies on dividend payments. SOE reforms were also supported by the World Bank.¹⁸ Recognizing the importance of public infrastructure for growth, the 2018 ECF included three benchmarks designed to strengthen the effectiveness of public sector investment. And each of the three ECFs included a structural benchmark relating to the design or launch of a financial sector development strategy. Nevertheless, combined growth-promoting structural reforms comprised a small minority of overall structural conditionality, ranging from 2 percent in the 2012 ECF, to 13 and 21 percent in the 2010 and 2018 ECFs. Analysis conducted for this evaluation

¹⁸ The World Bank supported reforms focused on the power and water sectors, involving five projects during 2008–2019 with cumulative financing of about \$480 million.

suggests that, in comparison with a sample of PRGT-supported programs, structural conditionality in Malawi's 2012 ECF was relatively "deep" in terms of seeking meaningful economic change (Table 8).¹⁹ However, the implementation rate of structural reforms was generally low and the orientation toward promoting efficiency and growth was at the lower end of range for comparator programs.

Table 8. Malawi—Structural Conditions by Depth and Growth-Orientation: 2012 ECF				
	Malawi 2012 ECF	Comparator PRGT programs ¹		
		25th percentile	Mean	75th percentile
Implementation of structural conditionality	0.61	0.66	0.77	0.89
Depth of structural conditionality	0.66	0.47	0.54	0.62
Growth orientation of structural conditionality	0.39	0.38	0.45	0.50

Sources: IEO calculations and Kim and Lee (2021).
¹ Based on comparator PRGT arrangements approved and completed between September 2008 and December 2019.

26. **Staff highlighted other reform priorities during program discussions, albeit without conditionality.** Staff noted the need to improve food security policies, where unfavorable state maize procurement prices and periodic bans on private maize trading and exports had discouraged food production and trade; the World Bank was prominent in supporting reforms to agricultural policy.²⁰ Staff also highlighted the importance of strengthening the business climate through improved legal institutions and regulatory frameworks.

27. **Coordination with the World Bank on growth issues became less intense over time.** The Joint Managerial Action Plan (JMAP) framework, documented in Article IV reports, noted World Bank requests for Fund staff projections and views on the real, monetary, fiscal and external sectors, and for periodic assessment letters to inform Bank and other donor financing operations. The JMAP showed a diminishing specificity of Fund requests of the Bank. In 2010 and 2012, the Fund sought inputs from a World Bank public expenditure review to inform fiscal consolidation plans and World Bank views on the costing of social safety net programs. By the 2015 and 2018 Article IVs, staff JMAP requests to the World Bank were limited to regular updates on the Bank's support to Malawi. Bank and Fund staff worked jointly to prepare debt sustainability analyses as well as the 2012 Joint Staff Assessment Note (JSAN) of the authorities' poverty reduction strategy. The Fund also exchanged information and coordinated engagement with the World Bank and other development partners through the Fund's resident representative office. The World Bank and bilateral donors coordinated their country engagement on growth and poverty reduction issues through a series of sector-wide approaches (SWAs). These

¹⁹ See Kim and Lee (2021) for a cross-country analysis of structural conditionality in IMF-supported programs over the period of 2008–2019.

²⁰ The World Bank approved 12 loans for agricultural development, rural land development, and related goals between 2008 and 2018 with cumulative financing of close to \$800 million.

provided a vehicle for joint funding, a coordinating mechanism for TA delivery, and a single channel for dialogue with the authorities. Given that SWAp typically focus on detailed developmental issues (social aspects, microeconomic reforms, district-level application), the Fund did not participate as a SWAp member. Thus, in overall terms, coordination on growth issues was strongest between the Bank and bilaterals, with Fund staff engaging with this group more informally, depending on program needs.

IV. PROGRAM IMPLEMENTATION AND OUTCOMES

28. **In general, program implementation was erratic.** Reflecting a failure to advance exchange market reforms, the 2008 program went off track without completing either of the two scheduled reviews, while the 2010 program went off track after only one review. Under the 2012 program, the structural reform agenda was repeatedly delayed, leading to multiple program extensions. Reviews were combined because of a PFM crisis (third and fourth reviews), misreporting related to non-concessional borrowing (fifth and sixth reviews), policy slippages (seventh and eighth reviews), while the ninth review was extended to respond to a drought-related humanitarian crisis. Multiple extensions were granted under the 2012 program together with the adoption of prior actions to keep the program on track and complete the remaining structural reform agenda. Under the 2018 program, the second and third reviews were also combined to provide additional time to address fiscal slippages.

Growth and Poverty Developments

29. **Growth has persistently slowed since 2012.** Compared to the preceding 6-year period, average growth in 2012–18 slowed by 3 percentage points (Table 9). In per capita terms, this marked a profound slowdown (from 4 to 1 percent). Growth slowed across all main sectors, with notably smaller GDP contributions from agriculture, manufacturing, trade, and finance. Regression analysis conducted for this evaluation suggests that actual growth generally underperformed the benchmark growth estimated based on external factors alone during the period of 2012–18 (Figure 4).²¹ The major part of Malawi's growth slowdown appears to have reflected a combination of reduced foreign aid inflows, exogenous weather-related shocks, and weak domestic policies.

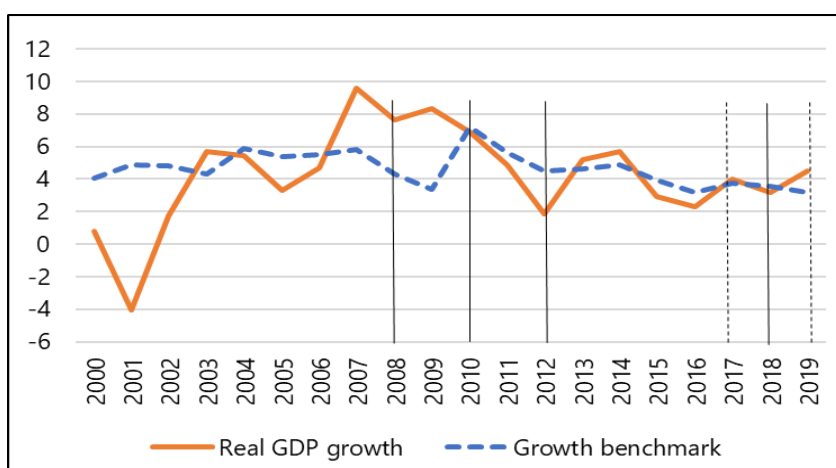
²¹ The benchmark growth was constructed based on a panel regression for a large sample of 174 countries over the period of 1990–2019. Explanatory variables used to model growth were change in the terms of trade, trading partners' growth, regional growth, US interest rates, and a dummy for global financial crisis. See IEO (2021a) for further details.

**Table 9. Malawi—Sectoral Contributions to GDP Growth, 2006–2018
(In percent)**

	Growth rates		Growth contributions	
	2006–11	2012–18	2006–11	2012–18
Agriculture, forestry and fishing	5.0	2.7	1.6	0.8
Mining and quarrying	20.9	1.8	0.1	0.0
Manufacturing	13.0	3.1	1.0	0.3
Electricity, gas, etc.	0.5	2.4	0.0	0.0
Construction	6.9	3.4	0.2	0.1
Wholesale and retail trade	6.7	4.6	1.3	0.9
Information and communication	11.0	7.6	0.4	0.3
Finance, insurance, real estate	8.2	4.1	1.0	0.5
Public administration	4.3	3.2	0.2	0.2
Other sectors	12.2	5.5	0.2	0.1
GDP	<u>7.0</u>	<u>3.9</u>	<u>7.0</u>	<u>3.9</u>
GDP per capita	4.0	0.9		

Source: GDP data from UN online database.

Figure 4. Malawi—Actual and Benchmark Growth



Source: IEO estimate.

Note: See Kim and others (2021) for a detailed explanation of the methodology.

30. **Over time, staff increasingly recognized the persistent nature of the slump in growth performance.** Staff analysis shifted from attributing weak growth to one-off shocks (foreign currency shortages, drought-affected harvests) toward recognizing more systemic shortcomings. Thus, the 2018 ex post assessment noted that growth over 2012–17 had been depressed by high rates of inflation (linked to currency devaluation and fiscal dominance), poor infrastructure, and a weak business environment (IMF, 2018). To this list can be added the decline in budget support grants equivalent to about 4 percentage points of GDP, the decline in

aggregate and public investment in relation to GDP, and possibly the slowdown in broad money and private credit growth (Table 10).

Table 10. Malawi—Potential Factors Influencing GDP Growth

	2006–11	2012–18
Budget grants (percent of GDP) ¹	7.8	3.8
Investment (percent of GDP)		
Gross fixed capital formation	16.2	13.3
Public investment, <i>of which</i> ¹	7.1	5.3
Domestically financed ¹	2.6	1.3
Financial indicators		
Real money growth	20.3	1.4
Real private credit growth	17.1	-4.1
Non-performing loans/gross loans	4.0	12.7
CPI inflation	8.2	19.7

Sources: GFCF (UN online database); public investment (IMF database, 2007 excluded as an outlier); financial indicators (IMF staff reports); CPI (IMF database).

¹ 2006/07–2011/12 compared to 2012/13–2018/19.

31. **Poverty measures have shown mixed trends during recent programs.** Non-income dimensions of poverty have improved considerably over the past two decades. Primary school completion rates rose by 17 percentage points to 75 percent between 2004 and 2013, and the under-5 mortality rate fell from 133 to 64 per 1,000 live births between 2004 and 2015 (IMF, 2017). Measures of childhood nutrition and disease prevalence show similar improvements. However, although the proportion of the population living below the national poverty line fell significantly between 1997 and 2004, the rate subsequently stabilized and showed a small increase between 2010 and 2016.²² The latter increase was anticipated by the World Bank, given the vulnerability of rural populations to the large-scale floods of 2015 and the major drought of 2016 (IMF, 2017) as well as the broader growth slowdown.

Fiscal Outcomes

32. **Fiscal performance repeatedly fell short of program goals.** Given the intention to strengthen external performance, fiscal limits were established for domestic financing of the budget.²³ Over the period between 2008/09 and 2018/19, domestic financing was targeted to average 0.5 percent of GDP but outcomes averaged 3.3 percent of GDP (Table 11). Large financing needs in 2008/09 reflected election-year spending overruns on fertilizer and seed subsidies and road construction. After a brief policy tightening in 2009/10 supported by an upturn in budget support grants, financing pressures reemerged in 2010/11 and 2011/12 as

²² The poverty rate was estimated at 65.3 percent in 1997, 52.4 percent in 2004, 50.7 percent in 2010, and 51.5 percent in 2016.

²³ Effectively accommodating fiscal spending financed with external loans and grants.

domestic revenue yields weakened and grant aid dropped due to governance concerns on the part of some donors.

**Table 11. Malawi—Domestic Financing of Central Government
(In percent of GDP)**

	2008 ESF		2010 ECF		2012 ECF				2018 ECF		
	08/09	09/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18	18/19
Targets ¹	-0.1	-1.0	-1.5	-1.3	0.0	0.0	0.0	0.7	0.9	4.7	3.1
Outcome	<u>3.9</u>	<u>-0.9</u>	<u>1.7</u>	<u>6.7</u>	<u>-0.1</u>	<u>4.2</u>	<u>3.3</u>	<u>1.7</u>	<u>2.7</u>	<u>6.3</u>	<u>6.9</u>
Difference	4.0	0.1	3.2	8.0	-0.1	4.2	3.3	1.0	1.8	1.6	3.8
<i>Memorandum items:</i>											
Grants (outcome-actual)	-1.6	-1.9	-3.0	-4.1	4.1	-4.0	-1.5	0.1	0.6	-1.3	-1.1
o/w budget grants	-0.3	2.1	-2.0	-2.5	1.9	-4.7	-1.2	0.3	0.3	0.0	-0.5

Source: IMF staff reports.

¹ Targets are from the November 2008 ESF request; February 2010 ECF request; July 2012 ECF request (for 2012/13–2014/15); March 2015 ECF extension (for 2015/16); June 2016 ECF extension (for 2016/17); and April 2018 ECF request. Starting in 2014/15, targets and outcomes reflect the upward revision to the level of GDP introduced in 2016.

33. **Fiscal performance strengthened in 2012/13 as the incoming Banda administration was supported by a surge in grant aid.** However, foreign aid declined again in 2013/14 following the Cashgate scandal. The loss of external grants equivalent to about 4 percentage points of GDP was offset by a combination of higher international trade taxes (boosted by about 1 percent of GDP due to the impact of currency depreciation), expenditure cuts, and an increased provision for domestic borrowing.²⁴ In practice, domestic borrowing exceeded the relaxed program ceilings by significant margins (see Table 11). As discussed below, looser-than-programmed fiscal policy added to pressures on the currency and inflation.

34. **Program social spending floors were mostly met.** Considering financial year outcomes (and ignoring within-year slippages), targets were met in 5 out of 7 years for which program floors were established, with an average margin of 0.5 percentage points of GDP.²⁵ The two missed targets were for the first two years of the 2012 ECF. In 2012/13, the shortfall (0.3 percent of GDP) reflected savings on fertilizer purchases and lower than expected take-up of subsidized seeds, while goals for other elements of social spending were met. In 2013/14, the shortfall (0.5 percent of GDP) reflected external financing shortfalls after the Cashgate scandal.²⁶

²⁴ In early 2014, staff also noted the prospective impact of ongoing measures to strengthen revenue modernization. By 2016, as prospects were fading for resumed strong donor funding, the government developed plans for a broad-based tax reforms, drawing on Fund TA.

²⁵ Targets applied to 2010/11 (2010 ECF), 2012/13–2015/16 (2012 ECF), and 2017/18–2018/19 (2018 ECF).

²⁶ Between 2013/14 and 2015/16, recurrent spending under the health and education sector-wide programs were 0.9 percent of GDP and 0.5 percent of GDP lower, on average, than in 2012/13.

35. **Domestically financed public investment was squeezed until recently.** While total public investment appears to have been broadly stable at around 5½ percent of GDP, the domestically-financed component fell from the 2½ percent of GDP range (through 2011/12) to just 1 percent of GDP (from 2012/13 through 2016/17) (Table 12).²⁷ This partly reflected expenditure cuts implemented to offset the fall in budget support grants after the Cashgate scandal. It also reflected a generally tight budget environment in the context of higher inflation and increased domestic interest costs after the 2012 currency depreciation and spending pressures following the 2014 elections (a surge in hiring of teachers and higher-than-programmed public wage increases). The tight squeeze on discretionary public investment compounded the challenges in addressing infrastructure gaps identified at the outset of the program. The 2018 program recognized the need for higher public investment, with provision in the fiscal program for spending of close to 2 percent of GDP.

