OSIWA
Discussion Paper
Key challenges of Fiscal Policy in ECOWAS
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Background

The economic landscape of most West African countries is marked by structural fiscal deficits, which coexist alongside rising public debt, resulting from a dependence on external aid. The latter being debt, disguised as financial assistance. This trend has always raised doubts amongst economists and development practitioners about the sustainability of public financing and the capability of West African economies to grow in the medium term, despite optimism on the matter. The situation is particularly worrying, given the underlying fiscal challenges, due to the importance of the informal sector in the region, persistent tax evasion, weak tax institutions and poorly coordinated and harmonized regional tax and fiscal policy rules. It is worth noting that the Economic Community of West African States (ECOWAS) is currently pushing to address these issues by coordinating and harmonizing though initiatives like the Common External Tariff (CET), the multilateral treaty to name a few.

The other key challenge in West Africa is the un-harmonized and nominal monetary policy, which – in practice – is used alongside fiscal policy. On the one hand, the CFA\(^1\) monetary union zone and currency makes it so that the countries’ currency is pegged to the Euro. Therefore, a large part of their foreign reserves is locked within the French treasury by virtue of the colonial era agreement with France, therefore limiting their ability to enact a meaningful monetary policy. On the other hand, the remaining countries outside the CFA zone maintain individual currencies.

West Africa has also been growing its Gross Domestic Products (GDP) but unfortunately, in many cases, those nominal increases have meant little to the wellbeing and the livelihoods of its citizens. Most people continue to live below poverty line and soaring unemployment rates have revived the debate on the importance of fiscal policy in the context of non-existent endogenous monetary policies. Considering the importance of sound public policy in contemporary developing economies, understanding fiscal policy as an important determinant of the cyclical dynamics of macroeconomic aggregates can make a valuable contribution to the design of stabilization and structural economic transformation agenda within the West African Region. Given the importance of regional dynamics of integration that support economic transformation, there is plenty analysis on fiscal stimulus in developed countries, while less research and analysis is dedicated to the cyclical behavior of fiscal policy rules in the context of regional economic integration within the ECOWAS states.

ECOWAS has developed macroeconomic convergence criteria for member states including fiscal policy\(^2\) and recently adopted and implemented the common external tariff (CET). However, it has no internal coordinated common fiscal rules to support economic integration efforts and to mobilize adequate domestic resources to finance its regional and national development plans. In addition, weak tax systems combined with high and inefficient public spending are marked by institutional corruption, and have substantially contributed to increasing public debt. In the 2000s, most member countries benefited from

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\(^1\) The CFA Franc is a currency of 8 West African Economic and Monetary Union: Benin, Burkina Faso, Cote d’Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo

\(^2\) The proposed fiscal related criteria are: (i) primary criteria: Overall fiscal deficit including grants/GDP ratio < 3%, (ii) secondary criteria: Tax revenue/GDP ratio > 20%; Wage bill/tax revenue < 35%; internally funded public investment/tax revenue > 20%.
the Highly Indebted Poor Countries (HIPC) initiative but despite this, public debt continues to increase in the region and remains a big challenge to macroeconomic stability, sustainable inclusive economic growth and poverty alleviation. Moreover, divisive tax and fiscal policy negatively affects the development of regional economic projects, stifling local private sector and employment.

