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Reflections on Quantitative Fiscal Conditionality in African PRGF-Supported Programs

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Fiscal Affairs Department

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Abstract

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We survey quantitative fiscal conditionality in selected sub-Saharan African PRGF-supported programs, and assess the conditionality against some possible benchmarks and best practices. While noting many caveats, the paper suggests some possible scope for further attuning of this conditionality to countries' specific macro-fiscal situations. The paper also offers some suggestions on how quantitative fiscal conditionality might be further enhanced.

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Contents	Page
I. Introduction.....	3
II. Some Principles for Assessing the Design of Fiscal Conditionality.....	4
III. Macroeconomic Thresholds and PCs.....	6
IV. Other Aspects of Quantitative Fiscal Conditionality Design.....	11
V. Conclusions.....	13
Tables	
1. Macroeconomic Thresholds and Fiscal PCs.....	5
2. Implied and Applied Conditionality to Contain Inflation.....	6
3. Implied and Applied Conditionality to Contain Domestic Financing	7
4. Implied and Applied Conditionality to Contain External Debt	9
5. Implied and Applied Conditionality on Domestic Revenues	9
6. Distribution of Fiscal PCs.....	11
7. Distribution of Fiscal Benchmarks	12
8. Distribution of Adjustors	12
Figures	
1. Inflation Threshold and Actual Conditionality on NCG.....	7
2. Domestic Financing Threshold and Actual Conditionality on NDF	8
3. Private Sector Credit as a Percent of Broad Money	8
4. External Debt Threshold and Actual Conditionality on Fiscal Balances	9
5. Revenue Threshold and Actual Conditionality.....	10
Boxes	
1. Best Practice Principles on Conditionality	11
Appendices	
I. Survey of Quantitative Fiscal Conditionality	16
II. Actual and Implied Quantitative Fiscal Conditionality in Selected African Countries.....	20
Appendix Tables	
1. Distribution of Fiscal PCs.....	16
2. Distribution of Fiscal Benchmarks	17
3. Distribution of Adjustors	18
References.....	25

I. INTRODUCTION

The ongoing debate on the role of the IMF in low-income countries (LICs)—and more specifically, its role in relation to the scaling-up of aid and debt relief in the context of increased efforts to achieve the Millennium Development Goals (MDGs) and the implementation of the Multilateral Debt Reduction Initiative (MDRI)—may call for a possible reconsideration of how the IMF engages in these countries. Against this general background, we focus more specifically on quantitative fiscal conditionality. By taking stock of existing practices, we highlight some similarities and differences across selected PRGF-supported programs, and suggest some ways to look more systematically at these issues by casting the quantitative fiscal performance criteria (PC)² against the macro-fiscal objectives of these programs.

This paper draws in particular on the recent PRGF review that identified macro-fiscal criteria characterizing “mature stabilizers.”³ These criteria are used to design principles for mapping the macro-fiscal objectives of achieving and maintaining macroeconomic stability and fiscal sustainability into a set of fiscal PCs. The derived principles are then applied to a sample of 20 sub-Saharan African countries with PRGF-supported programs and the implied fiscal conditionality compared to actual.⁴

The note is organized as follows. Section II derives some principles for assessing the design of fiscal conditionality relative to a country’s macroeconomic conditions. Section III applies these principles to the sample. Some suggestions on the scope for improving fiscal program design are presented in Section IV. Practices on fiscal conditionality design are detailed in Appendix I and contrasted to “implied” conditionality in Appendix II.

² Quantitative fiscal PCs refer to numerical thresholds on key macroeconomic policy variables, such as ceilings on credit to government, budget balances, and spending, and floors on revenue, that are required to be met for the agreed amount of the IMF credit to be disbursed. Benchmarks can be applied to similar variables but are not, at least individually, conditions for drawing on Fund resources.

³ “Monetary and Fiscal Policy Design Issues in Low-Income Countries” <http://www.imf.org/external/np/pp/eng/2005/080805m.htm> (August 2005). Based on the criteria in this paper, the following countries in our sample qualify as “mature stabilizers”: Ethiopia, Madagascar, Mozambique, Rwanda, Senegal, Tanzania, and Uganda (Burkina Faso is excluded because its PRGF program only started in 2003). Mature stabilizers are defined as low-income countries that have achieved sustainable growth and low inflation, and brought their government deficits under control. The paper is available at.

⁴ These comprise: Burkina Faso, Burundi, Cameroon, Democratic Republic of Congo, Côte d’Ivoire, Ethiopia, The Gambia, Ghana, Kenya, Lesotho, Madagascar, Malawi, Mali, Mozambique, Rwanda, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia. Information and data refer to the latest available program documents as of end-2003.

II. SOME PRINCIPLES FOR ASSESSING THE DESIGN OF FISCAL CONDITIONALITY

Fiscal PCs in PRGF-supported programs should promote macroeconomic stability and lay the basis for sustainable growth. The first step in assessing fiscal program design is thus to link specific macroeconomic objectives to fiscal PCs. The recent PRGF review and its criteria for mature stabilizers suggests the following links (Table 1):

- *Inflation.* If a country has an excessive inflation (above 10 percent), attention should be paid to limiting sources of inflationary financing to the government (credit from the banking system). In addition to domestic sources of inflation, inflation pressures can also arise from large donor inflows; in this context, net credit to the government can also be targeted to reflect the sterilization needs envisaged under a program.
- *Domestic financing.* If there is a concern about an excessive level of domestic government debt, then total domestic financing (both bank and nonbank financing) should be targeted. Focusing only on credit from the banking system, for example, could create incentives to place government debt with the nonbank public, which, while non-inflationary, would contribute to increasing the stock of the government's domestic debt. The recent PRGF review indicates that domestic budget financing under 1 percent of GDP provides "a proxy for the sustainability of domestic debt accumulation."⁵
- *External, or total, public debt.* If there is a concern about external or total public debt sustainability viability, then total financing of the budget should be limited, or the primary balance be directly targeted.⁶ The recent PRGF review identified a threshold of 40 percent of net present value (NPV) of external debt to GDP to mark the limit where the risk of debt distress increases for countries with a "medium" rating for the quality of their policies and institutions.
- *Revenue.* A low revenue to GDP ratio could undermine a country's ability to finance its deficit, service its debt, and emerge from aid dependency.⁷ A general consensus

⁵ See 2005b, Box 1.

⁶ Strictly speaking, concerns about external public debt would be directly linked to limits on external borrowing. However, for some of the sample countries with high levels of external debt, larger recourse to domestic borrowing would generally not be appropriate—either due to possible crowding out effects and/or inflationary pressures. For these countries, keeping the external debt in check would translate into a need to control the build-up of total debt.