**Table 12. Malawi—Public Investment
(In percent of GDP)**

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Total public investment	5.0	5.4	5.3	5.5	5.8	4.4	5.3	4.7	6.5	4.8	5.3
Domestically financed	1.5	2.3	2.7	3.0	1.8	0.8	1.0	0.6	0.7	1.6	2.2

Source: IMF staff reports.

Exchange Rate and Monetary Policy Outcomes

36. **The 2012 currency float proved volatile.** Due to an unexpectedly large backlog of unmet foreign currency demand and shortfalls in tobacco export earnings, the currency depreciated sharply. By March 2013, staff estimated that the exchange rate had overshot, becoming undervalued by perhaps 18 percent. Over time, it became evident that currency movements were seasonal, with foreign exchange shortages leading to depreciation during October–February and excess supply leading to appreciation during April–September.²⁸ The central bank took advantage of peak periods of foreign currency supply to build gross reserve cover to 3.4 months of imports by end-2015, relative to a programmed 3.1 months of cover. Reserve cover was subsequently maintained in the range of 3–3½ months of imports. Analysis in the 2015 Article IV consultation estimated that real effective exchange rates remained broadly in line with fundamentals.

37. **From August 2016, Malawi’s exchange rate has been managed more actively to stabilize it within a 2 percent band relative to the US dollar.** Staff underlined that greater exchange rate flexibility was important for the transition to inflation targeting, to cushion shocks,

²⁷ The comparison adjusts the ratios for the recent upward revision to GDP levels.

²⁸ See, for example, Figure 2, page 20, of the staff report for the 5th and 6th reviews under the ECF, March 2015, IMF Country Report No. 15/83.

and to help economic diversification.²⁹ At the same time, staff noted that the managed regime had not given rise to foreign exchange shortages and that the external position remained in line with medium-term fundamentals (as assessed in the 2018 Article IV consultation). Given the authorities' reiterated commitment to exchange rate flexibility, the 2018 program did not seek further exchange system reforms.

38. **The 2012 exchange rate depreciation and subsequent float did not have any evident impact on economic diversification.** In welcoming the 2012 exchange regime reforms, staff envisaged that they would eliminate an important impediment to growth and encourage private investment and economic diversification. However, the share of traditional exports (tobacco, tea, cotton, sugar) in total exports remained virtually unchanged, falling from 62 to 61 percent between 2008 and 2019. Similarly, the contribution of agriculture to GDP declined only slightly over the same period (from 30 to 27 percent) while the decline in the contribution of manufacturing to GDP (from 10 to 9 percent) did not suggest any diversification into higher value-added tradeables. Staff analysis in the 2018 Article IV pointed to continuing non-price impediments to diversification, with large gaps relative to peers in infrastructure, worker skills, financial market development, and the business environment. Staff tentatively estimated that bringing Malawi's performance in these areas into line with the sub-Saharan African average could add 2.5 percentage points to long-term growth and potentially boost GDP per capita from US\$327 in 2017 to around US\$1,110 over the next 20–30 years.³⁰

39. **After the 2012 depreciation, inflation became entrenched.** CPI inflation was projected to fall to mid-single digits from 2014 after peaking at 23 percent at end-2012. Instead, inflation remained at or above 20 percent for more than four years, reflecting a strong pass-through from currency depreciation averaging 36 percent annually during 2012–16 (Table 13). The overall CPI was also boosted by weather-related shocks to food prices, but non-food CPI inflation, while declining somewhat earlier, also remained above 15 percent through 2016.

Table 13. Malawi—Monetary Indicators (In percent)			
	2008–11	2012–16	2017–18
CPI inflation	8.4	25.4	8.5
Exchange rate depreciation ¹	2.9	35.6	1.0
Average bank lending rate	24.8	42.2	35.5
Interbank rate	8.6	23.9	14.8
Real broad money growth	21.5	-1.4	6.6
Real private credit growth	29.1	-5.3	-2.4
Sources: Official data, staff estimates, and World Bank.			
¹ Average annual depreciation relative to US dollar.			

²⁹ The authorities attributed intervention to the need to avoid disorderly market conditions.

³⁰ See Malawi 2018 Article IV Selected Issues Paper "A Path Toward higher and More Inclusive Growth."

40. **Monetary policy was not tightened sufficiently after the 2012 currency float.**

Despite Fund TA on liquidity management and monetary operations in late 2012, interbank interest rates were frequently well below policy rates and inflation between mid-2013 and mid-2016, and program ceilings on central bank NDA and reserve money were exceeded in two-thirds of the test dates under the 2012 program, often by large margins.³¹ The failure to control liquidity reflected unsterilized reserve accumulation and domestic financing of the budget, notably in 2013/14 and 2014/15. This was exacerbated by a decision to halve liquid reserve requirements in July 2015 in an effort to stimulate the economy. Corrective measures under the 2012 program included a number of modest increases in the policy rate and changes to central bank policies designed to discourage the automatic financing of budget deficits. Despite these steps, liquidity was not consistently under control until mid-2016, just before the last review under the 2012 program.

41. **Inflation declined more durably in 2017, with single-digit rates established from 2018.** This reflected greater coherence in monetary policy, including improved use of open market operations and the central bank's deposit auction facility. Interbank rates became less volatile and for the first time, from mid-2016, were consistently managed within the band around the policy rate established by the central bank deposit and discount windows. Positive real interest rates helped stabilize the exchange rate over 2017–18, limiting the pass-through to domestic inflation (see Table 13). With liquidity under better control and inflation trending down, policy rates were gradually eased through 2017–18.

42. **In retrospect, concerns by staff and the authorities about the impact of higher interest rates on growth were probably misplaced.** With private sector credit accounting for just 12 percent of GDP,³² the impact of monetary conditions on growth operating through the credit channel would have been relatively weak. The more important transmission channel for interest rates and liquidity was through the exchange rate and inflation. Given the regressive and distortionary impact of high inflation and its adverse impact on confidence, establishing positive real interest rates likely had a net positive impact on growth, evidence by somewhat stronger growth starting in 2017 (see Table 1). Indeed, high inflation also ran counter to goals for financial deepening. With negative real bank deposit rates during 2012–16, savings incentives were undercut, leading to a decline in real broad money and a reduced supply of loanable funds. This trend reversed in 2017–18 after inflation was successfully reduced (see Table 13).

³¹ For example, the reserve money indicative ceiling was exceeded by between 18 and 33 percent between June 2013 and September 2014. That said, the financial program was not always a clear guide to monetary conditions: NDA and reserve money limits were met by large margins in 2015, even as interbank interest rates and excess reserves in the banking system pointed to ample liquidity.

³² End-2015 figure.

Growth-Related Structural Reforms

43. **Progress in implementing program conditionality on SOE reforms was mixed.** The 2010 ECF went off track before a March 2011 benchmark on publishing the annual audited accounts of major parastatals could be assessed. Under the 2018 ECF, a benchmark to enhance oversight mechanisms of large SOEs and publish audited annual statements and fiscal risk statements by end-June 2019 was converted into three new benchmarks in the first program review. As a first step, by December 2018, Malawi would issue draft arrangements governing SOE ownership, dividend payments, and performance plans. The elements of this benchmark were met, other than in regard to dividend policies, which was rescheduled for Cabinet approval by end-2019. The other two benchmarks required submission to parliament of a pilot audit of the main SOEs (by end-June 2019, met with a delay) and a consolidated annual report on SOEs (by end-March 2020).

44. **Other pro-growth reforms are ongoing.** Benchmarks for Cabinet approval of a financial sector development strategy (December 2010) and its subsequent launch (December 2012) were met, albeit with a delay in the latter instance. Efforts to promote financial deepening remain ongoing, evidenced by a further benchmark in the 2018 ECF on developing a roadmap for increasing access to finance (December 2019). A December 2018 benchmark to enhance the efficiency, planning, and allocation of public investment was converted into benchmarks for piloting performance audits of three important capital projects (June 2019 benchmark) and auditing the public sector investment program database to help improve project management (December 2019 benchmark). The data base audit was completed as planned, as were two of three performance audits (with the third rescheduled for June 2020).

45. **To date, structural reforms have not significantly transformed Malawi's economy.** The direct impact of reforms on economic activity, diversification, and living standards is difficult to judge, given the shocks to which Malawi's economy is prone. In the 2018 Article IV consultation, staff noted the beneficial impact of an improved electricity supply, even as pre-election uncertainties and disruptions from post-election protests weighed on manufacturing and wholesale and retail trade. Realistically, the beneficial impact of institutional reforms will take time to accrue. In practice, they may be modest, given Malawi's limited overall progress with reforms. In 2019, the World Economic Forum ranked Malawi in the 91st percentile of its Global Competitiveness Index, a slight deterioration from an 89th percentile ranking a decade earlier. Similarly, on Transparency International's corruption perceptions index, Malawi's 62nd percentile global ranking in 2019 was down from a 49th percentile ranking a decade earlier.

V. PERSPECTIVES OF THE AUTHORITIES AND FUND AND WORLD BANK STAFF

46. **Staff confirmed that growth concerns increased after 2012.** At the time of 2008 ECF, growth remained strong and was not viewed as an immediate policy issue. Even as late as 2012, staff expected an upturn in donor financing and increased national investment to support growth in the 7 percent range. The deteriorating growth performance from 2012 was attributed by staff

to a range of factors, including the slump in donor grants, the failure to tighten fiscal policy in response, and the crowding out of private credit and investment by domestic financing of the budget. In the authorities' view, Fund programs through 2016 focused primarily—and appropriately—on restoring macroeconomic stability; increased attention to growth issues was evident from 2017 onwards.

47. **As concerns about macro stability diminished, staff highlighted the importance of addressing structural obstacles to growth.** They noted the unfinished agenda for modernizing agriculture, including through investments in irrigation, more reliable power supplies, and better seed varieties. Access to private sector finance was also cited as a continuing challenge. The authorities agreed that Malawi remained subject to important structural obstacles to growth, notably because of limited public funding for development programs, including in the critical power and irrigation sectors. They noted that growth had picked up slightly in 2018 and 2019 as improved macroeconomic stability and an uptick in credit availability boosted business confidence. However, growth was adversely affected again in 2020 as a result of the coronavirus pandemic.

48. **Staff generally defended the Fund's limited engagement in structural reforms directly targeting growth performance.** They noted the lack of staff expertise for prioritizing the benefits of, say, fertilizer subsidies versus irrigation. Given the need for parsimony in program conditionality, they argued that the Fund should focus on its core areas of engagement, such as PFM and financial stability. They noted that the Fund had addressed important obstacles to growth through its advice on eliminating exchange market distortions, resolving fiscal arrears, strengthening PFM practices, and promoting financial deepening. More generally, the Fund's programmatic support for macro stability helped catalyze engagement by donors and other international institutions. For example, Fund support for the design and implementation of a PFM reform program and action plan after the Cashgate crisis provided one necessary element for the gradual resumption of budget support. Similarly, following a drought-induced humanitarian crisis, the augmentation of access and policy flexibility in the combined 8th and 9th reviews of the 2012 ECF arrangement helped catalyze additional donor support equivalent to 2 percent of GDP. While most staff saw little scope for the Fund to have done more to promote growth through structural reforms, one possible gap was the absence of conditionality designed to strengthen SOE performance during the 2012 ECF—an area of reform for which the authorities had little appetite at the time.

49. **The authorities broadly supported the Fund's concentration on its core areas of expertise.** They saw broader growth-promoting institutional reforms, such as those in the energy sector, as adequately supported by the World Bank and other partners. That said, the authorities suggested that Fund programs should go beyond merely identifying growth as an objective, with staff dedicating more effort to analyzing the potential sectoral sources of growth and how these could be supported by public policy. World Bank counterparts also supported the Fund's focus on macro stability issues in Malawi and shared the authorities' view that more attention could be given to sources of growth. In the Bank's view, the Fund's growth projections tended to reflect

overly optimistic assumptions about the near-term impact of development programs and projects. This optimism was evident, for example, in DSA projections.

50. **There was broad recognition of the important role played by the Fund in strengthening PFM practices, even while the process had been slow and subject to setbacks.** Staff noted that donor support had been buffeted by repeated fiscal mismanagement: the non-transparent purchase and sale of a presidential jet, the Cashgate fraud, and unreported non-concessional borrowing to finance military equipment. In staff's view, Malawi had the administrative capacity to have made faster progress in addressing PFM challenges. That said, the modalities of TA delivery were important: more progress was made after the appointment of a resident technical advisor than achieved with peripatetic advisors. More generally, staff noted that Fund TA was critical for guiding program design in regard to PFM and other structural reforms. The authorities and World Bank staff commended the Fund's support for the design and implementation of PFM reforms. The authorities noted, in particular, Fund support for the regularization of government spending arrears which had strengthened the financial position of government suppliers, as well as analysis of the fiscal risks posed by SOEs. Bank staff noted the importance of the Fund's TA on PFM issues, with the Fund's resident advisor in the Ministry of Finance viewed as providing critical information and guidance to the World Bank and other partners supporting PFM reforms. Bank staff welcomed Fund program conditionality designed to preclude the emergence of new fiscal arrears but noted that it was not fully effective. The limit applies to arrears at the point they are officially confirmed but ignores unpaid claims early in the accounting process. Thus, a recent AFRITAC TA mission identified emerging road sector arrears that had not been captured under the Fund program's ceilings.

51. **Staff expressed concerns about the absence of effective safety nets for the most vulnerable, which provided a continuing challenge for program design.** Given this, programs sought to mitigate the impact of adjustment by preserving funding for social spending programs. This was seen as a blunt instrument, given the breadth of coverage of this measure and the lack of tailoring to the evolving social impact of different programs, with some, such as FISP, having become less effective over time. Some staff saw scope for greater Fund engagement in developing PFM practices designed to monitor the benefits of different public spending programs for low-income groups, and to promote funding for those that were most effective. While concurring on the importance of social spending, the authorities saw the targets as having been too ambitious, particularly given the decline in donor budget support. The authorities noted an active debate in Malawi about the appropriate balance between financing social spending and development programs. Those who favored the latter argued for "growing the cake before eating it." In their view, scarce public resources should prioritize growth-promoting development programs, including in the road sector, agriculture, energy, and tourism. In this connection, it was noted that program floors for social spending include the wages and salaries of government employees, spending that does not directly benefit the most vulnerable. World Bank staff noted their limited involvement in the design of social spending floors under Fund

programs. Given their expertise in assessing public expenditure programs, this could be a fruitful area for Bank-Fund collaboration.

