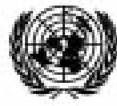
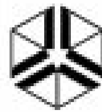

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Overcoming the Fiscal Crisis of the African State

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Abstract

A critical task is to construct a development state—a set of democratically-accountable institutions capable of effective policy design and implementation. The new state agenda is ambitious and resource intensive. It cannot therefore be achieved unless the fiscal crisis of the African state is resolved, especially low and distorted spending on pro-poor services, weak budgetary institutions, distortions in civil-service expenditure, and the weakness of customs and taxation institutions in raising much-needed revenue. These problems are common across SSA but they are severe in the conflict/post-conflict country group. Reform is therefore urgent, and this issue illustrates how reform—if it is well designed—can support reconstruction. Furthermore, reduced military spending, more grant aid, and more debt relief all release or add resources for core spending.

Keywords: Sub-Saharan Africa, conflict, economic reform, debt relief

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1 Introduction[1]

A critical task is to construct a development state—a set of democratically-accountable institutions capable of effective policy design and implementation (Addison 2001b). The new state agenda is compared to the old agenda in Box 1. The new agenda is ambitious and resource intensive. It cannot therefore be achieved unless the fiscal crisis of the African state is resolved, especially low and distorted spending on pro-poor services, weak budgetary institutions, distortions in civil-service expenditure, and the weakness of customs and taxation institutions in raising much-needed revenue. These problems are common across SSA but they are severe in the conflict/post-conflict country group. Reform is therefore urgent, and this issue illustrates how reform—if it is well designed—can support reconstruction (Addison 2001a and 2001b). And reduced military spending, more grant aid, and more debt relief all release or add resources for core spending. So international action must complement national fiscal reform.

We begin by discussing the fiscal crisis and its characteristics (section 2), and then turn to the size of the fiscal peace-dividend that can be expected (section 3), and the setting of expenditure priorities and the reform of budgetary institutions (section 4). We emphasize the need to reduce the fiscal burden of debt-servicing and show how reductions in debt-service could boost spending on health and other basic needs (section 5). However, improvements in the sectoral allocation of spending cannot be achieved if the target for the fiscal deficit is unduly restrictive. We therefore address the question of whether IMF fiscal conditionality is too tight in countries that are reconstructing, an issue that is related to size of the budget support provided by aid inflows (section 6). The paper concludes by emphasizing the importance of a development state to achieving reconstruction, the need for macro-policy design to fully incorporate development objectives, and the importance of peace to improving economic management.

2 The fiscal crisis

There are four major dimensions to the fiscal crisis in SSA. First, the level and shares of public spending on basic pro-poor services (primary education, primary health care, and infrastructure for sanitation and safe water) are too low. Angola's government spends a negligible US$ 0.01 per capita on primary health care despite US$ 2.6 billion per annum in oil revenues (Adauta et al. 2001, World Bank 1995: 3). Moreover, spending is urban-biased, thereby neglecting the poorest rural areas in particular. These distortions are prevalent in SSA, but they are accentuated by wars that disproportionately destroy rural services; many Angolans depend entirely on humanitarian medical assistance—when they can find it. Comparing Eritrea and Ethiopia with a poor non-conflict country such as Tanzania is instructive. Public health spending is substantially lower in Eritrea and Ethiopia as a percentage of GDP (0.9 and 1.9 per cent respectively) than in Tanzania (2.5 per cent) and as a share of total government spending: 2.8 per cent for Eritrea, 3.6 per cent for Ethiopia, and 8.2 per cent for Tanzania (Shaw 1997). Curative health care (an urban-based service) accounts for 88 and 79 per cent of total health spending in Eritrea and Ethiopia, compared with 57 per cent in Tanzania. Correspondingly, the

[1] Research assistance by Robert Osei is gratefully acknowledged.

