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Fiscal consolidation after COVID-19: issues and policy options in SSA

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The fiscal context in SSA

A challenging – but varied – fiscal outlook

1. COVID-19 has deteriorated public finances due to a combination of reduced GDP and revenue shortfalls
   - Average budget deficits increased from 4.3% to 5.8% in 2020
   - Driven by revenues rather than expenditure – unlike high-income countries

2. Debt levels and debt servicing cost have increased relative to GDP and revenue, adding to a difficult pre-pandemic outlook

Debt levels have increased in the region

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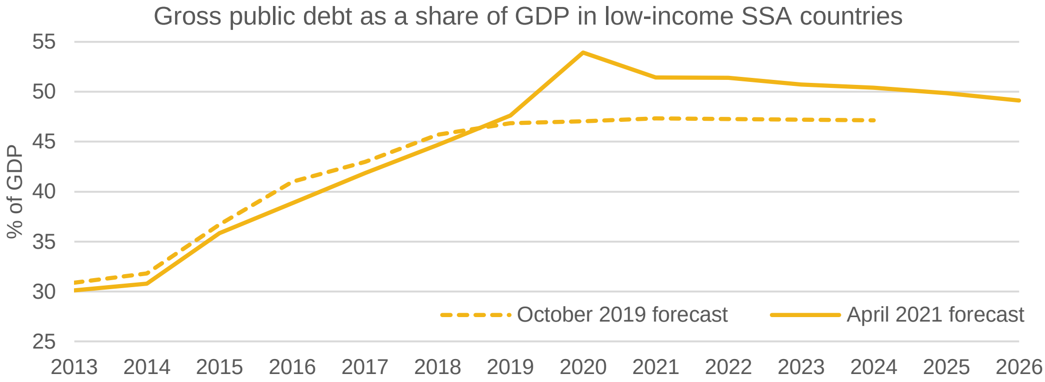
Debt as a share of GDP was 7pp higher in 2020 than 2019 forecast



Note: Graph shows outturns and forecasts for gross public debt according to October 2019 and April 2021 vintages of IMF Fiscal Monitor, for low-income sub-Saharan African nations according to IMF classification, calculated using 2019 GDP weights.

Source: IMF Fiscal Monitor, October 2019 and April 2021; IMF World Economic Outlook, April 2021.

Debt levels have increased in the region

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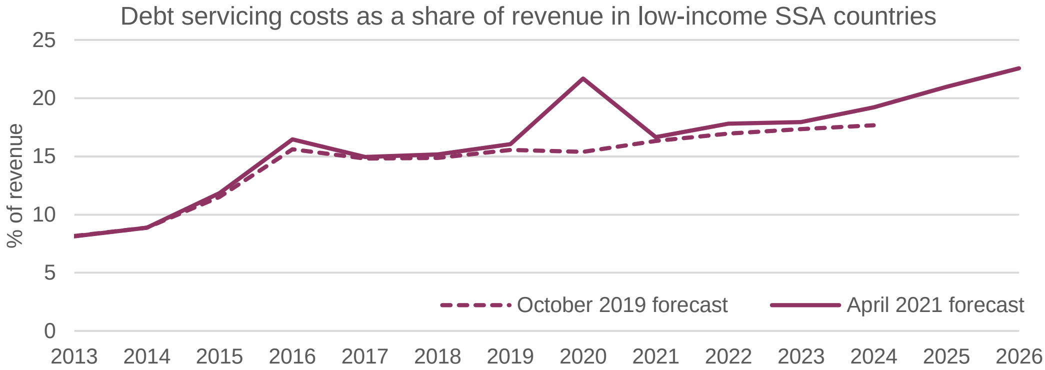
Debt servicing costs spiked at 22% of revenue in 2020, and are forecast to be on an upward trajectory after 2021



Note: Graph shows outturns and forecasts for debt servicing costs according to October 2019 and April 2021 vintages of IMF Fiscal Monitor, for low-income sub-Saharan African nations according to IMF classification, calculated using 2019 GDP weights. Debt servicing costs are calculated as the difference between the overall budget balance and the primary budget balance.

Source: IMF Fiscal Monitor, October 2019 and April 2021; IMF World Economic Outlook, April 2021.