52. **Staff also regretted the decline in domestically financed public investment which they attributed to a variety of factors.** The downturn in donor budget support grants from 2014 was an important influence. In addition, fiscal pressure from public salary increases may have reduced resources for investment, and the limited administrative capacity to manage investment projects was a further consideration. To focus attention on addressing these concerns, it was suggested that programs might include an indicative floor on public investments with an estimated high value-for-money (such as those that eliminate growth impediments or build resilience to climate-related shocks). Staff also noted that improved fiscal data were needed to confidently monitor investment spending trends.

53. **The authorities cited the constraining impact on development spending of the zero ceiling for non-concessional borrowing under the Fund program.** They noted that Malawi's access to concessional financing was limited to a few institutions (primarily the World Bank and AfDB) and in amounts modest relative to development needs, especially given the high upfront costs of beneficial energy and irrigation projects. In their view, some recourse to non-concessional financing was needed to support development spending. By contrast, the World Bank found the DSA projections in Fund programs to be relatively generous, given Fund staff's upbeat growth projections.³³ As a result, Fund programs have recently been willing to accommodate relatively sizeable fiscal deficits, albeit financed by costly domestic borrowing rather than non-concessional external debt.

54. **The move to exchange rate flexibility was undermined, in staff's view, by lack of supportive policies.** Engagement on exchange rate policy under the 2004–2012 Mutharika administration was hampered by the authorities' skepticism about demand pressures on the currency and the case for depreciation. This skepticism, in staff's view, contributed to the lack of fiscal adjustment and mounting currency market distortions through early 2012. Subsequently, while the 2012 depreciation and float were in line with staff advice, the central bank failed to provide adequately supportive monetary conditions until mid-2016. This came at a high cost in terms of currency depreciation, high inflation, and weak growth. Staff noted that the unpopularity of high inflation through 2016 was a key factor motivating the return to a more managed exchange rate from August 2016. Some within staff argued that programs could have focused more on developing an effective monetary policy framework for managing the float. A case was made that, with hindsight, an early move to inflation targeting might have provided more discipline.

55. **The exchange rate and monetary policy regimes have remained a source of concern.** The authorities agreed that monetary policy was not adequately supportive of the

³³ Although DSAs are a joint Bank-Fund product, Bank staff noted the Fund's lead role in formulating the underlying macro framework.

currency float at the outset. However, while monetary policy was initially undercut by efforts to support credit expansion, after 2015 priority was given to maintaining positive real interest rates, contributing to a generally successful disinflation. The World Bank noted that both exchange rate and monetary policy remained non-transparent. The stability of the exchange rate since 2017 has been associated with a significant real effective appreciation, queues for foreign currency have reemerged in commercial banks, and a drawdown of foreign currency reserves has been offset by contracting currency swaps. As regards monetary policy, the authorities have sought to influence interest rates through a complicated reference rate regime, while data on actual market interest rates (weighted by transaction) are not available. In the view of Bank staff, Fund programs should press more forcefully for transparent, market-based exchange rate and monetary policy practices. The authorities recognized that further progress in these areas was necessary.

56. **The authorities welcomed Fund support for financial deepening.** While potentially beneficial for growth, they noted that access to finance was not sufficient for achieving higher private investment. Parallel steps were also needed to address other growth obstacles, such as unreliable power supplies.

57. **Staff was generally positive about collaboration with other development partners.** A large number of institutions are active in Malawi across multiple development areas. The World Bank plays a central role, joined also by AfDB, UNICEF, UNFPA, Global Fund, MCC, and regional and national development agencies (EU, Belgium, Germany, Ireland, Norway, UK, US). Staff noted that these entities provide comprehensive support for poverty reduction and growth, with close and fruitful collaboration with the Fund. It was suggested, however, that a reliable big-picture analysis of growth constraints was missing: the World Bank and other agencies tend to gravitate to sectors where they have expertise and where the government is most interested to engage, rather than prioritizing based on an objective overall analysis of growth constraints. The authorities saw engagement by the Fund, World Bank, and other partners as generally complementary, with no major strategic differences. Bank staff agreed that collaboration with the Fund was generally strong, subject to the differences in policy perspective noted above. The Bank noted, in particular, the beneficial presence of the Fund's resident representative office.

VI. CONCLUSIONS AND LESSONS

58. **Malawi's economic performance over the past decade was disappointing.** Despite broadly continuous IMF program engagement, per capita income growth stalled while the poverty rate increased. Weak performance reflected long-standing vulnerability to shocks and insufficient policy implementation. Aid dependency left Malawi exposed to sharp drops in grant financing in 2011 and again after 2013. Rainfed harvests were vulnerable to adverse weather in 2015, 2016, and 2018. And vulnerability to shocks was exacerbated by weak policy responses—delays in addressing foreign currency shortages; delays in tightening monetary conditions to stem inflation after the float; weak progress in strengthening PFM after the 2013 Cashgate crisis; and inadequate fiscal tightening following the resulting drop in grant financing. Reflecting Malawi's vulnerability to shocks, uneven program ownership, weak governance, and other institutional shortcomings,

programs quickly went off track (2008 and 2010 programs) or were characterized by combined reviews (2012 and 2018 programs) and multiple extensions (2012 program).

59. **Different approaches to program design could have helped to foster better policy outcomes, albeit within a difficult context.** Given Malawi's lack of diversification against shocks and the entrenched political and administrative constraints to reform, restoring macro stability while supporting growth was inherently a challenge. To some extent, program design was adjusted to address these challenges, for example, by modifying structural conditionality to account for the fragile institutional framework. While recognizing this, experience suggests that aspects of Fund engagement could have been strengthened to achieve better program outcomes. Specifically:

- More attention could have been given to identifying political and institutional constraints to growth and explicitly integrating them into program design.
- Staff could have engaged more substantively with the World Bank, other agencies, and civil society on how Fund policy analysis, program conditionality, and technical assistance could support longer-term growth prospects.
- Greater attention could have been given to growth as a core program goal, with macroeconomic policies examined more closely in terms of how they contribute, directly or indirectly, to this goal.

Political and Institutional Constraints to Growth

60. **Political resistance and structural impediments to growth and poverty reduction were not consistently reflected in program design.** In reviewing the outcome of the 2012 program, staff concluded that "program objectives such as achieving higher, more inclusive and resilient growth as well as poverty reduction were challenged by not fully accounting for deep structural rigidities, weak implementation capacity, and limited productivity and economic diversification in program design (IMF, 2018)." In the same assessment, staff concluded that missed targets in the 2012 program partly reflected insufficient incorporation of political-economy and capacity constraints in program design. The early demise of the 2008 and 2010 programs similarly reflected inadequate commitment by the authorities to the envisaged exchange rate regime reforms, which may have reflected a lack of ownership.

61. **A more central focus on growth and poverty reduction as program goals would help bring greater attention to political and structural impediments.** Framing the Malawi programs more explicitly in terms of supporting growth would have highlighted implicit assumptions about the growth dynamics where the authorities and staff may have had different views. Thus, the 2008 and 2010 programs apparently failed because the authorities did not share staff's views about the importance of exchange rate flexibility for development and growth. In the absence of such agreement, it may have been better to advance other reforms, perhaps

under a staff-monitored program, while building common understandings on the case for exchange regime reform. Indeed, reviewing the 2012 program staff noted that when targets were fully aligned with the authorities' objectives, policy implementation was effective and often remarkably fast (IMF, 2018). As noted below, substantive early engagement with civil society, the World Bank, and other agencies would help identify political and institutional impediments to growth and identify priorities for Fund policy support and conditionality.

Engagement with Partners on Growth Issues

62. **Given resource constraints and accumulated areas of expertise, Fund staff showed a reluctance to engage on reforms to enhance Malawi's flexibility, governance, investment climate, and productivity.** This reflects important differences of established comparative expertise between the Fund and other agencies. The authorities and World Bank broadly support this approach, with little appetite for the Fund to substantially expand its areas of engagement. That said, a flexible approach is needed. Some areas of Fund engagement in Malawi that are presently highly valued by the authorities and other partners (SOE fiscal risks, public investment management, financial deepening) are areas in which the Fund has deepened its expertise and engagement over the past decade. Staff should remain open to developing further areas of new expertise that complement existing skills.

63. **The World Bank would welcome closer collaboration in areas where its engagement on growth issues overlaps with that of the Fund.** One example is how to ensure that a realistic assessment of the impact of Bank-supported development programs is reflected in the Fund's macro framework and the joint DSA. Another could be to draw on Bank views of the effectiveness of social programs when developing social spending floors in Fund programs. At the same time, certain features of Fund programs remain contentious with (or unclear to) the authorities and/or World Bank, including the appropriate limits on non-concessional borrowing, limits on fiscal deficits, and conduct and transparency of monetary and exchange rate policy. This suggests that strengthened communication is needed on potentially controversial aspects of the design and implementation of Fund programs—particularly given that the latter provide the macro foundation for engagement by other partners.

64. **Arrangements for collaboration on growth issues have weakened in recent years.** Coordination with the World Bank through the JMAP has become a formality, and the (minimal) collaboration formerly required for joint assessment of the authorities' poverty reduction strategy (PRS) has been replaced by a process that is largely devolved separately to each institution. While there continues to be periodic interagency collaboration on growth issues, it tends to be "bottom-up", driven by specific areas of engagement by the Fund and its partners, rather than "top-down", based on a comprehensive analysis of Malawi's underlying growth challenges. While the authorities' PRS could, in principle, provide a framework for coordinating engagement by the Fund and other agencies, in practice, it lacks the necessary precision and analytical rigor. At the same time, given the distinct nature of the Fund's expertise and engagement, there is little

advantage in it joining the SWAp framework that coordinates the pro-growth policies of the World Bank and other participating agencies.

65. **Approaches should be explored for strengthening collaboration on growth issues with the World Bank and other agencies.** These issues should ideally be explored prior to each new Fund program, possibly through a workshop or conference. A shared assessment of the policy priorities for supporting growth and the respective roles of the Fund, Bank, and other agencies could be agreed with the authorities and included as part of the documentation for the program request. Following this baseline appraisal of growth challenges, further inter-agency discussions would likely be needed as new macroeconomic policy challenges for growth emerge (as discussed below).

Attention to the Growth Impact of Macroeconomic Policies

66. **The Fund's engagement on Malawi sometimes gave inadequate attention to the indirect impact of economic policies on growth.** Given staff's comparative policy expertise, growth is generally seen as an indirect policy goal, best achieved by promoting macro stability and efficient resource allocation. While correct as a general proposition, this over-simplifies the relationship between macro policy levers and growth. It understates the multiplicity of factors needed to support growth and can ignore second-round effects of macro reforms that may undermine growth.

67. **For example, the move to exchange rate flexibility was less effective in promoting growth and diversification than envisaged.** In urging steps to eliminate foreign currency shortages and parallel market premia, staff envisaged that market-based allocation of foreign currency would eliminate an important impediment to growth and encourage private investment and diversification. Despite eventually adopting successful exchange regime reform, the payoff for diversification was limited because of continuing structural impediments to investment and trade. With earlier attention to these obstacles, relevant reforms could have been discussed with the World Bank and other agencies, and potentially covered by conditionality under the 2012 program.

68. **The dramatic step to float the exchange rate was not supported by an adequate monetary policy framework.** Inconsistent policies were not helped by the delivery of Fund TA on exchange reform options and liquidity management in separate missions, with an interval of almost a year between, and with TA on the latter delivered some months after the currency float. However, even following Fund TA, liquidity was not adequately managed for several years. Although the 2012 program included several measures designed to strengthen liquidity management and tighten monetary conditions, a stronger focus on delivering sustained performance in these areas for completing program reviews was probably warranted. Several factors may have contributed to delayed policy tightening. With monetary policy transmission mechanisms not well understood, both staff and the authorities may have overestimated the potential impact of tighter liquidity policies on growth. Thus, as late as 2015, the authorities had cut reserve requirements to support the economy, while staff, in discussing the March 2015

program review, referred to the need to avoid a squeeze on private sector credit and growth when tightening the monetary stance. Caution about protecting credit was compounded by mixed messages from NDA ceilings about the adequacy of monetary conditions. In the event, the exchange rate stabilized, and inflation fell quite quickly as soon as market interest rates were managed consistently at positive real levels. This suggests that, where monetary transmission channels are not well understood, as in Malawi, staff should give more attention to a holistic evaluation of developments in liquidity and interest rates when completing program reviews, rather than focusing primarily on monetary aggregate ceilings.

69. **Programs should press more forcefully for greater transparency of exchange rate and monetary policies.** The shift from NDA to reserve money ceilings in the 2018 ECF was likely warranted. At the same time, the complex manner in which interest rate policy has recently been implemented, the lack of market interest rate data, and the reemergence of foreign currency queues prevents a clear assessment of both the authorities' monetary and exchange rate strategy and the present policy stance. Progress in developing greater policy transparency and the availability of reliable supporting data should be early priorities, key for near-term policy management as well as for Malawi's longer-term transition to inflation targeting.

70. **A stronger focus on understanding financial-growth linkages would have been welcome.** This could have resulted in earlier attention to the adverse impact of high inflation on poverty, economic confidence, financial deepening, and growth. It could also have prompted greater emphasis in Fund programs on financial deepening, supporting reforms developed in coordination with technical assistance being provided by the World Bank.

71. **At the margin, international reserve buffers could have been used more actively to cushion the economy from external shocks.** In general, programs sought to strengthen Malawi's low reserve cover to provide a buffer against shocks. However, when donor grants slumped after the Cashgate scandal, the program sought further reserve accumulation (\$50 million in 2014) rather than pausing the reserve buildup or making a modest drawing on the accumulated buffer (\$400 million, or 2 months of projected imports at end-2013). Indeed, the program "over performed" in 2014, with \$200 million of further reserve accumulation, despite a 15 percent currency depreciation over the course of the year. A more modest reserve buildup would have reduced the inflationary impact of the donor pullback. This, in turn, could have mitigated the impact of high inflation on private credit and economic activity.

