

Analysis of imf report 2014



**ASSIGN
BUSTER**

ANALYSIS OF STAFF REPORT ON COMMON POLICIES FOR MEMBER STATES OF WESTERN AFRICAN ECONOMIC AND MONETARY UNION (WAEMU)

IMF REPORT 2014

MEER A. P. R

ROLL; 047

UID: 131403

SYBA

SYNOPSIS

The March 2014 IMF staff report for the West African Economic and Monetary Union was prepared with the objective of tracing the economic growth and development of these countries and to suggest changes in policy measures.

The countries experienced a strong escalation in growth from 2011 to 2013. The main objective of WAEMU and Central Bank of Africa is to stabilize this growth rate in the medium term. Policy recommendations have been made in 4 major fronts. The report suggests freezing of the current macroeconomic policy mix as a further stimulus might become too much for a developing country to uphold. Fiscal policies should be made more sustainable with an increase in public investment. The current account deficit recorded a higher value of 6.7% in 2013 owing to public investments and a decline in gold prices. Hence the overall balance of payments recorded a small deficit which in turn led to a decline in official reserves. The report suggests tightening of

the monetary policy in order to reduce the country's highly negative current account deficit.

Political instability has hindered the economic growth of these countries to a large extent. The 2012 Tuareg Rebellion in Mali, electoral political instability in Cote d'Ivoire posed major threats to the growth of WAEMU countries.

Severe disease outbreaks, famines and droughts are also major factors that have contributed to the slow-down in the proposed growth targets. It has also resulted in a high incidence of aid from foreign countries. In the current scenario of the spread of Ebola virus, it can be presumed that incidence of debt will shoot up from the current 39% of GDP and it will pose a major threat to the economic growth.

The report also tries to understand the disparities prevalent among the WAEMU countries and also the structural, institutional and macroeconomic factors that have prevented these countries from keeping pace with the Sub-Saharan African countries.

The most important chapter in this report is "Coordinating policies to ensure stability and support growth" because it explains the economic position of Western Africa by explaining its macroeconomic, fiscal, monetary and political stand precisely.

The WAEMU region has a common monetary policy and fixed exchange rate scheme due to which changes in national monetary policy is very limited. Hence the national fiscal policies are the main stabilization instrument adopted by the region to deal with regional shocks. Since the WAEMU regions has experienced asymmetric shocks relating to socio political events,

region specific fiscal policies should be taken to ensure reduction of non policy related shocks. WAEMU has sought to obtain a positive fiscal balance, but the idea of opening up the market to the international market contradicts with this idea since fiscal balance does not take into account the foreign financed investment. Hence, their objective of obtaining a positive fiscal balance is not viable with their existing policy of market liberalisation. With respect to the fiscal policy coordination, the first point highlighted in the report is the ineffective implementation of fiscal policies. The main reasons for this is the non compliance with the policies and the non-binding character of these policies in the short term. Very less intra-regional fiscal transfers have taken place and there is very low mobility of labour. Political instability in WAEMU has resulted in large amounts of debt relief funds flowing in. But the region has been able to keep up with their 70% of GDP debt ceiling. The region with the highest public debt is Guinea Bissau followed by Cote d'Ivoire where electoral instability led to the inflow of debt relief funds.

The current fiscal policy criteria contains multiple objectives such as fiscal sustainability, altering the composition of spending, revenue mobilization etc. In such a situation, the authorities will not focus sufficiently on the main objective of fiscal sustainability . Only when this objective is fulfilled will policies become more effective and sustainable in the medium term. Another important measure to ensure fiscal sustainability is the simple and easy implementation and monitoring strategies. Although the monetary policy is national, there should be provision for regional changes because the strengths and weaknesses of each region varies and policies specific to a certain region has to be taken in order to maximise productivity. Proper

planning for contingencies is the key to the success of fiscal rules. An important issue highlighted in the report is pertaining to the energy sector in WAEMU regions. The cost of supporting the energy sector has been very high, and often higher than the budgeted. This complicates the fiscal management policies and inefficient adjustment.

One of the reasons for the lack of effectiveness of fiscal rules is the insufficient compliance with the rules. The Non-compliance deficits account for 35 points whereas that of compliance deficit accounts for meagre 12 points ^[1] Increasing the fiscal transparency could be another solution to increase the effectiveness of fiscal rules. Establishment of fiscal councils could play an important role regarding this front. A more efficient risk sharing fiscal mechanism could provide greater insurance against shocks.