⁷ A case can be made that revenue conditionality should be limited to less binding benchmarks rather than PCs to ensure that it does not create perverse incentives for tax administrators and does not undermine the soundness and transparency of the tax regime. For example, revenue targets could be met by delaying tax refunds and/or extorting advance tax payments.

seems to have emerged that a revenue/GDP threshold of 15 percent provides a “reasonable target for most low-income countries.”⁸

Table 1. Macroeconomic Thresholds and Fiscal PCs

Macroeconomic Variable	Threshold	Appropriate PC/Benchmark
Inflation	10 percent	Credit to the government from the banking system (NCG)
Domestic budget financing (DBF) and debt	DBF/GDP = 1 percent	Net domestic financing of the government (NDF)
Net present value of external public debt (EPD)	NPV(EPD)/GDP = 40 percent	Total financing (TFin) or primary fiscal balance (PB)
Revenue (Rev)	Rev/GDP= 15 percent	Domestic revenue (Rev)

These criteria can be applied to map a program’s macro-fiscal objectives into fiscal PCs. The result is a set of macroeconomic thresholds that identify levels above/below which a program might be expected to “intervene” with quantitative fiscal conditionality, thus setting a yardstick against which to gauge the appropriateness of quantitative fiscal conditionality relative to the macroeconomic framework.

A number of important caveats limit the usefulness of mechanically applying proposed principles for designing fiscal conditionality:

- *Overlapping conditionality.* In many cases the thresholds, and hence the related conditionality, may overlap. For example, there may be cases where inflation is high, domestic financing is excessive, and external debt large. A mechanical application of the PCs suggested in Table 1 would lead to overlapping conditionality: credit to the government from the banking system, total domestic financing, and total financing would be indicated. In these cases, the appropriate choice of quantitative conditionality will need to take into account countries’ specific circumstances.⁹
- *Insufficient or no conditionality.* At the other end of the spectrum, there may be situations where such mechanical application can lead to too few program conditions—or no conditionality at all, when a country meets all the above criteria for

⁸ See IMF 2005b, paragraph 68. In addition, the same threshold is also used as a sustainability target under the HIPC Initiative.

⁹ For example, if nonbank holdings of government debt are limited due to small market size, targeting total domestic financing or net credit from the banking system may be broadly equivalent (and hence, in the example above, only one of the two PCs should be retained).

macro-fiscal stability. As above, in such cases a judgment based on country-specific circumstances would need to be made to correctly assess whether the fiscal conditionality under the program is appropriate.

- *“Preventive care.”* As in the cases just outlined above, while there may be no illness to cure, conditionality may be useful to prevent past problems, such as inflation, from recurring.
- *Unfavorable dynamics.* The proposed principles are based on *levels* for each variable, without tracking *changes* in these levels. In contrast, program design would typically take into account variables’ levels as well as their dynamics. For example, there may be a need to limit rapid increases in public debt, even if from a low base. However, the paper’s “static” approach to assessing conditionality by considering a snap-shot of fiscal programs at a particular point in time would not reveal such a need.
- *Country specifics.* The derived thresholds are indicative and do not cover all possible macroeconomic imbalances and vulnerabilities a specific country may face.
- *Quantitative thresholds.* A limited focus on these, as taken in this note, may ignore other aspects of conditionality design, including: (1) data reporting constraints that preclude the fine-tuning of performance criteria; and (2) the relationship between fiscal and non-fiscal PCs and the relationship between quantitative fiscal conditionality and structural fiscal conditionality.

III. MACROECONOMIC THRESHOLDS AND PCs

Inflation

While inflation was above 10 percent in eight of the 20 countries in the sample, only three targeted NCG directly (Table 2 and Figure 1);¹⁰ of the remaining five, four targeted NDF, and one the primary deficit.¹¹

Table 2: Implied and Applied Conditionality to Contain Inflation 1/

	Applied	Not Applied
Implied	3	5
Not implied	7	5

Source: Fund staff calculations.

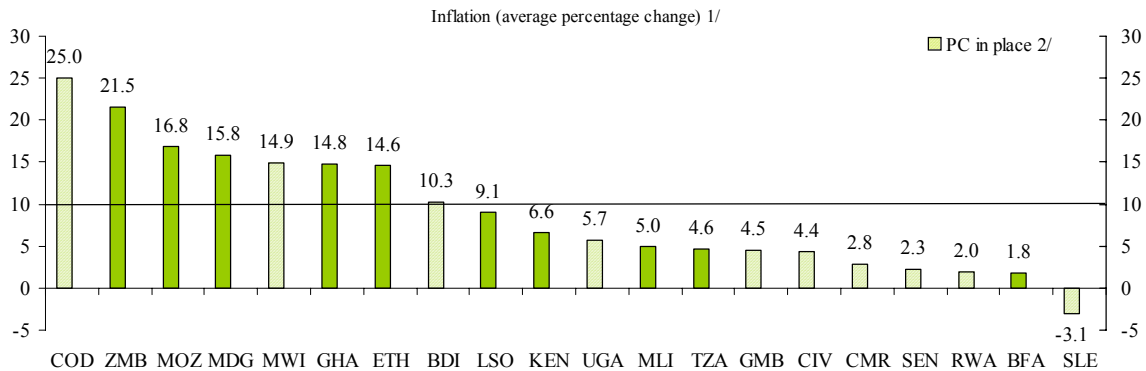
1/Number of countries.

¹⁰ The table reports the relationship between conditionality implied by the principles derived above and conditionality in place. For example the cell implied/applied shows the number of countries in the sample where implied conditionality matches the applied conditionality; similarly, the cell implied/not applied shows the number of countries in the sample where the PC on net credit to the government would be warranted on the basis of macroeconomic fundamentals, but instead such a PC is not retained in the program.

¹¹ Ethiopia is classified as a mature stabilizer, despite inflation above 10 percent during 2002/2003 fiscal year. Headline inflation was 14.6 percent, on account of supply shocks (high cereal prices as a result of severe draught), while core inflation remained low at 3 percent.

Conversely, NCG was still targeted even when inflation was low. Of the 12 countries in the sample that reported an average inflation rate below 10 percent, seven targeted NCG—and four of them exhibited inflation below 3 percent, with one country actually recording deflation (Sierra Leone, Figure 1).

Figure 1. Inflation Threshold and Actual Conditionality on NCG



1/ CY 2003 data: Burkina Faso (BFA), Burundi (BDI), and Zambia (ZMB); FY 2002/2003: Ethiopia (ETH), Kenya (KEN), Lesotho (LSO), and Uganda (UGA); CY 2002: Cameroon (CMR), Democratic Republic of Congo (COD), Ghana (GHA), Madagascar (MDG), Malawi (MWI), Mali (MLI), Mozambique (MOZ), Rwanda (RWA), Senegal (SEN), Sierra Leone (SLE) and Tanzania (TZA); CY2001: Côte d'Ivoire (CIV) and The Gambia (GMB).

2/ Denotes countries that have an actual PC in place for net credit to the government.

Source: IMF Executive Board documents.

However, targeting NCG in these latter cases might reflect: (1) negligible nonbank financing (in two countries, Cameroon and Sierra Leone)—or in other words, limiting NCG would be equivalent to setting a ceiling on NDF and addressing excessive domestic debt, rather than high inflation; (2) the need to curb rising inflationary pressures (Côte d'Ivoire); (3) the need to accumulate government deposits at the central bank to achieve sterilization objectives (Uganda); and (4) a legacy of past problems with inflation (Rwanda and Senegal).