72. **Greater attention to public investment may have been warranted.** In seeking to restore macroeconomic stability after the slump in donor budget support in 2014, poverty-reducing spending was maintained at programmed levels while cuts were made in domestically financed investment. This choice appears to have been made without close consideration of the implications for growth. While safeguarding poverty reducing spending appears important, the selected programs were partly chosen for ease of monitoring rather than because they have the highest estimated impact on poverty. In practice, they may be less important for growth and distribution outcomes than some public investment projects. The subsequent assessment that

underfunded public infrastructures were an important constraint on diversification and growth suggests that spending decisions in the aftermath of the Cashgate crisis may have exacerbated the economic slowdown. Greater attention in the 2018 ECF to financing infrastructures critical for building resilience and to improving public investment management is welcome. At the same time, it may be useful to work with the World Bank to refine the definition of poverty-reducing spending, drawing on public expenditure review or other metrics, to identify programs that are reliably worth safeguarding in the face of budget pressures. Potentially, this measure could be expanded to cover public investment spending of high value for long-term growth, economic diversification, or resilience against climate shocks.

REFERENCES

- International Monetary Fund, 2012, "Malawi: Joint Staff Advisory Note of the Poverty Reduction Strategy Paper, IMF Country Report No. 12/223, August (Washington).
- _____, 2017, "Economic Development Document," IMF Country Report No. 17/184, July (Washington).
- _____, 2018, "Ex Post Peer-Reviewed Assessment," Annex I in "Staff Report for the 2018 Article IV Consultation and Request for a Three-Year Arrangement under the Extended Credit Facility," IMF Country Report No. 18/115, May (Washington).
- Kim, Jun, and others, 2021, "Cross-Country Analysis of Program Design and Growth Outcomes: 2008–19," IEO Background Paper, BP/21-01/01 (Washington: International Monetary Fund).
- Kim, Jung Yeon, and Kwang Yeon Lee, 2021, "Structural Conditions, Structural Reforms and Growth in IMF-Supported Programs," IEO Background Paper, BP/21-01/04 (Washington: International Monetary Fund).
- Nsengiyumva, Fabien, and others, 2015, "Malawi: Reforming the Farm Input Subsidy Program," IMF Selected Issues Paper, November (Washington: International Monetary Fund).
- World Bank, 2019, "Malawi Economic Monitor: Charting a New Course," World Bank, June (Washington).

CHAPTER 5. SENEGAL

MARCO PINON-FARAH^{*}

^{*} Consultant, Independent Evaluation Office of the IMF.

EXECUTIVE SUMMARY

This study presents an evaluation of how well the IMF-supported programs in Senegal during 2008–19 protected growth and social conditions, while delivering the necessary adjustment. Senegal is a country with a diversified economy and generally regarded as having responsible macroeconomic policies but where growth has fallen short of rates needed in view of its low-middle income status and high population growth rate. As a member of a monetary union, its macroeconomic toolkit is largely restricted to fiscal policy. This evaluation is based on discussions held prior to COVID-19 pandemic.

With few exceptions, Senegal has consistently chosen to rely on IMF instruments that are meant to offer a signal of strong policies to markets and development partners but not involving disbursements. Medium-term programs have been supported by three successive Policy Support Instrument (PSI) arrangements approved in 2007, 2010 and 2015 and, more recently, by a Policy Coordination Instrument (PCI) approved in January 2020. With the PSI/PCI not entailing Fund disbursements, the 2007 PSI was supplemented in 2008 with a high-access-component Exogenous Shocks Facility (ESF) arrangement to provide financial assistance to deal with higher oil and food prices. A Rapid Credit Facility (RCF) and a Rapid Financing Instrument (RFI) was approved in April 2020 to help address the urgent budgetary and external financing gaps arising from the COVID-19 pandemic.

Overall, the design of programs supported by the IMF have struck a good balance between seeking moderate adjustment and promoting higher and sustained growth. Of particular importance has been their emphasis on structural reforms to remove obstacles to growth and on important infrastructure projects, particularly since 2015. The World Bank and other development partners have played important roles in critical areas such as electricity. While growth was weaker than anticipated during the first programs covered in this evaluation, during 2015–19 Senegal achieved high and sustained rates of growth.

While fiscal adjustment under the programs does not seem to have affected growth negatively, little of the intended adjustment has been carried out. While Senegal had episodes of low growth, these were generally characterized by counter-cyclical fiscal expansions and deviations from adjustment targets. More broadly, the underlying fiscal adjustment ex post has fallen short of the adjustment sought under the programs and, as a result, government debt has increased substantially and, with it, some medium-term risks.

This evaluation found a need for a more systematic approach to assessing trade-offs between public investment and indebtedness. While government debt has risen fast, the efficiency of public investment (value for money) has remained low. Borrowing on reasonable terms to fund productive investments can contribute to growth and development but spending with low returns can lead to dangerous increases in debt and ultimately hamper growth. In this connection, Fund-supported programs should involve: (i) at the outset, a consistent and properly costed strategy, identifying major infrastructure gaps being addressed, expected costs, and a

timeline for their implementation, in collaboration with development partners; (ii) a more effective project evaluation and monitoring process, with all large projects, including from bilateral offers, subject to transparent cost benefit analyses, covering their expected contribution and financing terms; and (iii) subjecting all large projects to public tenders and, in the case of bilateral offers, ideally assessing them against alternative providers and financing.

Program design should ensure a more effective monitoring and management of public spending. Senegal's experience in which public debt has increased faster than implied by monitored public borrowing needs suggests fiscal and other targets should be defined broadly enough to capture all relevant avenues of spending, and prevent the use of possible off-balance sheet, "below-the-line" operations, or domestic arrears as options to meet program targets. It will also be important to prevent accumulation of arrears to domestic suppliers like those that took place in 2007–08 and 2017–18 when spending outran available financing.

Despite progress, further improvement in the business environment will be required to achieve a large and sustained expansion over the longer term. Despite being a key program objective for over a decade, the private sector take-off has not materialized. More transparent and predictable criteria to select public investment projects and preventing accumulation of domestic arrears would contribute. Other key reforms such as land and labor reforms, while difficult, will be of utmost importance if Senegal is to sustain growth and achieve its ambitious medium-term to long-term development goals.

I. INTRODUCTION

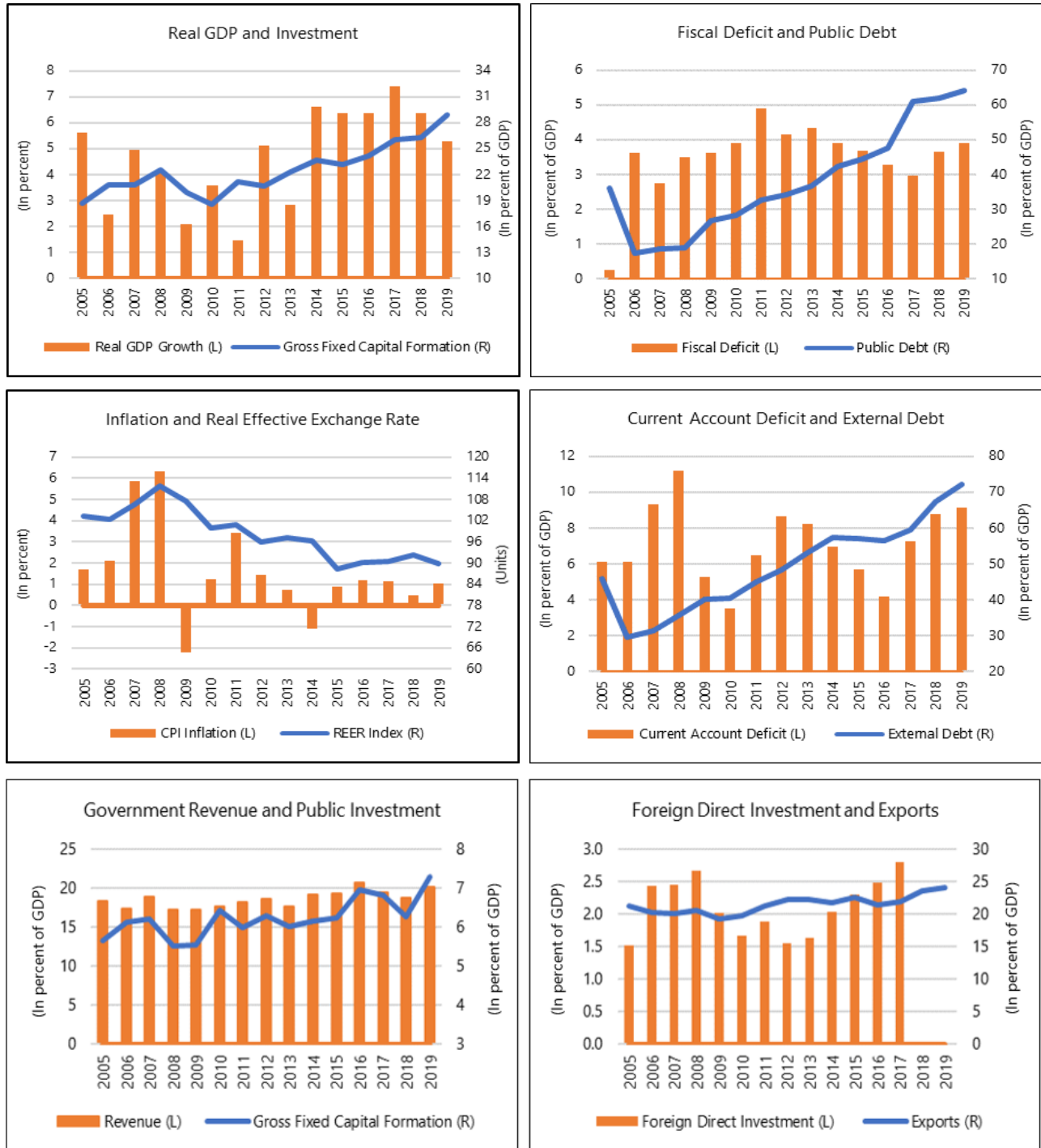
1. **Several factors make Senegal an interesting case study.** While generally considered to have sustained responsible macroeconomic policies, historically growth has fallen short of aspirations, given its relatively low per capita income and its high population growth rate. As a member of a monetary union, Senegal's macroeconomic policy toolkit is essentially constrained to fiscal policy. Finally, with the exception of access to the Exogenous Shock Facility (ESF) in December 2008 and to the Rapid Credit Facility (RCF) and the Rapid Financing Instrument (RFI) in April 2020, Senegal has consistently chosen to rely on IMF instruments that are meant to offer a signal of strong policies to markets and development partners, but do not involve purchases or disbursements.
2. **This evaluation focuses mainly on programs and outcomes during 2008–19.** It draws on program documents and interviews with country officials and staff held prior to the COVID-19 pandemic. The report also provides factual information on key developments in 2020. As has been the case elsewhere, the COVID-19 pandemic has adversely affected Senegal's economy and the IMF has provided financial support to help deal with the crisis.

II. CONTEXT

3. **Senegal is a lower-middle income country with a relatively diversified economy, both in terms of export products and trading partners.** It has a per capita GDP estimated at US\$1,430 as of 2019, with a population of about 16.8 million. Despite setbacks in the past, growth has accelerated significantly in recent years, largely driven by the public sector. While doing-business rankings show some improvement, success in shifting toward a private sector investment-led growth has been limited. However, the recent discovery of oil and gas, which adds a new dimension to the Senegalese economy, is expected to boost growth over the medium term.
4. **Senegal is a member of the West African Economic and Monetary Union (WAEMU).** This regional arrangement, involving a common currency tied to the euro, is generally seen as having served the country (and the region as a whole) well, but not without challenges. The arrangement has been instrumental in maintaining low rates of inflation, even after sustaining external shocks. However, the country does not have an independent monetary policy or flexible exchange rate to act as shock absorber. This has at times raised concerns about competitiveness and growth. Membership includes other commitments such as fiscal targets aimed at buttressing the currency arrangement. Of particular importance are the so called "convergence criteria" consisting of a fiscal deficit ceiling of 3 percent of GDP. In practice these criteria are not always observed by member countries. For example, Senegal was able to observe the WAEMU convergence fiscal deficit criterion only once during the period 2008–19 (in 2017).
5. **Episodes of increased growth over the last three decades have not generally been sustained.** Average growth has barely been above population growth. Growth of 4.5 percent in 2007–08 quickly fell back to growth rates around 3.0 percent during 2009–13 (Figure 1). This

reflected in part the impact of the global crisis but, more generally, a poor business climate, problems in the energy sector, inadequate infrastructure, and low efficiency of public investment.

Figure 1. Senegal—Selected Economic Indicators



Sources: April 2020 WEO database; INS database; FFA database.

6. **The government launched an ambitious national development plan in 2014.** The Emerging Senegal Plan¹ (*Plan Sénégal Émergent* – PSE) targeted to raise Senegal to emerging market status by 2035, aiming to achieve growth rates of about 7–8 percent by 2018. A second phase of the plan (PSE II), launched in 2019 aims for growth rates above 10 percent by 2022–23. Annual growth has increased considerably to 6.4 percent on average during 2014–19.
7. **The COVID-19 pandemic hit Senegal hard in 2020.** Growth is now estimated to have fallen sharply in 2020 and to remain below previous projections in 2021–22.
8. **Despite the recent growth, persistent poverty, unemployment and low wages have, at times, fomented difficult social and political conditions.** For example, street protests by students and workers in the health and education sectors in early 2018 pushed up wages and transfers and prevented increases in domestic energy prices in the face of rising global oil prices, thus eroding fiscal discipline. Similarly, ahead of presidential elections scheduled for February 2019, reforms were delayed, budget targets exceeded, and domestic arrears accumulated.
9. **Debt vulnerabilities have increased in recent years.** The public debt-to-GDP ratio has tripled since 2008 to 64 percent of new GDP at end-2019,² owing in part to the implementation of large infrastructure projects. It is important to put in perspective this debt accumulation as it started from a low base following a sharp reduction in the context of the Heavily Indebted Poor Countries Initiative (HIPC) completion point and the delivery date of Multilateral Debt Relief Initiative (MDRI). Nonetheless, the most recent DSA in 2020 determined that Senegal was now subject to moderate risk of debt distress.

History of Fund Engagement

10. **Over the past decade, Senegal has been supported by a series of signaling arrangements with the Fund, with the primary objective of providing a framework for policies to achieve considerably higher economic growth over the medium term.** During the 1980s and 2000s, Senegal received concessional financing under the Poverty Reduction and Growth Facility. The latest medium-term programs have been supported by three successive Policy Support Instruments (PSIs)³ approved in 2007, 2010 and 2015 and, more recently, a Policy Coordination Instrument (PCI) approved in January 2020.⁴ Generally speaking, all of these

¹ Republique du Sénégal (2014).