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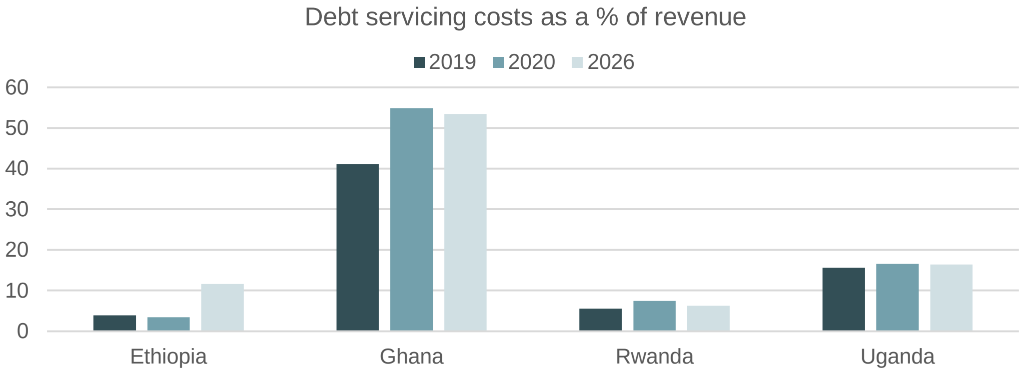
3. Forecasts out to 2026 suggest that many economies in the region may need to take further steps to improve their fiscal situation

A varied picture in the region

For some, measures to improve public finances may need to be considered



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Source: IMF Fiscal Monitor, April 2021.

Considerations for fiscal consolidation

Design considerations

SSA governments face a difficult trade-off

- Some SSA governments may want to – or may be required to – consider fiscal consolidation measures in the coming years
- At the same time, governments need to combat pandemic and secure economic recovery
- Goal: meaningfully improve public finances whilst minimising hardship and negative effects on the economy in short- and long-term
- What are the main design considerations for policymakers?

1. Scale – how much consolidation?
2. Timing – when to begin and over what timeframe?
3. Composition – revenue or expenditure?

Timing of fiscal consolidation

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1. **Economic conditions**
   - Short- and long-term economic harm likely to be greater during downturn
   - Consolidation should begin after economic and public health recovery secured

2. **Financing conditions**
   - May prevent delayed action in case of liquidity problems
   - Exposure to financing conditions due to debt maturity, for instance, may be relevant

3. **Implementation timelines**
   - The policies that are most feasible in the short-term might not be the most desirable

Composition of fiscal consolidation

Overall, expenditure reductions likely to be less desirable

- Public expenditure important for essential services (especially in crisis) and investment
- Empirical work suggests expenditure-led consolidation is less effective and more harmful
- But fossil fuel subsidies are an opportunity; public sector reforms sometimes appropriate

It is useful to distinguish between the short- and long-term

1. In the short-term, policies should minimise the harmful demand-side impacts
   - Direct tax increases likely to be preferable
2. In the long-term, policies should improve the efficiency of taxation/expenditure
   - E.g. targeting externalities or unresponsive activities, or removing distortions

Policy options

Revenue-raising policy options

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We identify a (non-exhaustive) list of policy areas with broad appeal

Short-term / temporary

1. One-off wealth taxation
2. Progressive personal income tax increases
3. Corporate income tax surcharges, or similar

Long-term / permanent

1. ‘Green’ taxes
2. Property taxation
3. Administrative reforms
4. The value-added tax base
5. Other tax expenditures

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Short-term revenue-raising options

Implementable policies that minimise impact on aggregate demand

E.g. corporate income tax surcharges could be considered

- Likely to be administratively feasible
- If temporary, the impact on investment and location decisions of firms should be small
  - Some investment might even be brought forward to claim allowances
  - Credibility of policy is important here
- Only applies to profitable companies
- Surcharges, or other business taxes, could be targeted at sectors that have done well

Long-term revenue-raising options

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Policies which have substantial revenue potential and long-term payoffs from improving the tax system in other ways

E.g. tax expenditures should be reported on, reviewed, and reduced

- Lower bound estimated revenue loss of 2.9% of GDP in Africa (Redonda and Gupta, 2020)
- Rarely reported on, so lacking transparency and evidence on effectiveness
- Create horizontal inequities, and likely to be regressive in many cases too
- VAT exemptions and reduced rates are a particularly large source of revenue loss, and are poorly targeted for achieving redistribution
- Not every tax expenditure is poorly targeted but there is scope for streamlining to achieve a fairer and more efficient tax system yielding more revenue

Summary

1. Many countries in sub-Saharan Africa face a difficult economic and fiscal outlook and may have to consider policies that can improve public finances

2. Fiscal consolidation policies should account for the economic and financing conditions and implementation timelines, ideally waiting until economic recovery has taken root

3. Short-term measures should be mindful of demand-side impacts; in the longer term, measures that yield sustainable revenues in an efficient way should be targeted

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