Net domestic financing

Of the 12 countries with NDF below the 1 percent of GDP threshold, four had an explicit NDF target, despite low domestic financing and low inflation (Burkina Faso, Ethiopia, Mali, and Tanzania, Table 3 and Figure 2). While the use of the NDF PC can be explained by possible crowding out concerns in Tanzania, given its limited monetization,

Table 3: Implied and Applied Conditionality to Contain Domestic Financing 1/

	Applied	Not Applied
Implied	5	3
Not implied	4	8

Source: Fund staff calculations.

1/Number of countries.

private sector credit growth appears to be relatively strong in Burkina Faso and Mali (Figure 3). At the same time, three out of the eight countries with high domestic financing targeted NCG, rather than NDF (The Gambia, Sierra Leone, and Malawi).

Figure 2. Domestic Financing Threshold and Actual Conditionality on NDF

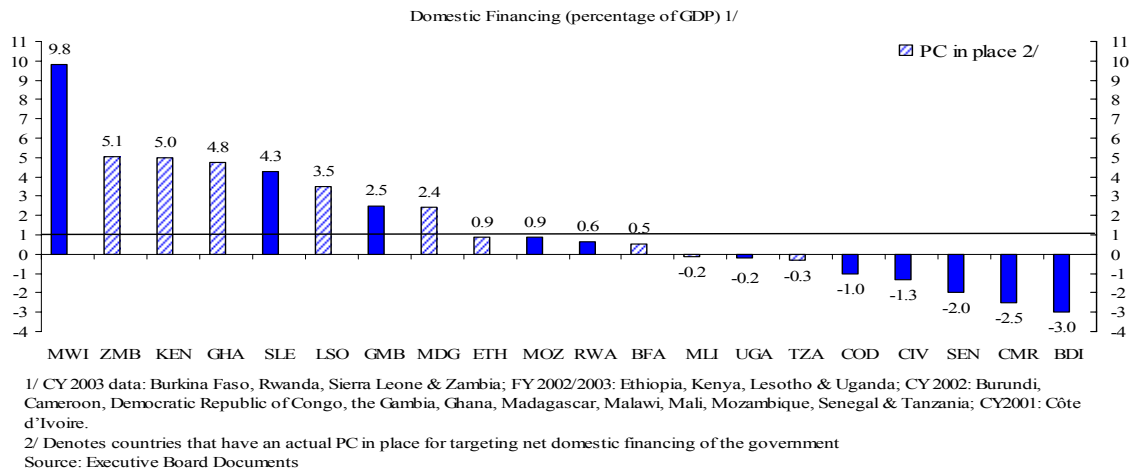
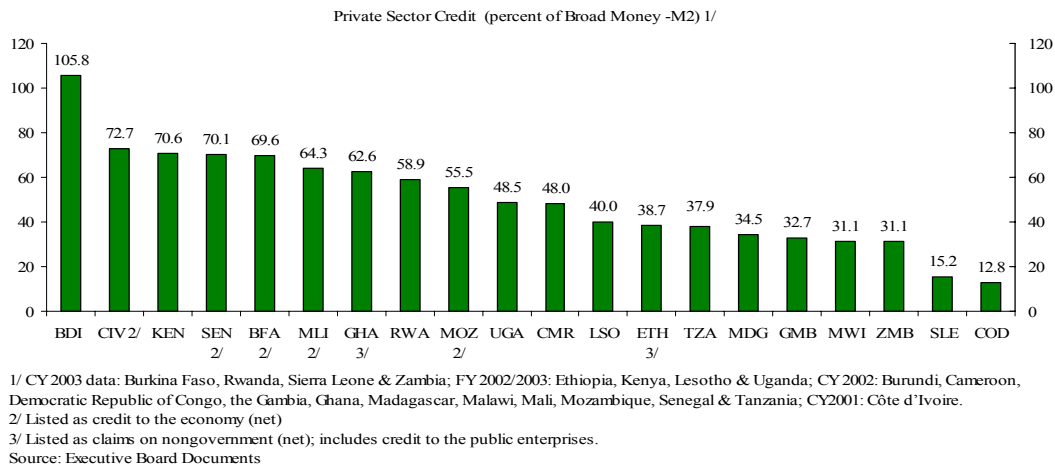


Figure 3. Private Sector Credit as a Percent of Broad Money



Debt sustainability

Of the 13 countries with a ratio of the NPV of external debt to GDP above 40 percent, only seven directly targeted some definition of fiscal balance, with another two applying a benchmark on the primary balance and cumulative fiscal balance, respectively (Table 4 and Figure 4). Although the remaining six had limits on the amount of concessional debt they can contract, this could still leave open the possibility of excessive accumulation of concessional external debt.

Table 4: Implied and Applied Conditionality to Contain External Debt 1/

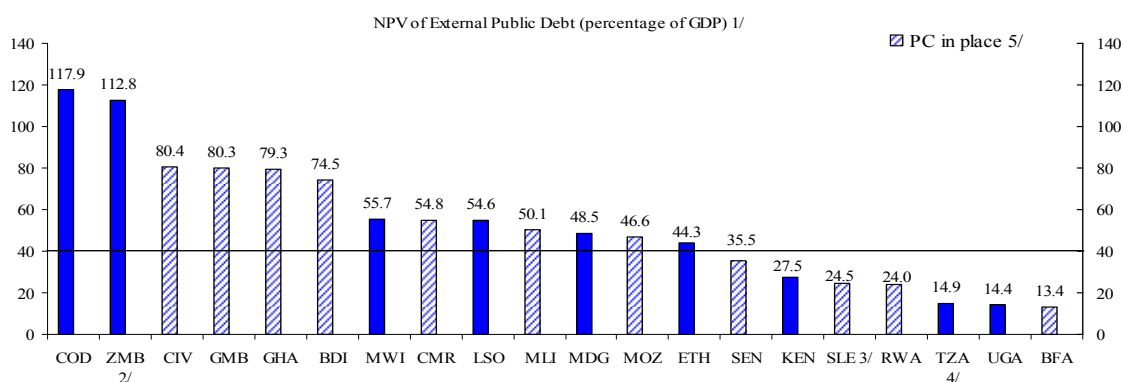
	Applied	Not Applied
Implied	7	6
Not implied	4	3

Source: Fund staff calculations.

1/Number of countries.

Conversely, the fiscal primary balance was targeted in four countries that would not appear to have an external or total debt problem. In some of these countries, conditionality on the primary balance could be imposed as a preventive measure; for example, if the NPV of external debt ratio was rapidly increasing (e.g., in Sierra Leone) or was close to the indicative threshold (Senegal).

Figure 4. External Debt Threshold and Actual Conditionality on Fiscal Balances



1/ CY 2004 data: Malawi & Mozambique; CY 2003 data: Burkina Faso, Rwanda, Senegal & Zambia; FY 2002/2003: Ethiopia, Kenya, Lesotho & Uganda; CY 2002: Burundi, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, Ghana, Madagascar, Mali, Sierra Leone & Tanzania; CY2001: the Gambia.