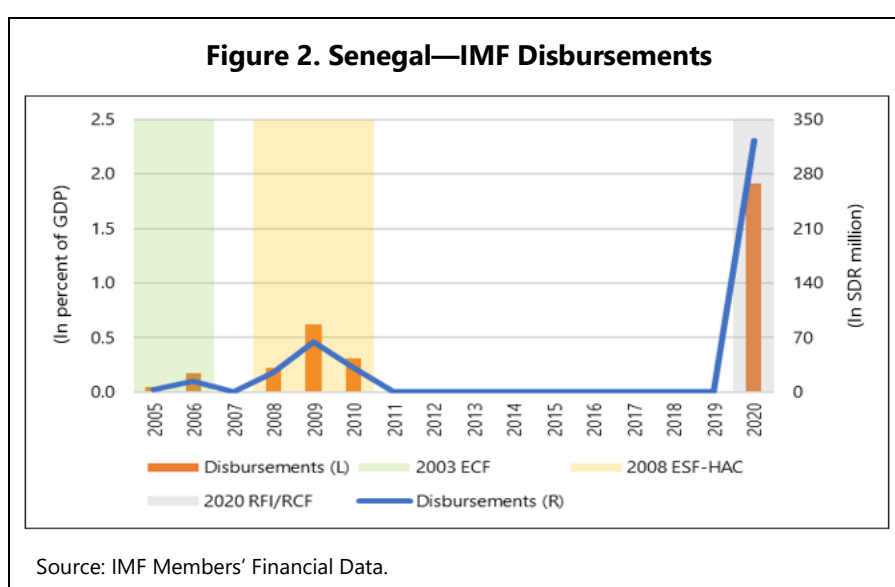
² A new GDP series was adopted in 2017, which is broadly 30 percent higher than the previous series.

³ The PSI offers low-income countries that do not want—or need—Fund financial assistance a flexible tool that enables them to secure Fund advice and support without a borrowing arrangement. The PSI helps countries design effective economic programs that deliver clear signals to donors, multilateral development banks, and markets of the Fund's endorsement of the strength of a member's policies.

⁴ Similar to the previous PSIs, the PCI is an arrangement introduced by the IMF in 2017 to support countries that can benefit from IMF support under a program, but that do not need financial resources from the IMF. It enables countries to signal commitment to reforms and catalyze financing from other sources.

programs sought to implement reforms to foster growth in the private sector, including by increasing infrastructure and social public spending, while maintaining a stable macroeconomic environment.

11. **2007 PSI and 2008 ESF.** In October 2007, the Executive Board of the IMF approved a three-year Policy Support Instrument (PSI) for Senegal. In December 2008, the authorities requested a one-year high-access-component ESF arrangement for 30 percent of quota (equivalent to SDR 48.54 million) to help finance the balance of payments (BOP) impact of higher oil and food prices (Figure 2).⁵ The ESF ran concurrently with the 2007 PSI. In June 2009, the Executive Board approved an extension of the ESF to 18 months and an augmentation (to a total 75 percent of quota or SDR 121.35 million). All disbursements took place and the ESF expired in June 2010.



12. **2010 PSI.** A new three-year PSI was requested in December 2010 in the context of the 6th review and cancellation of the 2007 PSI. In their request, the authorities emphasized the need for a successor PSI to help accelerate growth, reduce vulnerabilities, and lower poverty.

13. **2015 PSI.** The authorities requested a third PSI in June 2015. The arrangement supported the authorities' Emerging Senegal Plan (PSE) which sought to increase growth considerably. The seventh and last review of Senegal's economic performance under the program was completed in January 2019. The arrangement was canceled in April 2019, before assessing performance in 2018 as a whole, to begin discussions on a successor arrangement.

⁵ The ESF provided concessional financing to low-income countries facing BOP needs caused by sudden and exogenous shocks. It is intended to focus on adjustment to the underlying shock, with less emphasis on the broad structural adjustment that often characterizes other IMF-supported programs.

14. **2020 PCI.** In January 2020, a three-year PCI arrangement was approved by the IMF Executive Board. The program aimed to further accelerate growth rates in the context of the implementation of the second phase of the authorities' Emerging Senegal Plan (PSE II). It sought to return to the fiscal targets envisaged under the previous program in 2020 and maintain a broadly constant deficit thereafter. It also incorporated a framework to prepare for the start of operations of oil and gas fields in 2022 or 2023, with IMF technical assistance. At the time of the completion of the first review of the PCI in July 2020, the fiscal targets were relaxed temporarily, especially for 2020, reflecting a severe slowdown in growth and cost of measures to deal with the effects of the COVID-19 pandemic.

15. **2020 RCF/RFI.** In April 2020, the IMF Executive Board approved a disbursement of SDR 323.6 million (100 percent of quota) under the RCF and the RFI to address the urgent budgetary and external financing gaps arising from the economic impact and mitigation efforts to the COVID-19 pandemic. The authorities also requested debt service relief under the Debt Service Suspension Initiative (DSSI) of the G20.

III. PROGRAM DESIGN

A. Program Growth and Adjustment Objectives

16. **The three successive PSIs and the current PCI have all targeted simultaneously (different degrees of) domestic adjustment and significant GDP growth acceleration and poverty reduction.**⁶ Table 1 and Figure 3 show several of the key program targets at the time of approval and as adjusted in the context of program reviews. The text of this section describes key elements of the strategy and objectives for each of the programs, while the following section provides further detail about pro-growth policies.

2007 PSI⁷

- A reduction of the fiscal deficit to 4 percent of GDP by 2010 was the cornerstone of the program to return fiscal policy to a sustainable position. For 2007, the program sought to bring the deficit down to 4¾ percent of GDP, after it doubled to near 6 percent in 2006. This fiscal path would be consistent with maintaining the (low) debt-to-GDP ratio achieved following completion of the HIPC/MDRI broadly constant.

⁶ While the Fund conducts regional discussions with regional bodies, in the case of Senegal the IMF programs did not incorporate regional conditionality nor require policy assurances from WAEMU as its policies were not considered critical for the success of the program. In March 2018, the Executive Board approved a paper on Program Design for Currency Unions, which formalized the conditions for regional policy assurances. Under this policy, regional authorities' policy assurances would be required when those policies are deemed macro critical, monitorable, and time bound.

⁷ IMF (2007).

- The fiscal targets would be achieved largely through expenditure cuts. For 2007, the adjustment would be based on sharp cuts in subsidies to the energy sector and nonpriority spending. In addition, domestic arrears would be cleared and payment delays reduced. Over the medium term, spending restraint would rest on aligning the authorities' ambitious investment program with their implementation capacity, limiting domestically financed capital spending, and stabilizing the public wage bill.
- The program targeted an improvement in the composition of public spending. To this end, the energy sector would be reformed, in cooperation with the Bank and other partners. This, in turn, would result in sharp cuts in budgetary subsidies, which were crowding out spending on priority sectors (health, education, environment, judicial system).
- Growth was expected to accelerate from 2.1 percent in 2006 to 5.1 percent in 2007 and to 5.8 percent by 2010. Medium-term economic growth was expected to be driven by investment—mainly in several planned large infrastructure projects.

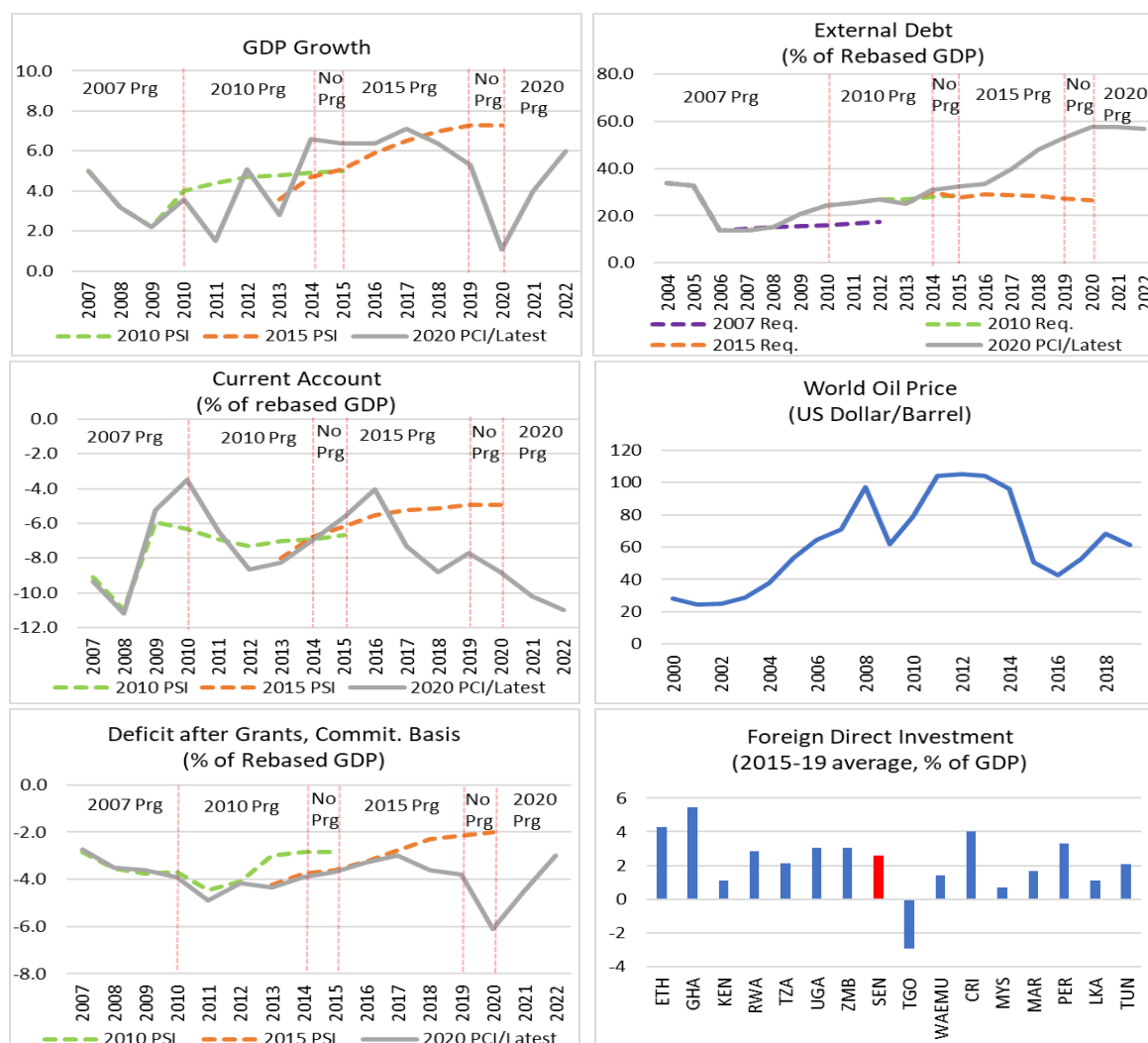
Table 1. Senegal—Overall Fiscal Balance, After Grants¹
(In percent of GDP)²

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
2007 PSI Request – December 2007	-3.6	-3.5	-3.2	-3.1	-3.1	-3.0	--	--	--	--	--	--	--
2 nd Review & ESF Request December 2008	-2.8	-2.5	-2.1	-3.1	-3.0	-3.1	-3.0	--	--	--	--	--	--
4 th PSI Review & ESF 2 nd Review December 2009	-2.8	-3.5	-3.5	-3.8	-3.5	-3.3	-3.1	--	--	--	--	--	--
6 th PSI Review December 2010	-2.8	-3.5	-3.8	-3.7	-4.5	-4.1	-3.0	-2.8	-2.8	--	--	--	--
2010 PSI Request – December 2010	-2.8	-3.5	-3.8	-3.7	-4.5	-4.1	-3.0	-2.8	-2.8	--	--	--	--
1 st Review June 2011		-3.5	-3.7	-4.0	-5.3	-4.3	-3.5	-3.4	-2.8	-2.9	--	--	--
3 rd Review June 2012			-3.7	-4.0	-5.2	-4.9	-3.6	-3.3	-3.0	-2.9	-2.8	--	--
5 th Review & Extension June 2013					-5.2	-4.5	-4.1	-3.5	-3.0	-2.8	-2.7	-2.7	--
2015 Prog. Request – September 2015	--	--	--	--	--	--	-4.2	-3.8	-3.6	-3.2	-2.8	-2.3	-2.2
3 rd Review January 2017	--	--	--	--	--	--	--	-3.8	-3.7	-3.2	-2.8	-2.7	-2.3
5 th Review January 2018	--	--	--	--	--	--	--	--	-3.7	-3.2	-2.8	-2.7	-2.3
6 th Review July 2018	--	--	--	--	--	--	--	--	-3.7	-3.3	-3.0	3.5	3.0
7 th Review 2015 – January 2019	--	--	--	--	--	--	--	--	-3.7	-3.3	-2.9	-3.4	-3.0
2020 PCI Request – January 2020	--	--	--	--	--	--	--	--	--	--	-3.0	-3.6	-3.7
Actual/Latest estimate	-2.7	-3.5	-3.6	-3.9	-4.9	-4.1	-4.3	-3.9	-3.7	-3.3	-3.0	-3.6	-3.7

Source: IMF Staff Reports.

¹ At time of program approval and selected reviews. It contains historical figures and program targets, as presented/estimated at the time.

² For comparability purposes, figures from programs documents prior to the 6th review of the 2015 program have been recalculated using the new GDP series adopted in 2017, which is broadly 30 percent higher than the previous series.

Figure 3. Senegal—Evolution of Program Indicators

Sources: WEO database; INS database; FFA database; IMF Members' Financial Data.

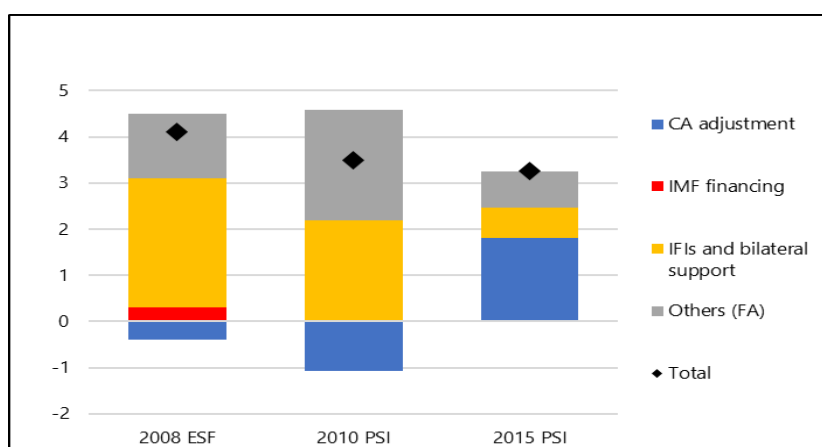
2008 ESF⁸

- The 2008 ESF was approved to be concurrent with the 2007 PSI. Amid significant slippages in 2007, the revised program sought to address identified weaknesses in the public financial management (PFM) systems and fiscal reporting, while reiterating medium-term fiscal objectives. The program sought to address the impact of the food and energy price shock, with steps to contain imports, including by eliminating costly and untargeted subsidies for food and energy products, broadening agricultural production, and embarking on an energy sector reform.