Box 1 State Institutions: Old and New Agendas

Old Agenda	New Agenda
Public administration	
• over-centralized public administration, neglecting local needs	• decentralized public administration to match political decentralization
• large civil service with unsustainable fiscal costs, favouritism in hiring (sometimes involving ethnic discrimination)	• smaller scale and professional civil service, elimination of 'ghost workers'
• underpaid and demotivated state employees: narrow salary range, real wage decline	• public wages commensurate with private sector; real wages increased
• over-complex bureaucratic rules and regulations linked to corruption	• straightforward and clearly understandable system fairly applied with over-sight by the legislature
Budgeting and planning	
• weak budgetary and planning process; budget overruns, capital spending not matched by recurrent spending and therefore poor service and infrastructure quality	• tight budgetary and planning process to co-ordinate sector plans/budgets to overall development strategy, and focus public money on core expenditures
• non-transparent budgeting and planning, weak financial control, expenditures and revenues off-budget, debts incurred outside normal Treasury procedures	• greater transparency: accountability to new legislatures, all expenditures and revenues brought within the budgetary framework, strict debt reporting procedures
Tax and customs authorities	
• weak and corrupted tax and customs authorities, resulting in limited revenue mobilization and impediments to private-sector and community development	• modernization of tax records and administration, consolidation of tax legislation to reduce complexity and raise revenue • customs service put out to private tender for reform; restructured with increased wages and oversight to reduce corruption and improve efficiency
State owned enterprises	
• loss-making SOEs in production, commerce and utilities	• privatization, commercialization, foreign and domestic purchase of equity, construction of regulatory system for privatized SOE utilities
• inefficient state financial system, insufficient savings mobilization	• privatization or commercial banks permitted to operate alongside restructured state banks
Central bank	
• weak voice in macro-policy decisions relative to government and political leadership	• increased autonomy from government
• politicized financial regulation	• strong powers to regulate and supervise the financial system in the public interest
Government statistical service	
• weak capacity to collect social and economic data, culture of data secrecy	• investment to ensure regular data collection for policy making, increased subcontracting of data collection to non-government researchers, data made public
• data collection disconnected from policy formulation	• data collection informs policy reform and public-expenditure priorities

shares of community services—which are more likely to reach rural communities—are only 2 and 5 per cent in Eritrea and Ethiopia (11 per cent in Tanzania), and preventive services are 10 and 16 per cent (32 per cent in Tanzania). Tanzania itself needs to raise and reallocate health spending, so this indicates the scale of the task facing Eritrea and Ethiopia.

The second dimension of the fiscal crisis is the weakness of budgetary institutions. Planning systems often concentrate on producing 'wish lists' (i.e. lists of projects and programmes that cannot possibly be implemented given the available or expected resources) rather than on setting priorities, and making the hard choices that this requires. Analysis to help make better—pro-poor, pro-growth—choices remains underused (although Mozambique has made significant progress: see Addison and Ginja 2000). Such analysis must include benefit-incidence studies (to identify the distribution of public spending across income groups) as well as participatory poverty assessments in which communities assess the quality of services they do receive (if any) and identify priorities for new spending (Norton 1999, van de Walle 1995).

Budgets are often drawn up on the basis of historical patterns, and do not reflect new priorities—especially in poverty reduction. Moreover, actual spending patterns may bear little relation to budgeted allocations due to loose expenditure control. The practise of 'supplementary' budgets favours politically powerful departments such as defence and the presidency over the social sectors in many countries (Healey et al. 2000). Capital investments are made without budgeting sufficient recurrent funds leading to schools without books, clinics without basic drugs, and roads without maintenance. This problem is exacerbated when donors finance capital investment without due consideration to their recurrent budget implications (see for example Wuyts 1996 on Mozambique) and by instability in revenues—caused by fluctuations in the prices of commodity-exports—which generates expenditure instability.[2] These problems are common to low-income countries, but they are particularly prevalent in conflict and post-conflict economies.