2/ Figures reflects traditional debt relief

3/ Assumes unconditional delivery of enhanced HIPIC assistance from 2000 onwards

4/ Estimated in June 2004 based on completion point debt data, new disbursements and other macroeconomic developments, full delivery of enhanced HIPIC Initiative assistance. It also assumes a higher level of projected new borrowing

5/ Denotes countries that have an actual PC in place for targeting an overall balance or a primary balance

Source: Executive Board Documents

Domestic revenue

Twelve countries in the sample collected more than the "standard" threshold for domestic revenue (Table 5 and Figure 5), but four of these (Cameroon, Ghana, Mali, and Senegal) continued targeting domestic revenue. On the

Table 5: Implied and Applied Conditionality on Domestic Revenues 1/

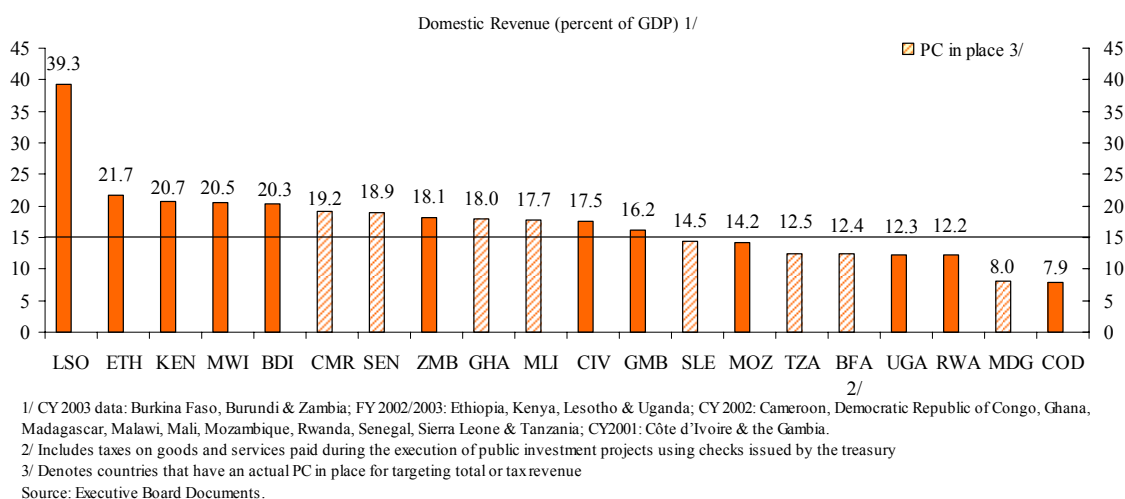
	Applied	Not Applied
Implied	4	4
Not implied	4	8

Source: Fund staff calculations.

1/Number of countries.

other hand, four countries displaying domestic revenue-to-GDP ratios below 15 percent did not set fiscal conditionality on this variable. Strengthening domestic revenue collection is especially important in light of these countries' aid dependency and their need to build gradually a domestic resource base that will allow an exit strategy in due time. This, however, may be better achieved by focusing on structural measures (such as strengthening tax administration and broadening the tax base by streamlining exemption and tax incentives); experience shows that quantitative floors on tax collections can be easily evaded by, for example, delaying VAT refunds or demanding anticipated tax payments.

Figure 5. Revenue Threshold and Actual Conditionality



In addition to the PCs covered above, a number of PRGF-supported programs also applied quantitative benchmarks on specific expenditure items (Appendix I). This may be appropriate, for example, when a program focuses on the composition of expenditures and the quality of fiscal adjustment, though it needs to take account of a country's ability to monitor such spending. An example is the targeting of pro-poor spending. While PRGF-supported programs need to protect and enhance poverty reducing spending and meet MDGs, many of the low-income countries covered in this note do not have adequate capacity to track and report such spending. Moreover, setting PCs on poverty reducing spending may create a perverse incentive to misclassify expenditures to meet the targets. Well-designed and rigorous definitions of these concepts in the Technical Memoranda of Understanding (TMUs) could help address these shortcomings.

IV. OTHER ASPECTS OF QUANTITATIVE FISCAL CONDITIONALITY DESIGN

In addition to whether the design of fiscal quantitative conditionality meshes with the country's macroeconomic context, other criteria can be used to assess the design of fiscal conditionality (Box 1).

Box 1. Best Practice Principles on Conditionality

Additional principles help define best practice in designing fiscal conditionality. Based on previous IMF work (FAD, 2000, and FAD, 2001) these include:

- *Parsimony*. Fiscal conditionality should be focused on a few key variables. The use of too many performance criteria may unnecessarily complicate the program and make it less transparent and more difficult to understand for the authorities and the public, thus undermining public support. The proliferation of PCs and adjustors that accompany them may be a signal that the program is being micro-managed and that ownership is weak. Moreover, by complicating reporting arrangements, proliferation of PCs can also make it more difficult to detect misreporting on a timely basis.
- *Simplicity and transparency*. Fiscal PCs should be presented clearly so that they can be easily understood and the choice of particular PCs should be explained; the use of adjustors should be avoided wherever possible by augmenting the performance criteria to achieve similar effect.
- *Appropriate coverage*. This depends on the assignment of fiscal responsibilities across levels of government and the extent of quasi-fiscal activities; and
- *Measurability*. Fiscal conditionality should be based on quality data reported in a timely manner.

Parsimony

Quantitative fiscal conditionality seems to be applied parsimoniously. Out of the sample of 20 countries, nine had only one fiscal quantitative PC; two, however, had four fiscal PCs (Senegal and Rwanda) (Table 6).

Table 6. Distribution of Fiscal PCs

	Number of Fiscal PCs			
	1	2	3	4
Number of countries	9	5	4	2

Source: Recent staff reports.

Indicative benchmarks also seem to have been relatively lightly used. Half of the sample countries had either no or one fiscal benchmark (Table 7). At the other end of the spectrum, two countries had four benchmarks (Burkina Faso and Sierra Leone) and one country had five (Senegal).

Table 7. Distribution of Fiscal Benchmarks

	Number of Fiscal Benchmarks					
	0	1	2	3	4	5
Number of countries	6	4	5	2	2	1

Source: Recent staff reports.

Transparency and simplicity

The number of adjustors does not seem excessive, except possibly in a couple of cases. Most countries had only two adjustors; one country had no adjustor (Mozambique), but Senegal had six adjustors (Table 8).

Table 8. Distribution of Adjustors

	Number of Adjustors					
	0	1	2	3	4	6
Number of countries	1	6	6	4	2	1

Source: Recent staff reports.

There could be scope for simplifying the treatment of deviations in external financing across countries. Countries may or may not have caps on the amount of “excess” foreign financing that should be saved, or “shortfalls” compensated by domestic borrowing (Appendix I). These adjustments may be relative or specific, be linked to certain expenditure items, and so on. While there may well be valid differences for treating deviations in foreign financing differently across countries, there could perhaps be a role for a more simplified and generalized approach.