⁸ IMF (2008a).

- The fiscal program sought a reduction of the fiscal deficit to 3.3 percent of GDP in 2008 and 2.7 percent in 2009, well below the targets under the original 2007 PSI, to make space for the repayment of significant arrears identified during the PSI review. The fiscal path would return to the previously agreed 4 percent of GDP deficit by 2010. As in the original 2007 program, the adjustment would be based largely on expenditure control. Public debt would be moderately higher than originally programmed but would remain low.
- To help address the impact of the food and energy price on the poor, the program envisaged the elimination of protective taxes on vegetable oil and expansion of the school feeding program.
- IMF technical assistance under the 2007 PSI and 2008 ESF would emphasize public financial management and fiscal reporting and the creation of an appropriate environment for Public Private Partnerships. The World Bank would take the lead on reforming the energy sector, particularly electricity, and agriculture sectors. Other development partners would provide technical assistance (TA) on restructuring public contracts.
- IEO calculations suggest that the 2008 ESF-supported program sought to fill the annual BOP need of 4.1 percent of GDP through IMF financing of 0.3 percent of GDP, bilateral and multilateral BOP support of 2.8 percent of GDP and other financing of 1.4 percent of GDP, while allowing a widening of the current account deficit equivalent to 0.4 percent of GDP (Figure 4).
- Growth targets were moderately reduced to 5.2 percent and 5.6 percent in 2009 and 2010, respectively, reflecting more ambitious fiscal adjustment.

**Figure 4. Senegal—Balance of Payments Need Decomposition
(In percent of GDP, Annual)**



Sources: IEO calculations and Kim and others (2021).

Note: See Kim and others (2021) for a detailed explanation of the methodology.

2010 PSI⁹

- Having increased to 4.8 percent of GDP in 2010, the fiscal deficit was programmed to further increase to 5.8 percent of GDP in 2011 to make space for pro-growth spending, before steadily declining to 3.7 percent of GDP by 2014. As a result, public debt would increase by some 4 points of GDP by 2013–14.
- Both the reduction of the deficit and higher levels of public investment in infrastructure would be achieved by increasing revenues. To this end, comprehensive tax reforms would be carried out, building on analysis of tax expenditures completed under the 2007 arrangement. These reforms would broaden the tax base, rationalize tax expenditure, and further strengthen tax and customs administrations.
- Progress in PFM would be consolidated by improving budget transparency and avoiding accumulation of domestic arrears. Reforms would also aim to couple an increase in investment with better investment planning and higher quality of spending.
- IMF technical assistance would focus on reforms to expand the tax base and to continue strengthening PFM. Other development partners would also support PFM reforms, based in part on a 2007 Public Expenditure and Financial Accountability exercise. The World Bank would support improving the efficiency of spending, particularly on education, while continuing to take the lead on energy reform.
- The program did not envisage a need to reduce the current account deficit, buttressed by solid external financing. IEO calculations suggest an annual BOP need equivalent to 3.5 percent of GDP during the program period. This annual BOP need was to be covered by bilateral and multilateral BOP support of 2.2 percent of GDP and 2.4 percent of GDP from other FA flows (including project financing) (see Figure 4).
- After growth declined to 2.2 percent in 2009, the program estimated that growth had recovered to 4 percent in 2010 and projected a gradual further recovery to near 5 percent by 2014 (annual average of 4.7 percent). This was to be achieved in part because of higher public investment in infrastructure, improved quality of spending, and improvements in the business environment.

2015 PSI¹⁰

- The fiscal deficit would remain broadly unchanged at 4.7 percent of GDP in 2015 (3.6 percent of new GDP) and decline to 4.2 percent in 2016 (3.2 percent) and 3.0 percent by 2018 (2.3 percent), consistent with Senegal's commitments with WAEMU. Public debt

⁹ IMF (2010c).

¹⁰ IMF (2015c).

was projected to remain broadly constant at about 49 percent of GDP (equivalent to 38 percent of the new GDP).

- Building on the 2010 reforms, the program targeted further revenue-neutral tax reforms, involving a broadening of the tax base, as well as rationalizing considerably current expenditures to create fiscal space for financing infrastructure and social expenditure. Reforms would focus on reducing tax expenditures, simplifying the new tax code, bringing small taxpayers in the tax network, and rationalizing the tax regime of the financial sector, patent, and telecommunications.
- The program included significant measures and reforms aimed at increasing the quality of expenditure, including investment, as well as strengthening public financing, transparency, and economic governance.
- IMF TA would support tax reforms to attract FDI and simplify compliance by SMEs, and new PFM reforms and planning, with an emphasis on cost benefit analysis to improve the efficiency of investment. At the same time, IMF TA would also seek to reduce financial sector vulnerabilities for the WAEMU region as a whole. The World Bank and the African Development Bank would support the expansion of capacity and reduction in the cost of electricity generation. The World Bank would also support reforms of the agriculture, land, labor market and tourism sectors.
- IEO calculations suggest that an annual BOP need of 3.3 percent of GDP during the program was expected to be met through current account adjustment of about 1.8 percent of GDP, exceptional bilateral and multilateral BOP support of 0.7 percent of GDP and other FA flows of 0.8 percent of GDP (see Figure 4).
- Growth was expected to increase to 5.1 percent in 2015 and gradually to 7 percent by 2018, with a rising private sector contribution. This would follow a period of 3.5–4.5 percent growth during 2013–14.

2020 PCI¹¹

- The 2020 PCI would build on the success of the previous arrangements, essentially by following up and deepening measures and reforms. Oil and gas production would come to fruition toward the end of the program period. The program envisaged setting up a transparent framework to manage oil and gas revenues.
- Fiscal policy would be anchored by the WAEMU convergence criterion to limit the fiscal deficit to 3 percent of GDP, which was expected to be reached in 2020 and sustained thereafter. The public debt-to-GDP ratio was projected to begin declining in 2020 after

¹¹ IMF (2020b).

reaching some 54 percent of GDP in 2019, a major change from the pattern observed for over a decade.

- To create further fiscal space for priority spending, domestic revenue mobilization would be strengthened by further increasing the tax base, notably by bringing the informal sector into the base; and by stepping up efforts to reduce energy subsidies and rationalize government consumption. The medium-term revenue strategy would target an increase in the tax-to-GDP ratio to 20 percent of GDP by 2023.
- Fiscal risks would be contained, including by clearing unmet domestic obligations, improving the recording and monitoring of arrears, eliminating below-the-line operations, and better managing subsidies.
- Against the background of mixed traction of TA in the run-up to the February 2019 presidential elections, the capacity development strategy would further emphasize revenue mobilization, public financial management, and debt management. In addition, it would support establishing a sound legal and fiscal framework for managing hydrocarbon revenues, in coordination with the World Bank.
- Having declined to about 6 percent in 2019, higher growth was expected to resume at about 7 percent in 2020–21, reaching temporarily double-digit growth rates in 2022–23, with the oil and gas field production coming online. Program documents explicitly indicated that fiscal multipliers for 2020 were assumed in-line with the empirical literature for low-income countries. The contribution of government capital to real GDP growth was conservative and in the order of historical magnitudes.

B. Strategies Used to Support Growth and Greater Inclusiveness

17. To protect economic activity and foster high and sustained medium term growth, while delivering needed fiscal adjustment, all the programs approved since 2007 have had several broad elements in common:

- Commitments to typically moderate fiscal consolidation over the medium-term.
- An important re-composition of public spending in favor of increased infrastructure and social spending.
- Reforms to boost productivity of public sector investment.
- Reforms to gradually foster a private sector-led expansion, particularly after 2015, including by lowering the cost of doing business in Senegal.

18. **On fiscal policy, programs generally targeted a moderate and gradual adjustment.**

With an exception at the beginning of 2007, Senegal's adjustment needs were generally deemed moderate and efforts sought to maintain a medium-term sustainable fiscal position. There were even periods when the deficit was programmed to increase, or increased during reviews, to accommodate investment and other priority spending. Moreover, much of the fiscal adjustment envisaged over the medium term was driven by commitments under membership to the monetary union.

19. **All programs sought to create fiscal space for growth-enhancing expenditures by containing nonpriority current spending and increasing tax revenues.** To this end, spending on infrastructure (roads, water, and electricity) and social programs (education and health) was prioritized. Even in the 2007/08 program, which cut overall spending, reforms to reduce energy subsidies were expected to create space for priority spending, including safety nets. Starting with the 2010 Policy Support Instrument (PSI) and reinforced during the 2015 PSI, the strategy has been buttressed with significant comprehensive tax reforms to broaden the tax base, rationalize tax expenditure, and further strengthen tax and customs administrations.

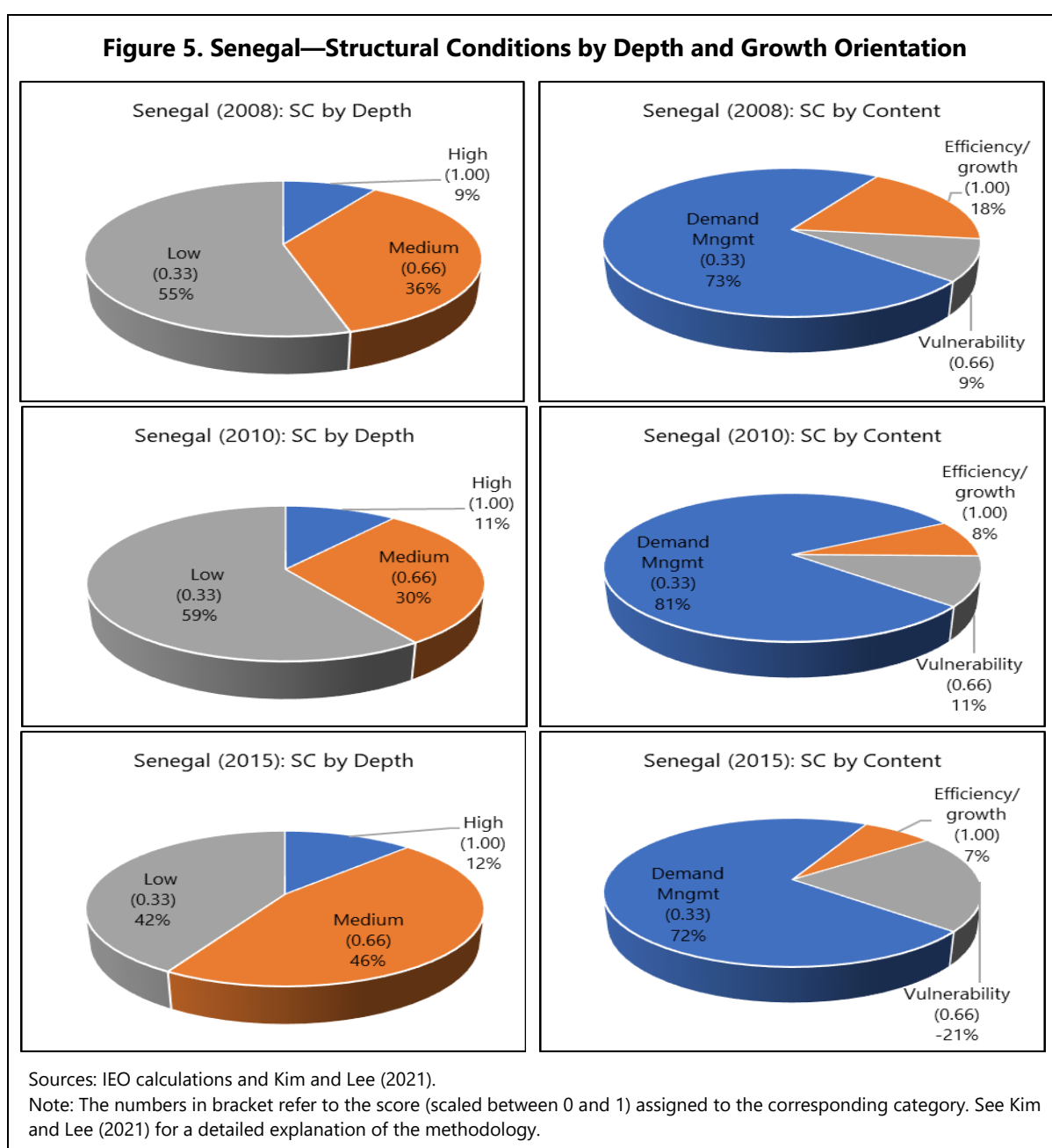
20. **There has been a growing emphasis on the need for more inclusive growth with more explicit strategies and measures.** The 2015 PSI, in particular, included language stating that the authorities' objective was to achieve stronger, more inclusive growth for meaningful poverty reduction. In addition to emphasizing investment on education and health, other key actions included putting in place a national financial inclusion strategy and promoting the use of banking facilities and non-cash methods of payment, including payment of taxes via mobile phones. The focus on participatory growth was intensified in the context of the 2020 program, aimed at reducing urban-rural disparities and strengthening economic prospects for women and the youth, and implementing social protection initiatives, including the emergency program for community development and the national cash transfer program.

21. **Fiscal reforms to support transparency as well efficiency of public investment spending were prominent parts of the Fund-supported programs.** For example, the 2007/2008 and 2010 programs stressed strengthening public financial management to enhance fiscal transparency and budget planning and execution, and improve investment efficiency. The 2015 program emphasized the need to improve efficiency and transparency including by limiting single tender contracts, emphasizing the need to conduct cost-benefit analysis, and expanding the "Precautionary Reserve Envelope," a mechanism to withhold financing for projects until feasibility studies are completed.

22. **Programs also targeted significant improvements in the business climate.** In addition to improving physical infrastructure and human capital, and enhancing budgetary procedures and transparency, programs pursued to varying degrees other measures to encourage private sector activity. Among these, programs targeted reforms of the energy sector, strengthening property rights, buttressing fragile public enterprises, eliminating arrears to domestic suppliers, and addressing financial sector vulnerabilities. The 2015 program, for example, sought to improve the

land registry; enhance minority investor protections; license operation of credit bureaus (through WAEMU); simplify tax compliance; update the investment law, and develop public-private partnerships. With World Bank support, further increasing capacity and lowering the cost of electricity generation was also at the core to support private sector activity.