MONETARY POLICY EFFECTIVENESS

Monetary policy easing has continued in 2013 with reduction in policy interest rates and interbank interest rates. Inflation continued to moderate to below 2% YOY in CPI and nearly zero in WPI due to lower price of imported food and fuel ^[2]. The capital mobility of WAEMU regions with the rest of the world is very limited. Hence there is scope for an active monetary policy within the region. The changes in monetary policy rates with regard to inflationary pressure has had very little impact on inflation. This depicts the shallow financial market, insufficient interbank market, lack of secondary market for government bonds and absence of an exchange rate channel. There has been an asymmetric distribution of monetary policies across regions. Changes in the money markets affects the lending rates of different

regions differently. For example, lending rates react quickly to changes in money market in Burkina Faso and Senegal whereas the impact is more delayed in Togo. Money market rates least affect Mali. This depicts the lack of integration among the regions.

The policy rates and deposit rates have not changed significantly over time. This is due to the recommendation of IMF to maintain the current macroeconomic policy mix to sustain moderate growth in the coming years.

The solution to this monetary policy ineffectiveness is the development of interbank services , proper secondary market and more integration among the regions. This would increase liquidity transactions within banks. The channels of monetary transactions should be traced and directed in order to increase the effectiveness of these policies. There should also be improvements in coverage, timeliness and quality of monetary policies. Annual indicators of financial and economic activities should be traced completely and analysed to understand the strengths and flaws pertaining to it. It has been found that monetary policy has been most effective in Benin, Senegal and Togo which happens to be the countries with the highest financial depth.

Hence, the report concludes that policy rates have an impact on other rates, whose size and significance varies across countries. It also has a significant impact on inflation. Effectiveness of monetary policy affects financial development and financial sector competitiveness.

MACROECONOMIC POLICY MIX

The report suggests that the area wide fiscal deficit would decrease in spite of an increase in public investment. The overall fiscal deficit is highest in Niger due to the government's expenditure on the hydrocarbon project. The current expenditure of the government as a ratio of the GDP is also expected to decrease. Authorities have pegged the public debt ratio at 39% of the GDP to reduce the debt vulnerability. Although growth is now better entrenched, the current account deficit is worsening and official reserves are declining. The government is looking forward to maintain moderate current account deficit and not a negative one. As Dr. Raghuram Rajan mentioned in his speech at Conclave'14, it is passable for countries to have a moderate current account deficit and achieve higher economic growth. Countries like Australia and Canada have grown out of foreign investments.

The authorities have predicted a higher potential growth with the return of political stability and security. They have also emphasised on higher developmental needs which require public investment and social spending.

The ascend of growth in Africa has been one of the most salient features of a budding global economy. But the per capita GDP of the fast growing Sub Saharan African countries have more than doubled in the past two decades whereas the WAEMU countries have grown only moderately. The reasons for this divergence are political instability, challenging business and legal environments, weak governance and regulatory framework, lack of structural transformation, infrastructure gap and weak investment management capacity. The share of industries and services sector has not increased in WAEMU. Non resource rich SSA countries like Ethiopia and Mozambique have recorded sustained growth whereas WAEMU countries similar to them have

recorded only a moderate growth of 20% since 1995. WAEMU countries have received less FDI and foreign aid than benchmark countries. This is due to the high cost of finance and low returns on economic activity. The lower Total Factor Productivity explains the underperformance of growth of WAEMU countries.

If the current monetary and fiscal policies are maintained with greater political stabilization, there will be assured economic growth in WAEMU countries. The only factor constraining this growth is the effective implementation of these policies.

THE SIGNIFICANCE OF THE REPORT FOR A STUDENT OF MACROECONOMICS

It is necessary for a student of macroeconomics to understand the dynamics involved in the policy making of a country. Western Africa is a country with a diverse socio political and economic background and analysing the dynamics behind policy making in such a country requires extensive research to be conducted on all macroeconomic aspects.

A student of macroeconomics should be well versed with the different monetary and fiscal policies that can be taken in varied economic backgrounds. This report enabled me to thoroughly study the same.

The report shows how countries with such political instability manage to take their economy forward and achieve positive growth rates. The report urges a student to analyse not only the economic aspect but also the political aspect that guides the economic credibility of a nation.

A macroeconomic student should be aware of crisis prevention and resolution framework. The report projects a vivid example of crisis recovery by highlighting the Ivoirian Crisis and its recovery policies.

In a country drowning with import dependence, it is important to explore the various opportunities present within the country. The report highlights how these regions have sought to increase their GDP by increasing their agricultural productivity, efficient utilisation of natural resources and public investments. The report enables a student to understand how important it is for a diverse nation like Western Africa to have a well conducive environment for foreign investors and a well coordinated financial market.

The report teaches a student the necessity to maintain reserve for future contingencies because a region like Western Africa which is highly threatened by political insurgencies need to have a well established buffer system to impart resilience to the economy.