Consideration could be given to using actual rather than “program” exchange rates. This issue is particularly important in countries with large donor inflows. As Appendix I notes, practices vary greatly across countries. For example, using program exchange rates to calculate external assistance adjustors implies that the excess in external financing that arises from the difference between the actual and the programmed exchange rate can be spent when the currency depreciates more than programmed. Conversely, countries that experienced appreciation would be penalized by being required to save the resulting excess. Using actual exchange rates instead could offer a more transparency and comparable treatment of deviations in external program assistance across countries and would help prevent any unintended fiscal expansion consequences of exchange rate movements.

Coverage

There seems a case for broadening the coverage of fiscal conditionality. Fiscal PCs predominantly covered the central government. Only two countries, Ethiopia and Ghana, included PCs on the general government. No program had fiscal targets on the public sector, although in three countries PCs also targeted financing of selected public enterprises (central bank credit to PEs in the Democratic Republic of Congo, arrears of the electricity company in Senegal, and subsidies to the power company in Sierra Leone).

Ideally the coverage of fiscal conditionality should primarily reflect how fiscal policy is carried out and the sources of fiscal risk. And it seems unlikely that local governments and public enterprises play such a minor role in sub-Saharan African countries. Expanding coverage, however, should be done on a case-by-case basis taking into account public financial management capacity and will probably only be possible if done gradually.

V. CONCLUSIONS

Comparing fiscal conditionality implied by some basic principles to actual fiscal conditionality in a sample of PRGF-supported programs may not be sufficient to draw definite conclusions, given the important caveats of this analysis. Still, it may usefully suggest some questions to keep in mind when setting quantitative fiscal conditionality.

Are fiscal PCs designed to address the macroeconomic objectives of a program? While subject to a number of important caveats, the analysis suggests that:

- In some cases, countries with similar macroeconomic environments have different conditionality. While in some instances these differences are warranted by country-specific considerations, in other cases there seems to be an argument for revisiting conditionality to better align it with changing macroeconomic circumstances.
- On average, programs were broadly aligned with macroeconomic conditions in about half of the cases: they targeted a specific PC when warranted, or did not do so when this was not required. Out of 80 entries in Tables 2–5, in 19 cases “implied” conditionality was appropriately applied, and in 24 cases unnecessary conditionality was not applied.¹²
- However, in some cases PCs were retained that would not be directly implied by a simplistic application of macroeconomic criteria. For example, it could be argued that net domestic financing targets may not be needed in countries with low domestic

¹² These totals are derived from the sum of entries along the diagonals of the text tables presenting implied and applied conditionality for each financial aggregate.

borrowing and strong private sector credit growth; and that, similarly, domestic revenue targets may not be needed in countries with domestic revenue above 15 percent of GDP.

Is there room to simplify PCs? In a number of programs, our preliminary analysis would suggest this is the case. For example, the combination of the ceiling on NDF and the symmetric adjustor for external financing could be replaced with a ceiling on the total government borrowing. Similarly, the use of the adjustor for the excess of privatization receipts could be avoided by defining the domestic fiscal balance to exclude privatization receipts or by including privatization receipts in the definition of net credit to the government.

When should multiple fiscal PCs be used? This would be appropriate when: (1) the coverage of a single PC has to be narrow because of data quality problems; (2) particular public sector agencies (e.g., public enterprises) not covered by a single PC (e.g., general government) are a significant source of fiscal risk; (3) it is desirable to constrain the deficit in particular parts of the public sector that are thought likely to be the main source of fiscal slippage (e.g., local governments); and (4) particular macroeconomic objectives have more importance than others (e.g., poverty reduction and quality of fiscal adjustment).

How broad should be the coverage of fiscal PCs? The answer should be dictated by the extent of quasi-fiscal activities and the distribution of fiscal responsibilities across levels of the government. Thus, if subnational governments have major fiscal responsibilities and their borrowing is not sufficiently restricted or controlled by central government, then general government coverage could be appropriate. The fiscal coverage should be expanded to the public sector if public enterprises carry out extensive quasi-fiscal activities and pose significant fiscal risks, and especially if their borrowing is guaranteed by the government. Where this is not possible, however, alternative solutions should be sought. For example, if consolidation of lower levels of government and/or public enterprises with central government operations is not immediately feasible, their borrowing could be kept in check by adopting a more comprehensive coverage of the limit on contracting new debt. Data quality and timeliness of data reporting place additional constraints on how broad the fiscal coverage can be; data quality and reporting should be sufficient for timely monitoring of fiscal PCs.

What if the need for broader coverage clashes with measurability problems? In these (quite common) cases, consistency checks would help address possible shortcomings. For example, the fiscal deficit often has to be measured from below the line; credit aggregates are often used because monetary bank data are in some countries more reliable and more timely than above-the-line budget data, and hence credit-based fiscal PCs can be computed at the same time as monetary PCs. The frequent use of NCG from the banking system, as opposed to NDF which includes both bank and non-bank financing, may be due to lags in obtaining data on non-bank financing. While generally it is best practice to measure fiscal PCs using below-the-line financing data, it also useful to monitor the underlying fiscal balance from

above the line to get a sense of the strength and quality of the fiscal effort.¹³ Careful investigation of discrepancies between above- and below-the-line data would flag possible problems.

All in all, appropriate program design ultimately rests on country-specific considerations—yet there may be scope for revisiting conditionality. This may be especially so in those countries that have successfully stabilized their economy. This conclusion, already put forward in the recent PRGF review with its sharper focus on mature stabilizers, certainly warrants more work. This note provides a starting point for future debate on these issues.

¹³ The underlying balance to measure fiscal effort would differ depending on the specific macroeconomic circumstances of a country in question and may include a primary non-oil balance for oil-producing countries and fiscal balance net of foreign grants and foreign-financed projects for some aid-dependent economies.

SURVEY OF QUANTITATIVE FISCAL CONDITIONALITY

Fiscal performance criteria

1. **Credit PCs are the most common form of quantitative conditionality.** Out of the sample of 20 countries, 19 have either a PC on net credit to government from the banking system or net domestic financing, which includes both bank and nonbank financing (Appendix Table 1). Mozambique, where the domestic primary deficit is targeted, is the only country not to have a “credit” PC. Côte d’Ivoire, The Gambia, Rwanda, Senegal, and Sierra Leone have both a “credit” and “fiscal balance” PC.

Appendix Table 1. Distribution of Fiscal PCs

	Type of Fiscal PCs			
	NCG	NDF	Fiscal balance	Other
Number of countries 1/	10	9	5 2/	11

Source: Recent staff reports.

1/ The total number of PCs exceeds the number of countries in the sample as programs typically include more than one fiscal PC.

2/ Mozambique has only one PC on the fiscal balance.