23. **The depth and growth orientation of structural conditions in Senegal's arrangements are shown in Figure 5.**



24. **The exchange rate was not an important part of program discussions about competitiveness.** This reflected the authorities' strong commitment to maintaining the current exchange rate arrangement and level, which they view as having served the region well in terms of maintaining low inflation and, more generally, protecting macroeconomic stability. The 2010 program request pointed out that a moderate appreciation of the real effective exchange rate had impacted Senegal's export performance negatively. However, it stressed that the key issue was the need to raise non-price competitiveness by improving the business climate, governance, and institutions. Over the next few years, the real effective exchange rate depreciated significantly, helped by a decline in the value of the euro against the US dollar over this period. More recent program documents, including in the context of the 2015 PSI, assess the real effective exchange as being broadly in line with fundamentals while reaffirming the importance of structural reforms to improve non-price competitiveness. The 2020 request points out that since 2015 business environment indicators, as well as exports and GDP growth have improved, although the real effective exchange rate (REER) has remained broadly constant since 2015.

C. Realism of the Macro Framework

25. **Program documents and the authorities' own development plans do not explicitly discuss fiscal multipliers or the payoffs of structural reforms, prior to the 2020 PCI.**¹² In interviews, staff indicated, however, that at the time of program design there was a significant amount of discussion about likely multipliers, particularly for the 2015 program. In line with historical evidence for low-income countries,¹³ multipliers were assumed to be relatively low. The authorities indicated that the program's growth targets were largely defined by the government development plans, which sought to achieve emerging market status by 2035. That said, they acknowledged that in program negotiations they accepted lower annual growth targets than their own development plans but insisted that recent improvements in growth performance has proven them right.¹⁴

26. **Program documents stress the importance of improving non-price competitiveness, while assessing the real effective exchange rate as being broadly in line with fundamentals.** In connection with this, the programs' emphasis has been on improving structural competitiveness by implementing reforms to enhance infrastructure and the business environment. This strategy was adjusted during 2007, 2010, and 2015, generally doubling down on the need for structural reforms and incorporating lessons learned from previous programs, particularly in areas where there had been lags. This strategy has been continued in the 2020 PCI. There is a question, however, as to whether staff's clear-cut separation between non-price

¹² The 2020 program, not covered by this evaluation, incorporated explicit fiscal multipliers in the projections.

¹³ For example, Arizala and others (2020) estimate that multipliers for spending-based fiscal consolidations in Sub Saharan Africa range between 0.3–0.4 in the short run to 0.4–0.7 over three years. However, they show that multipliers are lower where public expenditure management and revenue administration are more inefficient.

¹⁴ While growth was well above program targets for 2015–17, it was somewhat below the targets in 2018–19. Moreover, during the programs covered 2007–14 growth fell consistently well below program targets.

competitiveness (deemed a concern) and the level of the exchange rate (which was considered appropriate) may have been too sanguine. In particular, at least some of the alternative approaches used by staff pointed at an overvaluation of the exchange rate. That said, with the real effective exchange rate having depreciated during 2010–14, and exports responding positively during the 2015 program, it was reasonably concluded that the level of the exchange rate was less of a concern and gains in competitiveness more likely to be achieved through structural reforms.

D. Contingencies and Program Adjustments

27. **The programs generally did not incorporate explicit contingencies to deal with shocks or growth shortfalls.** In practice, the programs' objectives and policies were adjusted flexibly to changing conditions. For example, the ESF approved in December 2008 to run concurrently with the 2007 PSI, provided for use of Fund resources to meet additional financing needs associated with the global financial crisis, and conditionality and targets were adjusted to allow for higher fiscal deficits. In December 2009, the ceiling on non-concessional borrowing was increased (in the context of the 4th review of the 2007 PSI) to give space to finance a major toll highway project and for a Eurobond issuance. In mid-2011, the deficit target for 2011 was adjusted to deal with electricity and oil fuel prices shocks and lower than programmed growth. In July 2018, during the 6th review, the fiscal deficit was revised upward to accommodate increased subsidies to the oil sector (because of fixed prices in the run-up to the 2019 elections) and security spending.

28. **An important consequence of this pattern of flexible adjustments was to effectively accommodate significant increases in public debt.** Given that Senegal's public debt started off relatively low, it can be argued that raising public debt could be justified by the needs of increased investment spending. Also, the expected rise in oil and gas exports over the medium term have increased the country's external debt payment capacity. Even so, public debt progressively rose relative to GDP and by the end of 2019 the IMF Debt Sustainability Analysis (DSA) of the 2020 PCI request was signaling a rise from low to moderate risk of debt distress. The increase in debt above program targets was particularly dramatic during the 2015 program, reflecting in part debt-creating operations not captured in the fiscal target (see below) and an important accumulation of domestic arrears. The increase in debt was compounded relative to GDP by lower than projected growth prior to 2015.

Program Financing and Catalytic Role of the Fund

29. **Senegal has preferred IMF arrangements not involving IMF support to benefit from their strong signaling component resulting from stringent eligibility requirements.** In particular, the PSI is available to members that are considered not requiring significant macroeconomic adjustment and with institutions of sufficient quality to support continued good performance, but that may still benefit from IMF advice and structural reforms to support strong and durable poverty reduction and growth. The only recent exceptions are the 2008 ESF and the

2020 RCF/RFI which intended to deal with large exogenous shocks, which gave rise to larger, but temporary, BOP needs.

30. **The catalytic role of the use of IMF signaling instruments for program financing appears to have been strong, with the authorities highlighting the positive impact on both official and private financing.** Evidence of this is the authorities continued renewal almost without interruption of Fund arrangements since 2007. Official development financing, including from the World Bank and the African Development Bank, played important roles. The financing assumptions appear realistic and, if anything, conservative as Senegal was able to tap financing from bilateral sources and international bond markets well above assumptions. Unfortunately, an important part of this additional financing available was non-concessional, including from bilateral non-Paris Club official creditors.

IV. PROGRAM IMPLEMENTATION AND OUTCOMES

A. Program Implementation

31. **Performance under the 2007 PSI/2008 ESF and 2010 PSI was mixed.**¹⁵ There were fiscal overruns in both arrangements (see Table 1 and Figure 3). Early in the 2007 program, a substantial unreported accumulation of unpaid bills vis-à-vis the private sector and extrabudgetary spending, partly related to subsidies introduced as a response to oil price increases, led to nonobservance of program conditionality and to a case of misreporting, and some donors temporarily suspended budget support. The fiscal deficit after grants increased in 2009–10, again exceeding the ceiling under the ESF. The deficit under the 2010 program exceeded the original targets in every year (the ceilings for 2011–12 were observed, but only after they were revised mid-program during reviews).

32. **Implementation of the structural reform agenda also lagged behind both programs' objectives.** Generally, the implementation of reforms was seen as slow and insufficiently broad to deal with a poor business climate, and to address problems in the energy sector, inadequate infrastructure, and low efficiency of public investment.

33. **Performance under the 2015–19 PSI started well but gaps again emerged in fiscal performance.**¹⁶ The fiscal deficit was reduced broadly in line with the program through 2017. However, in January 2018 it was assessed that the debt had grown faster than implied by the measured fiscal deficit, reflecting the Treasury's financing of the Post Office and the Civil Service Pension deficit. As a result, a ceiling on the government's net financing requirement was added to supplement the target on the fiscal deficit, which was not capturing key debt creating flows.

¹⁵ IMF (2008a, 2009a, 2009b, 2010a, 2010b, 2010c, 2011a, 2011b, 2012a, 2012b, 2013a, 2014a, 2014b, 2015a).

¹⁶ IMF (2015c, 2016a, 2016b, 2017a, 2017c, 2018a, 2018b, 2019a).

34. **Fiscal program implementation weakened considerably in 2018, as pre-election-related pressures mounted** (scheduled for February 2019). As a result, the reduction of nonpriority current spending, an important objective the 2015–19 program, was unmet. In July 2018, the fiscal deficit target for 2018 was increased to accommodate increased subsidies to the oil sector resulting from fixed prices in the run up to elections and security spending. Later on, it was also reported that domestic arrears of some 3 percent of GDP had built up in 2017–18. The program was canceled in early 2019 before fiscal performance for 2018 as a whole could be assessed. However, even without considering the arrears built-up, the estimated deficits for 2018 and projected deficit for 2019 were above both the original and revised ceilings.

35. **Reform efforts were generally successful in raising fiscal revenues considerably and protecting priority spending, but progress in these areas was also adversely affected during the pre-2019 electoral period.** Fiscal revenues increased considerably during the 2010 program and the first years of the 2015 program, in the context of tax reforms aimed at enlarging the tax base, but declined in 2017–18. Similarly, social spending consistently exceeded the program targets and rural infrastructure, including roads and electricity capacity, was expanded considerably. Overall public investment declined in 2017–18, however, being crowded out by election-related spending.

36. **With public debt increasing considerably, particularly in recent years, the DSA has shifted its assessment from low to moderate risk of debt distress.** Each one of the three PSI arrangements approved since 2007 has sought to maintain the public debt ratio broadly constant. However, by end-2019 the overall public sector debt-to-GDP ratio reached 64 percent of new GDP, compared with about 19 percent of GDP in 2008.

37. **Implementation of the structural agenda during the 2015–19 program strengthened but still left important areas for improvement.** Progress was made in several areas including in improving the business climate, developing programs to improve credit access through reforms of credit bureaus (including a recent law improving data flow from banks to the bureaus) and new programs to help SMEs gain access to credit, and, to an extent, in improving PFM. Of particular importance was progress in the reform of the electricity sector, which is an important driver of growth and rural development (reform supported by the World Bank).

38. **A key area with recurring missed targets was related to improvements in transparency and assessment of large investment projects.** In particular, there were consistent shortfalls in the use of the precautionary resource envelope, which was supposed to subject projects' disbursements to cost-benefit analysis; and breaches of the ceiling for the value of public sector contracts awarded noncompetitively. Other areas with delays included the operationalization of the payment of taxes via mobile phones and implementing the action plan for reducing tax expenditures.

B. Growth Outcomes

39. **Growth performance during the 2007 PSI/2008 ESF and the 2010 PSI fell well short of the program's objectives (see Figure 3).** Adjustment does not seem to have played a major role in holding back growth, however, since the fiscal targets were breached and, in the end, little to no adjustment was carried out. Program documents attributed the lackluster performance to weak implementation of the structural reform agenda, including with regards to the business climate, although a terms of trade deterioration due to rising oil prices during 2011–13 also likely played a role.

40. **Under the 2015 PSI, growth improved considerably, exceeding the targets during 2015–17.** This growth acceleration was supported by a marked improvement in terms of trade starting in 2014, significant access to international capital markets, and a more vigorous implementation of the structural reform agenda. The improvement in growth occurred while the fiscal adjustment was being successfully carried out, including through tax administration efforts which boosted revenues, and expenditure growth control.

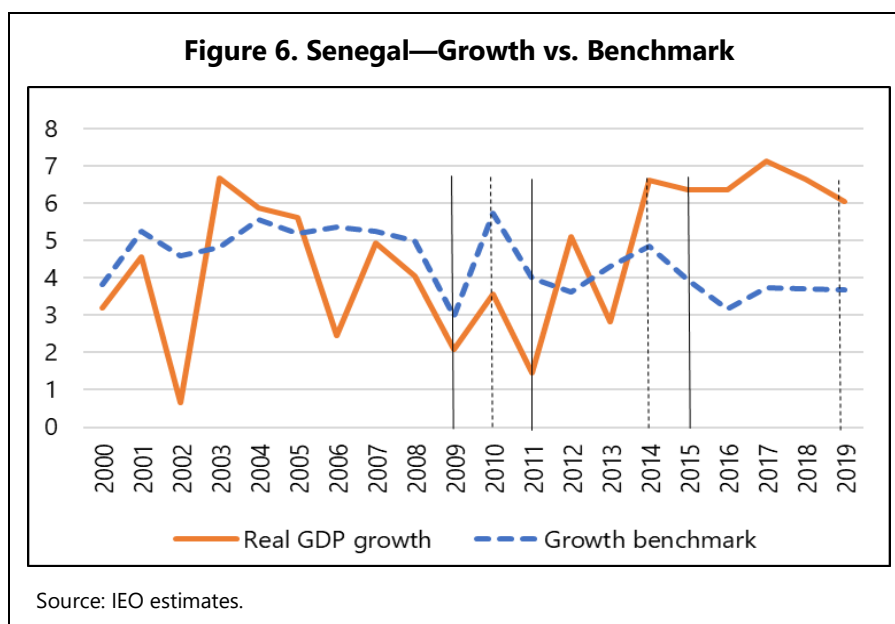
41. **Growth decelerated in 2018 and 2019 below program objectives but remained high by historical standards.** The slowdown coincided with a significant weakening in fiscal performance in 2018 and 2019 which, as previously mentioned, was largely explained by pre-elections pressures. A large accumulation of public domestic payment arrears starting in 2017 is also likely to have had a negative impact on growth.

42. **While staff has assessed the real effective exchange rate as broadly appropriately valued, and nonprice competitiveness has improved in recent years, further improvements are needed.** Following considerable depreciation in the years following the global crisis, since 2015 the real effective exchange rate has remained broadly unchanged. Consistent with staff's assessment of the exchange rate level, export volumes have grown considerably since 2015. At the same time, Senegal has outperformed regional peers with regard to governance and attractiveness for doing business in particular, as reflected in the World Bank's World Governance indicators and the World Economic Forum's competitiveness scores. However, its overall ranking is still relatively low, for example, at 123 out of 190 countries in the World Bank's rank. Moreover, FDI remains low relative to peers and the expected take-off by the private sector has not materialized.

43. **After several years of uneven growth, Senegal's growth performance seems to have improved.** The IEO's growth benchmark exercise suggests that this is not explained by external factors (Figure 6). More effective domestic reforms may have played a role, but also continued expansionary fiscal policies were a factor, at the expense of increased debt vulnerabilities. Despite progress, there are questions about whether some of the recent large projects would pass a careful cost-benefit analysis. A 2019 Public Investment Management Assessment (PIMA)¹⁷

¹⁷ IMF (2019c).

mission concluded that, while Senegal's public investment management system is relatively strong, the quantity efficiency gap (value for money) is still low. In addition, the key objective of shifting to private sector-led growth has not taken place, FDI has remained low relative to peers, and Senegal has improved only moderately in business competitiveness rankings.