**The Political Economy of Fiscal Policy in West Africa**

While fiscal policy should be responsive to economic and political choices in each country – or region - the World Bank and IMF’s Structural Adjustment Programs (SAPs) of the 80’s and 90’s left affected the African economic policy space, particularly on fiscal policy, debt management, and government expenditures for public services. The underlying assumption of the SAPs was that government intervention was inefficient and it distorted markets. This also meant that stringent conditionalities were set so that fiscal policy, and in particular taxation, would be geared towards “stability”, which incidentally meant servicing debt and reducing public expenditure. This has led to a substantial decrease in investment of state capacities, notably around tax policy formulation and collection, which remains an obstacle when trying to tackle fiscal leakages. 30 years later, it is difficult to fully put the “blame” on SAPs or its successors, African governments have access to the information and knowledge to initiate an overhaul of the assumptions that guide their fiscal policy choices and administrative capacities. In this sense, it is imperative that we go back to understanding fiscal policy as a process through which revenue is generated and expended in order for states to provide services to its citizens. This is a political choice that requires African governments to critically look at local needs, as well as global norms and initiatives, which many argue, do not adequately address African particularities. The OECD’s Base erosion and Profit Shifting – BEPS process - is an interesting case, in that it provides a good example of what may or may not be a good initiative, but in any case, Africa needs to contextualize and take ownership of it or create its own model. There are opportunities to work regionally within the various Regional Economic Communities and continentally through organizations such as ATAF/WATAF, to critically review taxation systems, and these processes should be taken more seriously coupled with the appropriate political and financial backing.

**Ongoing Tax/Fiscal Reforms**

Since 2010, there has been a paradigm shift related to new emerging economies. Most West African countries have enacted tax and fiscal code reforms with the main objective being to attract foreign direct investment (FDI) by giving away huge portions of scarce resources to multinational companies (MNC) at the expense of sustainably funding national budgets. Often times, those reforms have failed to address the increasing challenges of illicit financial flows (IFFs), the harmonization and rationalization of tax incentives and the setup of progressive tax systems to increase domestic resource mobilization. Finally, they have also failed in addressing the challenges of unemployment and the lack of conducive job environments. Considering the above context, the following critical questions need to be addressed:

- Considering the context of regional economic integration, can the adoption of common fiscal rules help to improve domestic resource mobilization and fiscal accountability?
- What type of common rules would be suitable regionally?
- What supporting institutions and reforms are needed to ensure their effective implementation?

Today, ECOWAS member countries have at their disposal fiscal policy and rules to influence the macroeconomic output and achieve the structural transformation agenda objectives. The working

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3 The paradigm shift from the concept of development to emerging economies in Africa has started in 2000’s. Since then out of 54 African countries, 37 have launched so-called “Emerging Plan” medium term.
hypotheses are: (i) West African countries have weak tax administrations using pro-cyclical\(^4\) fiscal policy and despite efforts, there is limited coordination and convergence, and (ii) West African countries use discretionary fiscal policy, which is pro-cyclical and has limited impact on economic performance and therefore, economic growth is not driven by its fiscal policy.

**OSIWA’s Work on Taxation and Financing for Development**

OSIWA work in this space is nascent but steadily increasing since 2014/15. The overall goal is to help countries develop equitable and progressive tax systems that generate more domestic resources to finance domestic development plans and advocate for ECOWAS to set up a domestic taxation department and better coordinate and harmonize regional fiscal policy.

To do this, OSIWA engages with tax administration bodies and civil society at the national and regional levels. Nationally and locally we seek to provide:

- Support to revenue authorities and tax policy units within finance ministries to better design and administer well-thought out tax reforms for effective and efficient tax systems;
- Technical support to reform-minded tax bodies that have the intent to generate more domestic revenue and reinvest it with development priorities in mind;
- Support to civil society and local businesses to better advocate for tax justice and fiscal accountability;
- Support to think tanks to foster development oriented tax and fiscal policy reforms that favor the domestic private sector and curb Illicit Financial Flows (IFFs);
- Support to investigative journalists to increase their reporting and capacity on tax and development issues;

At the regional level, OSIWA works with the West African Tax Administration Forum (WATAF) to build their capacities and engage with ECOWAS for setting up a domestic tax unit. We provide support to regional forums and platforms to engage key stakeholders (state and non-state actors) in addressing IFFs, and prominent cross border tax issues such as transfer price abuse and harmful tax competition (abusive tax incentives).

At the continental level, OSIWA together with other stakeholders, work with ATAF to provide technical support to targeted national tax administration and support the development and harmonization of tools to tackle IFFs. OSIWA also works with the ECA and the AU on the implementation of the Thabo Mbeki plan of action on IFF.

\(^4\) A pro-cyclical fiscal policy can be summarized simply as governments choosing to increase government spending and reduce taxes during an economic boom, but reduce spending and increase taxes during a recession.