2. **Fiscal balance PCs are usually based on a notion of primary balance that may be adjusted for specific expenditures.** The differences of treatment of these specific expenditures are reflected in the variety of names for these PCs. In the six countries with such a PC, this is either called “primary balance” (Côte d’Ivoire), “basic primary balance” (The Gambia), “domestic primary balance” (Mozambique and Sierra Leone), “domestic fiscal balance” (Rwanda), and “basic fiscal balance” (Senegal). Apart from the obvious exclusion of interest payments in primary balances, in all these countries foreign-financed capital expenditure is excluded; in Mozambique, bank recapitalization costs are also excluded.

3. **There are also other (non-credit, non-balance) fiscal PCs.** The majority of these concerns accumulation of arrears, wage arrears in the Democratic Republic of Congo; net reduction in arrears in Côte d’Ivoire (with a subceilings on accumulation of new arrears); accumulation of domestic arrears in Kenya, Senegal, and Uganda; changes in payment arrears in Mali; net accumulation of domestic arrears in Rwanda; payment of arrears in Zambia; and arrears to SENELEC (the electricity company) in Senegal (Table A3). There is also a PC ceiling on central bank credit to nonfinancial public enterprises (Democratic Republic of Congo); a PC ceiling on wage and salaries (Kenya); a floor PC on tax revenue (Madagascar); and a floor PC on recurrent priority spending (Rwanda).

Quantitative benchmarks

4. **Quantitative benchmarks typically cover fiscal variables that are not targeted by PCs.** Revenue floors are the most popular benchmark—in line with the emphasis on raising own resources in countries that are typically highly dependent on aid. Among spending components, the wage bill is the most targeted (in seven out of the 20 countries); other spending components also receive attention, including floors on poverty spending (in Sierra Leone and Uganda) (Appendix Table 2). Arrears continue to be an issue in most countries; however, due to difficulty in their measurement and potential for misreporting, they are usually better suited as fiscal benchmarks rather than PCs—as shown by the fact that they are used in many programs. Finally, three countries have adopted benchmarks on some concept of fiscal balances (basic fiscal balance in Burkina Faso and Mali, and domestic primary surplus in Ghana—again, and as noted above, their measurement is broadly similar).

Appendix Table 2. Distribution of Fiscal Benchmarks

	Type of Fiscal Benchmarks				
	Revenue	Wage bill	Arrears	Other spending	Fiscal balance
Number of countries	8	7	6	4	3

Source: Recent staff reports.

Fiscal adjustors

5. **The five most commonly used adjustors** are for: (1) shortfalls/excesses in external disbursements (all, except Mozambique which has no adjustors); (2) changes in the programmed clearance/net accumulation of domestic arrears (Cameroon (includes external arrears), Kenya, Malawi, and Uganda); (3) differences between HIPC resources and HIPC-related spending (Côte d'Ivoire, Mali, and Senegal—although in the latter, deviations in HIPC resources and spending are considered in their own merit and are not added together); (4) differences in programmed and actual privatization receipts (net in Senegal, gross in Rwanda); and (5) changes in total debt service payments (Ghana, Tanzania, and Uganda) (Table 3). Other adjustors include differences between programmed spending for addition to the strategic petroleum reserves and the related actual costs (Rwanda); spending on restructuring public enterprises (Democratic Republic of Congo); differences with programmed expenditures on structural reforms (Senegal); and excess customs revenues (Lesotho).

Appendix Table 3. Distribution of Adjustors

	Type of Fiscal Adjustor					
	External program assistance	Arrears	HIPC spending	Privatiz- ation receipts	Debt service	Other
Number of countries	19	4	3	2	3	13

Source: Recent staff reports.

6. **The most used adjustor intends to address deviations in external nonproject financial assistance from programmed levels.** This may include or exclude HIPC relief, privatization receipts, and debt service, but always excludes project financing and includes grants.

7. **Most programs allowed domestic financing to compensate (at least up to some threshold) for any shortfall in non-project external disbursements.** In some of these programs there are no caps on the extent by which performance criteria could be relaxed (The Gambia, Ghana—excluding shortfalls in divestiture proceeds—Lesotho, Mali, Tanzania, Uganda). Other programs have caps—implying that some fiscal adjustment would be required in response to a sufficiently large shortfall in external financing. The types of caps vary notably across countries. Some programs had relative caps defined as a percent of the deviation from programmed external financing (Burundi, Cameroon, and Ethiopia up to a fixed cap; the Democratic Republic of Congo, and Sierra Leone);¹⁴ other programs used variable caps that changed over time (Burkina Faso, Madagascar, and Rwanda),¹⁵ and yet others specified fixed caps (Côte d’Ivoire, Kenya, Rwanda, Senegal, and Zambia). One exception was the program with Malawi: reflecting concerns over unsustainable domestic debt levels, it required fiscal adjustment to compensate for the full extent of the shortfall in program assistance.

8. **Most programs require any excess external disbursements over the programmed amount to be saved** (The Gambia; Ethiopia, except certain types of spending (see below); Kenya, Lesotho, Madagascar, Malawi, Mali, Rwanda, Senegal, Sierra Leone, Uganda, and Zambia). In some cases, some of the excess above a cap could be spent. The types of caps

¹⁴ For example, the program for Burundi adjusts the ceiling on the stock of credit from the banking system to the government to accommodate 75 percent of any deviation from the projected disbursement of external non-project financial assistance.

¹⁵ For example, the program for Rwanda adjusts the ceiling on net credit to the government by the banking system for any positive difference between actual and programmed general budgetary support inflows, with ceilings that vary for each quarter under program.

again varied across countries. A relative cap was applied in Burundi, Cameroon, and the Democratic Republic of Congo; a variable cap was used in Burkina Faso; and a fixed cap was specified in Côte d'Ivoire and Ghana. A number of programs defined the type of permitted spending financed by the external assistance in excess of program (e.g., poverty-reducing expenditure, public enterprise restructuring, and domestic debt repayments in the Democratic Republic of Congo; the reduction of payment arrears in Côte d'Ivoire; and special programs and poverty-reducing outlays up to a fixed cap in Ethiopia). One notable exception is Tanzania, where full excess amount of external assistance could be spent; this likely reflects the fact that Tanzania is considered to be a post-stabilizer country, where macroeconomic stabilization has been successfully achieved and maintained in recent years.

9. **The practice for converting deviations in external assistance into local currency vary widely across countries.** Some countries used programmed exchange rate (Kenya, Lesotho, Malawi, and Sierra Leone). In the case of Kenya, however, the exchange rate used to calculate the upward adjustment cap differed from the one applied to calculate the deviation in external assistance. Other programs converted external financing into local currency on a quarterly basis using the average official exchange rate (Burundi and Ethiopia), or prevailing mid exchange rate (Rwanda and Zambia). Some programs, however, employed a more complicated system of conversion. For example, the program for Ghana converts the monthly deviations of external program support at the actual monthly exchange rate and then cumulates the deviations.