APPLICATION OF THE POLICIES TAKEN BY WAEMU REGIONS TO SRI LANKAN CONTEXT

Western Africa has shown a relatively good economic progress over the past couple of years. The WAEMU regions have evolved a development based integration agenda which aims at securing the benefits of economic growth without regional disparity and inequality. But it is questionable whether this agenda has resulted in economic development. Both WAEMU countries and Sri Lanka has had to deal with political instability and post-crisis resolution. Hence there are certain policies of the WAEMU countries which can be applied in the Sri Lankan context to convert EG to ED. This includes the

reduction of debt ceiling of Sri Lanka to less than their current 80% in order to reduce foreign dependence and make development more sustainable. The objective of WAEMU to maintain moderate current account deficit by keeping up the government expenditure on public investment should be adopted in Sri Lanka as well because it will boost the educational and health infrastructure in areas affected by the civil war and export infrastructure in areas where natural resources can be tapped.

Although Sri Lanka recorded a GDP growth of 6.1% from 2010-2013, the benefits of economic growth has not seeped into the masses equally due to the high income inequality in the country. But economic development in Sri Lanka is definitely ahead of economic development in Western Africa. The WAEMU countries lie in the bottom 20 of HDI whereas Sri Lanka ranks 76. Hence applying the policies of Western Africa to Sri Lanka in order to bring economic development from economic growth is not a feasible strategy. In the post crisis period, Sri Lanka has grown from its tourism industry. Western Africa could expand their tourism industry and tap revenue from it since Africa is home to the most vibrant landscape in the world.

My mentor, in her report, had projected the idea of poverty reduction in Sri Lanka through increasing farm returns and increasing productivity of wage workers. Western Africa could also increase their farm productivity by more efficient means of production, storage and distribution. Another important factor hindering the growth and development of west African region is the lack of globalisation and increasing marginalisation. This marginalisation occurs due to cross border trade which forms a deep rooted system of trade

in the regions. What needs to be done is the formalisation of this practice and its integration to the global economy. [3]

Another important factor that results in stagnation of development in West Africa is the IPR in pharmaceutical industry. IPR has increased the circulation of counterfeit drugs. Coupled with this is the degree of poverty, high price of drugs and lack of accessibility has caused the spread of many diseases which could have otherwise be prevented. This is one of the major reasons for the worsening health condition in Western Africa. [4]

In the paper “ Challenge of globalisation in Africa” [5], it has been mentioned that The essential social needs of the people have been ignored when African government and aid donors struggle to re-stabilize the crisis torn economies. This might be the reason why economic development has lagged behind economic growth in WAEMU countries.

The MPC of Sri Lanka from 1970-2006 was found to be 0. 68 [5] and 0. 78 in 2011-2012 ($\theta = 37. 95$) [6]. Hence the MPS over the years has decreased which signifies an increase in the multiplier effect. This also highlights that Sri Lanka has not been able to improve itself much in the development frontier.

LESSONS LEARNT

The most important lesson learnt from this assignment is that reading and analysing such a report is worth the time spent on it. This was the first macroeconomic report that I was exposed to and I did not know how it could supplement my knowledge in the subject. But the report has elevated my

<https://assignbuster.com/analysis-of-imf-report-2014/>

level of knowledge in macroeconomics to a whole new level. I learnt not only about the policies of the WAEMU and BCEAO, but also of various international regulations like BASEL II and BASEL III .

This assignment also enabled me to analyse the various policy measures taken by the African government to curb the impact of various insurgencies that have been taking place in the continent . That is one important lesson which I could not have learnt from any other report.

Another important lesson that learnt from this assignment is the importance of effective implementation of policy measures to yield the expected returns. The convergence criteria, interbank and credit facilities are similar to programmes like NREGA which has not been effectively implemented and hence remain highly underutilised.

The assignment enabled me to apply many theories to the reality faced by these nation. Comparing the policies taken by WAEMU to Keynesian theory of government intervention was one among them. It helped me understand how restrictions in the market reduce the financial credibility of a nation. The assignment has indeed helped in gaining a better understanding of the world from a macroeconomic perspective.

WEBLOGRAPHY

1. Figure 1, Page 57, WAEMU Report, International Monetary Fund.

0. Figure 3, Page 21, WAEMU Report, International Monetary Fund

0. *Emergent Africa: Inspired by George Ayittey's book " Africa Unchained"* , 2006, Available at , [Accessed]

<https://assignbuster.com/analysis-of-imf-report-2014/>

0. Gassikia G, 2014, Review of Intellectual Property Law, The John Marshall Law School, [Accessed]

0. *The challenge of globalization in Africa: The trade union response* , Labour Education 2001/2, No: 123, [online], Available at

/F506945503/123e. pdf> [Accessed]

0. *Economica*, La Plata, Vol. LIV, 2008, Deigo Cerdeiro , *International Trade Transmission Channel of a Local Crisis: A simple model* ,

0. *National Accounts of Sri Lanka 2012* , Department of Census and Statistics, September 2013, Government of Sri Lanka, Page 29, 70. [online], Available at

1