V. AUTHORITIES AND STAFF'S PERSPECTIVES¹⁸

44. **During discussions with country authorities and Fund staff, there was broad consensus that three-year signaling arrangements had suited Senegal well.** While the programs did not involve Fund financing, with the exception of the 2008 ESF and the 2020 RCF/RFI, the Fund seal of approval had provided an important signaling mechanism to development partners and capital markets. The time horizon was also seen as consistent with medium-term reform needs.

45. **Country officials generally emphasized that Fund-supported programs had not implied a contractionary impact on the economy.** In their view, without the programs, growth would have been lower, given the benefits from confidence in the discipline that they bring to macroeconomic policies and their catalytic effect on financing. They viewed the IMF input as providing objective assessments and warnings, which strengthened the economic team's position domestically. They stressed that the IMF has become more flexible in recent years in recognizing country characteristics and priorities. That said, there was a broad consensus that even higher growth than recently attained is needed to have a sufficient impact on people's lives and reach emerging market status by 2035, as envisaged under their development plans.

¹⁸ Based on interviews conducted before the COVID-19 pandemic.

46. **Staff acknowledged that the continued increase in public debt poses challenges.**

They stressed that under the 2020 PCI the debt ratio is projected to decline gradually over the medium term, and that the debt is still sustainable, provided that the course is corrected in some areas, including on the fiscal front. While recognizing the need to tighten control over public expenditures, they noted that much of the debt increase was related to important infrastructure spending and that gas and oil exports should boost foreign exchange earnings soon. Program documents for the 2020 RCF/RFI and the 2020 PCI first review ratified the assessment of moderate risk of debt distress rating, in line with the previous DSA (January 2020). This was based on the assumption that the previously envisaged fiscal deficit path would be restored by 2022 and that debt increases in 2020 would be for the most part the result of one-off measures to address the impact of the COVID-19 pandemic.

47. **The authorities explained that while during earlier programs their priority was to reduce the high fiscal deficit, they have increasingly focused on ensuring high growth.**

Measures taken in the context of the 2015 program, in particular, targeted inclusive growth and improvement in the rural areas. Some officials acknowledged that the private sector role in supporting growth had not materialized and that, to sustain growth over the medium term, further reforms were needed on labor, land, finance, and human capital. The development of the oil sector will be important, but it will be also crucial for the business environment to be strengthened to create conditions to ensure sustained inclusive growth across the economy.

48. **The authorities were generally less concerned than staff about rising debt levels, which they saw as normal and needed in their development process.** They regarded further increases in debt as justified by the need to close infrastructure gaps and meet Sustainable Development Goals, which have been recognized and, in some instances, even costed by multilateral institutions. They expressed satisfaction about their success in expanding infrastructure (roads, electricity) and social equity programs (assistance for families, universal health coverage and the emergency community program) in recent years. They stressed that staff could be more supportive of programs, such as their free health plan, even if current spending and the deficit were to increase, as the government must reconcile competing demands from different segments of society.

49. **Staff and officials assessed coordination with other development partners, especially the World Bank, as generally strong and productive.** They noted that all programs included coordination of key reforms which were well documented in the reports and, in some cases, included joint inputs from the Fund and that Bank. That said, staff also indicated the level of involvement and cooperation varied considerably with the specific representatives of the institutions.

50. **Former members of the government and representatives of the private sector expressed concerns, however, about the IMF being too accommodating.** While the IMF used to be diligent in identifying and resisting negative policies, in recent years in the view of some, it has helped conceal negative policies, directly contributing to bad outcomes. For example, in

2008–09, the IMF identified and firmly stopped nontransparent schemes to finance spending. By contrast in 2017–18, the IMF seemed to turn a blind eye to the substantial accumulation of arrears with domestic contractors, even though it was widely reported at the time. They also complained that the IMF kept assessing the debt as viable even as the government's cash flow problems were becoming increasingly apparent and resorting to practices not seen since 2010, like issuing payment promissory letters that private contractors use to secure bank credit to conduct public works.

51. **Regarding the large increase in domestic arrears, staff explained that the authorities did not report them on a timely basis.** They also stated that, once the authorities informed them, appropriate conditionality was introduced. Staff further emphasized that the 2020 PCI-supported program aimed at their gradual clearance.

VI. ASSESSMENT AND LESSONS

Assessment

52. **Overall, the design of programs supported by the IMF appropriately sought to encourage moderate adjustment and promote higher and sustained growth.** Use of signaling instruments, supplemented by disbursing arrangements in the face of exogenous shocks, seems to have generally served the purposes of providing a policy framework and catalyzing external finance from other sources. Of particular importance has been the emphasis on key infrastructure projects, particularly since 2015, and structural reforms to remove obstacles to growth. The role of the World Bank and other development partners has been important in critical areas such as electricity. The higher sustained rates of growth achieved during 2015–19 are noteworthy, although some of the improvement has been cyclical and the COVID-19 pandemic has been a major setback.

53. **The fiscal adjustment under the programs does not seem to have held back growth. Even when growth fell well below program targets, the adjustment did not seem to be a factor.** For example, fiscal adjustment does not seem to have limited growth during 2011–14, as the fiscal ceilings were exceeded. The acceleration of growth under the 2015 program may have benefited from expansionary policies starting in 2017, including through off-budget spending. Shifts in the composition of spending, the willingness to modify targets at reviews and the attention to clearance of arrears have helped to ensure that fiscal consolidation has largely been growth friendly.

54. **That said, medium-term debt sustainability risks have increased.** Overall, the underlying fiscal adjustment ex post was not in line with the adjustment sought under the programs. As a result, government debt has increased substantially, and related risks have risen. To be sure, borrowing to fund infrastructure and development spending can significantly enhance growth prospects, but given concerns about project selection and investment efficiency, the country may have missed taking full advantage of unusually easy financing conditions during

the last decade. Differences in coverage explain part of the apparent discrepancy between fiscal performance and debt evolution, but debt creating flows not captured under the targets also played an important role.

55. **Technical assistance has targeted reforms that are essential for the success of the program and has been well coordinated with the World Bank, although at times implementation has been affected by political factions.** Appropriately, the Fund has focused on tax policy and administration, PFM and efficiency of investment, and jointly with the World Bank on a policy framework for the hydrocarbons sector. The World Bank supported key sectors, including energy and electricity, and quality of government spending, including on education. Given Senegal's relatively strong absorption capacity, TA has significantly strengthened policy frameworks. However, spotty implementation of reforms at times, for example in the pre-2019 election period, has led to the need for renewed efforts in some areas. In addition, the nonobservance of conditionality in some areas, such as those related to project selection and cost-benefit analysis, has contributed to persistent weaknesses in the efficiency of public investment.

Lessons

56. **While the positive results of the program for Senegal have been widely lauded, particularly starting in 2015, this assessment needs to be qualified.** The increase in growth rates during 2015–19 has been impressive and, if sustained, could make a substantial difference for the wellbeing of the population. However, this has been achieved in part at the expense of a large accumulation of public debt, which is gradually reducing policy space and has raised the challenge of addressing the impact of COVID-19 pandemic. This means that, if anything, the question for this evaluation could be turned around: to what extent has growth depended on domestic expansion (as opposed to adjustment) and policies, which may not be sustainable over the medium term?

57. **Senegal's experience suggests the need for a more systematic approach to managing trade-offs between growth and indebtedness.** All programs approved since 2007 have projected that public debt would be maintained broadly stable, which turned out to be incorrect. Borrowing at reasonable terms to fund productive investments can provide an important contribution to growth and development, but insufficiently productive spending can lead to dangerous increases in debt and hamper growth prospects. In connection with this, ensuring the following elements could contribute to optimizing these trade-offs:

- **Realistic projections for growth and indebtedness, in collaboration with development partners.** To this end, it would be helpful to incorporate at the onset a consistent and properly costed growth strategy, particularly with regards to infrastructure projects. The strategy could usefully identify major infrastructure gaps being addressed, with expected costs and a timeline for their implementation. This could bring together development partners' joint expertise to assist the authorities and deal explicitly with the expectations

created by the Millennium Development Goals/Sustainable Development Goals; and, with the authorities' preference for higher investment and debt. IMF and WB technical assistance could play an important role in this area.

- **Effective project evaluation, execution, and monitoring process.** Ideally all large projects should be subject to public tenders. All large projects, including those resulting from bilateral offers, should be subject to transparent and detailed cost benefit analyses, covering both their expected contribution and financing terms, prior to incorporation into the program. This would help address the efficiency gap identified by PIMA missions through further scrutiny and documentation. It would also help assess implementation on an ongoing basis and make adjustments, as necessary. The World Bank and other developing partners, as well as more specialized entities, including from the private sector, could contribute in this regard.

58. **There is a need to more effectively monitor and manage public spending more broadly.** Program design should ensure that fiscal targets capture all relevant avenues of spending, and that there are appropriate incentives for candor and transparency. To this end, program design should preemptively seek to eliminate the scope for using off-balance sheet, "below-the-line" operations, or domestic arrears to meet program targets. At the formal level, broader fiscal aggregates should help reduce the scope for these operations, as the 2015 PSI did in the context of the reviews. In addition, the accommodation of deviations during program reviews should be carefully justified and made the exception rather than the rule, even when the letter (but not the spirit) of conditionality has been met.

59. **Despite progress, there remains much to do to improve the business environment and address concerns of the private sector.** After being a key program objective for over a decade, the private sector take-off has not materialized. Membership in a currency union provides a framework for macroeconomic policy discipline but means that the exchange rate is not a tool to help address possible competitiveness issues. As a result, greater attention needs to be paid to strengthening the business environment. More transparent and predictable criteria to select large and small projects would be an important step in the right direction. Similarly, preventing accumulation of domestic arrears, like those that took place in 2007–08 and 2017–18, which ties productive resources should be avoided. Other key reforms now needed, such as land and labor, are more difficult and will require time, persistence, and political will.

REFERENCES

- Arizala, Francisco, and others, 2020. "The Impact of Fiscal Consolidations on Growth in Sub-Saharan Africa," *Empirical Economics*, June.
- International Monetary Fund (IMF), 2007, "Senegal: Request for a Three-Year Policy Support Instrument—Country Report No. 07/358" (Washington).
- _____, 2008a, "2007 PSI—1st Review and 2008 Article IV Consultation—Country Report No. 08/209" (Washington).
- _____, 2008b, "Selected Issues—Country Report No. 08/221" (Washington).
- _____, 2009a, "2007 PSI—2nd Review and 2008 ESF Request—Country Report No. 09/5" (Washington).
- _____, 2009b, "2007 PSI—3rd Review and 1st Review of 2008 ESF—Country Report No. 09/205" (Washington).
- _____, 2010a, "2007 PSI—4th Review and 2nd Review of 2008 ESF—Country Report No. 10/13" (Washington).
- _____, 2010b, "2007 PSI—5th Review, 3rd Review of 2008 ESF, and 2010 Article IV Consultation—Country Report No. 10/165" (Washington).
- _____, 2010c, "2007 PSI—6th Review and Request for 2010 PSI—Country Report No. 10/362" (Washington).
- _____, 2010d, "Poverty Reduction Strategy Paper Annual Progress Report—Country Report No. 10/368" (Washington).
- _____, 2011a, "2010 PSI—1st Review—Country Report No. 11/139" (Washington).
- _____, 2011b, "2010 PSI—2nd Review—Country Report No. 11/373" (Washington).
- _____, 2012a, "2010 PSI—3rd Review—Country Report No. 12/227" (Washington).
- _____, 2012b, "2010 PSI—4th Review and 2012 Article IV Consultation—Country Report No. 12/337" (Washington).
- _____, 2013a, "2010 PSI—5th Review—Country Report No. 13/170" (Washington).
- _____, 2013b, "Poverty Reduction Strategy Paper—Country Report No. 13/194" (Washington).

- _____, 2013c, "Poverty Reduction Strategy Paper: Joint Staff Advisory Note on the National Strategy for Economic and Social Development—Country Report No. 13/195" (Washington).
- _____, 2014a, "2010 PSI—6th Review—Country Report No. 14/4" (Washington).
- _____, 2014b, "2010 PSI—7th Review—Country Report No. 14/177" (Washington).
- _____, 2015a, "2010 PSI—8th Review and 2014 Article IV Consultation—Country Report No. 15/2" (Washington).
- _____, 2015b, "Selected Issues—Country Report No. 15/15" (Washington).
- _____, 2015c, "2015 PSI—Request—Country Report No. 15/273" (Washington).
- _____, 2016a, "2015 PSI—1st Review—Country Report No. 16/3" (Washington).
- _____, 2016b, "2015 PSI—2nd Review—Country Report No. 16/144" (Washington).
- _____, 2017a, "2015 PSI—3rd Review and 2016 Article IV Consultation—Country Report No. 17/1" (Washington).
- _____, 2017b, "Selected Issues—Country Report No. 17/2" (Washington).
- _____, 2017c, "2015 PSI—4th Review and Request for Extension—Country Report No. 17/230" (Washington).
- _____, 2018a, "2015 PSI—5th Review—Country Report No. 18/8" (Washington).
- _____, 2018b, "2015 PSI—6th Review—Country Report No. 18/211" (Washington).
- _____, 2019a, "2015 PSI—7th Review and 2018 Article IV Consultation—Country Report No. 19/27" (Washington).
- _____, 2019b, "Selected Issues—Country Report No. 19/28" (Washington).
- _____, Departement Des Finances Publiques, 2019c, "Senegal-Evaluation de la Gestion des Investissements Public (PIMA)" (Washington).
- _____, 2020a, "2020 PCI—Request—Country Report No. 20/11" (Washington).
- _____, 2020b, "2020 RCF—Request—Country Report No. 20/108" (Washington).
- _____, 2020c, "2020 PCI—1st Review—Country Report No. 2020/225" (Washington).

Kim, Jun, and others, 2021, "Cross-Country Analysis of Program Design and Growth Outcomes: 2008–19," IEO Background Paper, BP/21-01/01 (Washington: International Monetary Fund).

Kim, Jung Yeon, and Kwang Yeon Lee, 2021, "Structural Conditions, Structural Reforms and Growth in IMF-Supported Programs," IEO Background Paper, BP/21-01/04 (Washington: International Monetary Fund).

Republique du Sénégal, 2014, Plan Sénégal Émergent, Février.

Republique du Sénégal, 2018, Plan Sénégal Émergent, 2019–2023, Décembre.