ACTUAL AND IMPLIED QUANTITATIVE FISCAL CONDITIONALITY IN SELECTED AFRICAN COUNTRIES

Country	Inflation > 10 percent	Net domestic financing > 1 percent of GDP	NPV of external debt > 40 percent of GDP	Domestic revenue < 15 percent of GDP	Implied PCs and benchmarks	Actual PCs and benchmarks	Comments
Burkina Faso	No	No	No	Yes	1. Floor on domestic revenue.	1. Ceiling on cumulative change in net domestic financing to government with an adjustor. 2. Ceiling on the cumulative amount of new nonconcessional debt. 3. Ceiling on the accumulation of new external arrears. 4. Ceiling on the accumulation of new domestic arrears. 5. Benchmark on government revenue. 6. Benchmark on current expenditure. 7. Benchmark on expenditure on wages and salaries. 8. Benchmark on basic balance. 9. Benchmark on the stock of expenditure committed, but without payment orders issued.	Fiscal PCs appear to reflect past problems with inflation and debt. The one implied benchmark is in place. The rationale for a benchmark on the stock of expenditure, in addition to a benchmark on current expenditure, revenue, and the basic balance, is not apparent.
Burundi	Yes	No	Yes	No	1. Ceiling on net credit to government from the banking system. 2. Ceiling on total financing and/or primary balance. 3. Ceiling on contracting new non-concessional external debt.	1. Ceiling on net credit to the government from the banking system. 2. Ceiling on central government's outstanding stock of short-term external debt. 3. Ceiling on new nonconcessional external debt. 4. Benchmark on the primary balance. 5. Benchmark on the government wage bill.	All implied PCs and benchmarks are broadly appropriate. Given the high level of external debt, it may be advisable to target direct total financing or some concept of fiscal balance.
Cameroon	No	No	No	No	In principle, no PCs are required.	1. Ceiling on net credit to the government from the banking system on the CG (net of privatization receipts and subject to adjustors). 2. Floor on primary budget balance. 3. Benchmark floor on revenue with a subfloor on non-oil revenue. 4. Benchmark floor on reduction of domestic debts.	PCs and benchmarks appear at prima facie to be redundant, given the relatively sound macroeconomic position of the country. However, this consideration would not take into account possible prospects and remaining vulnerabilities. In addition, the benchmark floor on total revenue could be dropped, with the benchmark on non-oil revenue retained – this would better reflect the purpose of targeting domestic revenue, given that oil revenue is highly volatile and is susceptible to external price shocks.
Democratic Republic of Congo	Yes	No	Yes	Yes	1. Ceiling on net credit to government from the banking system. 2. Ceiling on net domestic financing? 2. Ceiling on total financing and/or primary balance. 3. Ceiling on contracting new nonconcessional debt. 4. Floor on domestic revenues.	1. Ceiling on net credit to the government from the banking system. 2. Ceiling on central bank credit to nonfinancial public sector enterprises. 3. Ceiling on the contracting or guaranteeing of new nonconcessional short-term external debt. 4. Ceiling on wage arrears.	PCs generally reflect the macroeconomic objectives. The high level of total debt would call for a PC on the primary balance (the PC on the net credit from the banking system may be better targeted to address high inflation, rather than the high debt burden).

Country	Inflation > 10 percent	Net domestic financing > 1 percent of GDP	NPV of external debt > 40 percent of GDP	Domestic revenue < 15 percent of GDP	Implied PCs and benchmarks	Actual PCs and benchmarks	Comments
Cote d'Ivoire	No	No	Yes	No	1. Ceiling on total financing and/or primary balance. 2. Ceiling on contracting new nonconcessional external debt.	1. Floor on primary fiscal balance with adjusters. 2. Ceiling on the net banking system credit to the government. 3. Ceiling on new nonconcessional external debt contracted or guaranteed by the government. 4. Floor on the net reduction of foreign payments.	The rationale for the ceiling on the net banking system credit to the government is not clear, especially as the floor on primary balance is in place and given that inflation is under control. This PC likely reflects past problems with inflation.
Ethiopia	Yes	No	Yes	No	1. Ceiling on net credit to government from the banking system. 2. Ceiling on total financing and/or primary balance. 3. Ceiling on contracting new non-concessional external debt.	1. Ceiling on net domestic financing of the general government (including privatization receipts).	Given the high level of external debt, a ceiling on the primary balance of the general government would be useful. In addition, the existing NDF ceiling does not allow effective targeting of broad money that could be achieved by introducing a ceiling on the net credit to the government from the banking system.
The Gambia	No	Yes	Yes	No	1. Ceiling on net domestic financing. 2. Ceiling on total financing? (net credit to government) and/or primary balance. 3. Ceiling on contracting new nonconcessional external debt.	1. Ceiling on the net bank credit to the central government. 2. Floor on basic primary balance of the central government. 3. Ceiling on external payments arrears of the central government. 4. Ceiling on the new nonconcessional debt contracted or guaranteed by the government.	The PCs generally reflect the macroeconomic objective of reducing public debt. The ceiling on the net bank credit to the central government is likely used to limit excessive domestic debt, given the negligible level of nonbank financing.
Ghana	Yes	Yes	Yes	No	1. Ceiling on net credit to government from the banking system. 2. Ceiling on net domestic financing. 3. Ceiling on total financing and/or primary balance. 4. Ceiling on contracting new non-concessional external debt.	1. Ceiling on the net domestic financing of the government. 2. Benchmark floor on domestic primary surplus. 3. Benchmark floor on government revenue, excluding grants and divestiture proceeds. 4. Benchmark ceiling on the stock of government road sector arrears.	The high inflation would be best addressed by targeting broad money with a ceiling on net credit to the government from the banking system. The benchmark on government revenue may be redundant, given a relatively sound domestic revenue performance. A ceiling on new nonconcessional debt could be useful, in light of the high debt burden.

Country	Inflation > 10 percent	Net domestic financing > 1 percent of GDP	NPV of external debt > 40 percent of GDP	Domestic revenue < 15 percent of GDP	Implied PCs and benchmarks	Actual PCs and benchmarks	Comments
Kenya	No	Yes	No	No	1. Ceiling on the net domestic financing to the government	1. Ceiling on the cumulative change in net domestic financing of the central government, excluding government debt issues for any bank restructuring, and the new securitization of expenditure arrears. 2. Ceiling on central government wages and salaries. 3. Ceiling on the new contracted or guaranteed nonconcessional external medium and long-term debt by the central government or the central bank. 4. Ceiling on the new contracted of guaranteed short-term external debt by the central government of the central bank. 5. Ceiling on accumulation of new domestic budgetary arrears. 6. Ceiling on accumulation of new external payments arrears.	Fiscal PCs generally reflect macroeconomic objectives and appear appropriate. Ceilings on accumulation of new debt appear to address earlier debt problems.
Lesotho	No	Yes	Yes	No	1. Ceiling on net domestic financing. 2. Ceiling on total financing and/or primary balance. 3. Ceiling on contracting new nonconcessional external debt.	1. Ceiling on the domestic financing requirement of the central government. 2. Ceiling on the amount of new nonconcessional external debt contracted or guaranteed by the public sector.	Given the high level of external and domestic debt, the program could benefit from a floor on the primary balance. Existing PCs address the high existing domestic debt burden and the accumulation of new nonconcessional debt.
Madagascar	Yes	Yes	Yes	Yes	1. Ceiling on the net credit to the government from the banking system. 2. Ceiling on the net domestic financing to the government. 3. Ceiling on total financing and/or primary balance. 4. Ceiling on contracting new nonconcessional external debt. 5. Floor	1. Ceiling on domestic financing of the government. 2. Floor on tax revenue. 3. Ceiling on accumulation of domestic arrears.	In light of the high external debt, the program could benefit from a floor on the primary fiscal balance and a ceiling on the contracting of new nonconcessional debt. High inflation could be addressed by targeting broad money through a ceiling on the net credit to the government from the banking system.
Malawi	Yes	Yes	Yes	No	1. Ceiling on net credit to government from the banking system. 2. Ceiling on net domestic financing. 3. Ceiling on total financing and/or primary balance. 4. Ceiling on contracting new non-concessional external debt.	1. Ceiling on net credit to government from the banking system. 2. Reduction in the outstanding stock of domestic arrears of the central government. 3. Ceiling on the contracting or guaranteeing of external debt.	The PC on net credit to government from the banking system reflect the objectives of reducing inflation. Given the high level of public debt, a PC on total financing or primary balance would be appropriate.

Country	Inflation > 10 percent	Net domestic financing > 1 percent of GDP	NPV of external debt > 40 percent of GDP	Domestic revenue < 15 percent of GDP	Implied PCs and benchmarks	Actual PCs and benchmarks	Comments
Mali	No	No	Yes	No	1. Ceiling on total financing and/or primary balance. 2. Ceiling on contracting new nonconcessional external debt.	1. Ceiling on net domestic financing. 2. Cumulative change in government payment arrears. 3. No new nonconcessional external borrowing of one year or more contracted or guaranteed by the government and public enterprises. 4. Benchmarks on tax revenue, cumulative wage bill, and cumulative fiscal balance.	As reducing inflation and domestic debt may not be primary objectives, the ceiling on domestic financing may be better replaced by a PC on total financing or primary balance, as public debt is high.
Mozambique	Yes	No	Yes	Yes	1. Ceiling on the net credit to the government from the banking system. 2. Ceiling on total financing and/or primary balance. 3. Ceiling on contracting new nonconcessional external debt. 4. Floor on domestic revenue.	1. Ceiling on central government domestic primary deficit excluding bank recapitalization costs. 2. Ceiling on new nonconcessional borrowing contracted or guaranteed by the government	Given high inflation, a PC on credit to the government from the banking system would be appropriate. A benchmark on revenue would also be appropriate, given the low level of domestic government resources.
Rwanda	No	No	No	Yes	1. Floor on domestic revenue.	1. Ceiling on net credit to government from the banking system. 2. Floor on domestic fiscal balance. 3. Floor on cumulative priority spending. 4. Ceiling on accumulation of domestic arrears. 5. Floor on exceptional spending.	A benchmark or PC on domestic revenue would be appropriate, given the low level of domestic government resources. As the remaining PCs, these may appear redundant at first look (see text and Cameroon above).
Senegal	No	No	No	No	In principle, no PCs are required.	1. Floor on the basic fiscal balance, excluding temporary costs of structural reforms and spending with HIPC-related resources. 2. Ceiling on net credit to the government from the banking system. 3. Ceiling on domestic payments arrears. 4. Ceiling on the contracting or guaranteeing of new nonconcessional external debt. 5. Benchmark floor on tax revenue. 6. Benchmark ceiling on the wage bill. 7. Benchmark ceiling on the amount of current non-wage non-interest expenditures and domestically financed expenditures executed through exceptional procedures.	The long list of PCs makes conditionality redundant, especially in view that Senegal appears to be below (above) the relevant thresholds and is a mature stabilizer. The indicative benchmarks on revenue and wages and non-wage non-interest expenditure almost equate the basic fiscal balance, that is already targeted as a PC. There is scope for simplification.

Country	Inflation > 10 percent	Net domestic financing > 1 percent of GDP	NPV of external debt > 40 percent of GDP	Domestic revenue < 15 percent of GDP	Implied PCs and benchmarks	Actual PCs and benchmarks	Comments
Sierra Leone	No	Yes	No	Yes	1. Ceiling on net domestic financing. 2. Floor on net credit to government from the banking system. 2. Floor on the domestic primary budget balance of the central government. 3. Ceiling on subsidies to National Power Authority. 4. Ceiling on the contracting or guaranteeing of new nonconcessional external debt. 5. Benchmarks: floor on tax revenue; ceiling on the wage bill; and ceiling on the change in the stock of verified domestic arrears the central government.	1. Ceiling on net credit to government from the banking system. 2. Floor on the domestic primary budget balance of the central government. 3. Ceiling on subsidies to National Power Authority. 4. Ceiling on the contracting or guaranteeing of new nonconcessional external debt. 5. Benchmarks: floor on tax revenue; ceiling on the wage bill; and ceiling on the change in the stock of verified domestic arrears the central government.	Given this country's vulnerable macroeconomic framework, fiscal PCs generally reflect macroeconomic objectives and past problems and appear broadly appropriate. The ceiling on net credit to the government is sufficient for limiting excessive domestic debt.
Tanzania	No	No	No	Yes	1. Floor on domestic revenue.	1. Ceiling on net domestic financing. 2. Floor on tax revenue. 3. No extrabudgetary expenditure. 4. No accumulation of domestic arrears. 5. No new nonconcessional external debt.	Tanzania is a mature stabilizer. The low level of domestic revenue makes conditionality on revenue appropriate, and calls for close coordination with structural measures in this area.
Uganda	No	No	No	Yes	1. Floor on domestic revenue.	1. Ceiling on net credit to government from the banking system. 2. No accumulation of new domestic budgetary arrears of the central government. 3. Ceiling on new nonconcessional external borrowing with maturities greater than 1-year contracted or guaranteed by the government. 4. Benchmarks on ceiling on public administration expenditure; and floor on expenditures under the Poverty Action Fund.	Uganda is a mature stabilizer. The low level of domestic revenue makes conditionality on revenue appropriate, and calls for close coordination with structural measures in this area.
Zambia	Yes	Yes	Yes	No	1. Ceiling on net credit to government from the banking system. 2. Ceiling on net domestic financing. 3. Ceiling on total financing and/or primary balance. 4. Ceiling on contracting new non-concessional external debt.	1. Ceiling on net domestic financing. 2. Ceiling on the stock of short-term debt and on contracting or guaranteeing of nonconcessional debt. 3. Ceiling on cumulative new concessional loans collateralized or guaranteed by the CG or the bank of Zambia. 4. Floor on the cumulative payment of domestic arrears of the government. 5. Benchmark ceiling on wage bill. 6. Benchmark ceiling on the cumulative arrears on the central government wage bill.	Given high inflation, emphasis could be more directly placed on credit to the government from the banking system. In addition, a PC on total financing or primary balance may better address the high level of debt.

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