Distortions in expenditure on the civil service are the third dimension of the fiscal crisis. Low pay prevents states from attracting and retaining much-needed skills (one cause of weak budgeting and planning structures), reduces morale, and encourages corruption; the average state wage in Guinea-Bissau is less than half that of a hotel waiter. Retrenchment provides some savings. Eritrea reduced its public workforce by one-third shortly after independence, one of Africa's largest retrenchments, and doubled the pay of the remaining employees (IMF 1997). But the savings from reform are often disappointing since raising civil service wages to market levels is expensive; the professional labour market in post-conflict countries is thin, and the state must compete with aid donors, NGOs, and a revitalized private sector for scarce skills (a constraint that is particularly evident in Mozambique).

The retrenchment that inevitably accompanies civil service reform is politically sensitive. If conducted on a large-scale and rapidly it can have major social costs by depressing the urban labour market. This is true in all countries. However, the policy

2 Revenue instability in SSA is nearly three times higher than in developed economies, and twice as high as in developing Asia—the result of external shocks such as changes in commodity-prices that cause fluctuations in the economy and its revenue base (Bleaney et al. 1995: 887).

dilemma is acute in conflict/post-conflict countries since improving state capacity is an especially urgent priority—leading to pressure for rapid change and retrenchment (as in Eritrea)—but the social costs of retrenchment can be unduly large. This is because public employment accounts for disproportionately large shares of formal private employment when the private sector has contracted during war (in Angola the public sector constitutes 75 per cent of formal employment). Moreover, jobs become even scarcer as demobilization increases the supply of job-seekers. Ethiopia's demobilized soldiers faced a depressed urban job-market in 1991-92, the result of the fiscal reform and an associated reduction in public employment (Daniel Ayalew et al. 1999). Large and sudden public-sector retrenchments may reduce social peace by making it harder for ex-soldiers to reintegrate. Therefore achieving a fast recovery in community livelihoods and private-sector employment—to avoid a destabilizing spike in unemployment—is especially important in the early years of peace. And more concessional aid to finance civil service reform can ease the political dilemmas of post-war governments (Addison 2000).

The underdevelopment of revenue-raising institutions constitutes the fourth dimension of the fiscal crisis. Mobilizing more public revenue from general taxation is crucial for extending basic service provision. Cost-recovery can finance some provision, mainly of higher-level services that disproportionately benefit non-poor groups. But there is limited scope for large-scale cost-recovery in the social sectors, given the need to protect the access of the poor and the victims of war who often need long-term care and rehabilitation (Mwabu et al. 1999). Hence, the need for an increased tax effort.

Raising public revenues requires new institutional innovations. SSA's customs and tax institutions are underfunded, and frequently corrupt. Reforming the customs service is a priority since trade taxes account for large shares of revenue in SSA, especially in conflict countries where internal trade and sales taxes usually contract by more than external trade and tariff revenues. Inefficiency and corruption in the customs service also impedes reconstruction, which is very import-dependent in its first years. Mozambique has undertaken major institutional innovation in this area. The UK's Crown Agents won the first three-year contract (starting in 1997 and subsequently extended) to reorganize the customs service, cut delays in customs clearance, and meet higher revenue targets. Customs revenue rose to US$ 198 million in 1999, based on imports with a value of US$ 730 million, despite a reduction in the average tariff rate under the trade-liberalization programme (Crown Agents 2000). Customs revenue was declining prior to the reform, reaching a low of US$ 86 million in 1996.

Such state/private sector partnerships are a useful way forward, and ideally they should be implemented early in the process of post-conflict recovery when the need for public revenue is greatest. But to be truly effective they must be accompanied by an overhaul of the relevant legislation, and must take place in the context of democratization that provides for legislative oversight of the conduct of the state/private-sector partnership (hence Crown Agents operates within a strict and transparent reporting framework in Mozambique). Proponents of the 'minimal state' generalize from such examples to conclude that a radical reduction in the size and cost of the state is feasible. But most institutional reforms are expensive. Overhauling budgetary institutions and planning systems, regional decentralization, and delivering basic social services—to name just three critical tasks—are resource and skill intensive. Therefore the new development state will eventually look very different to the old state, but it is unlikely to absorb fewer resources, and may well require more.

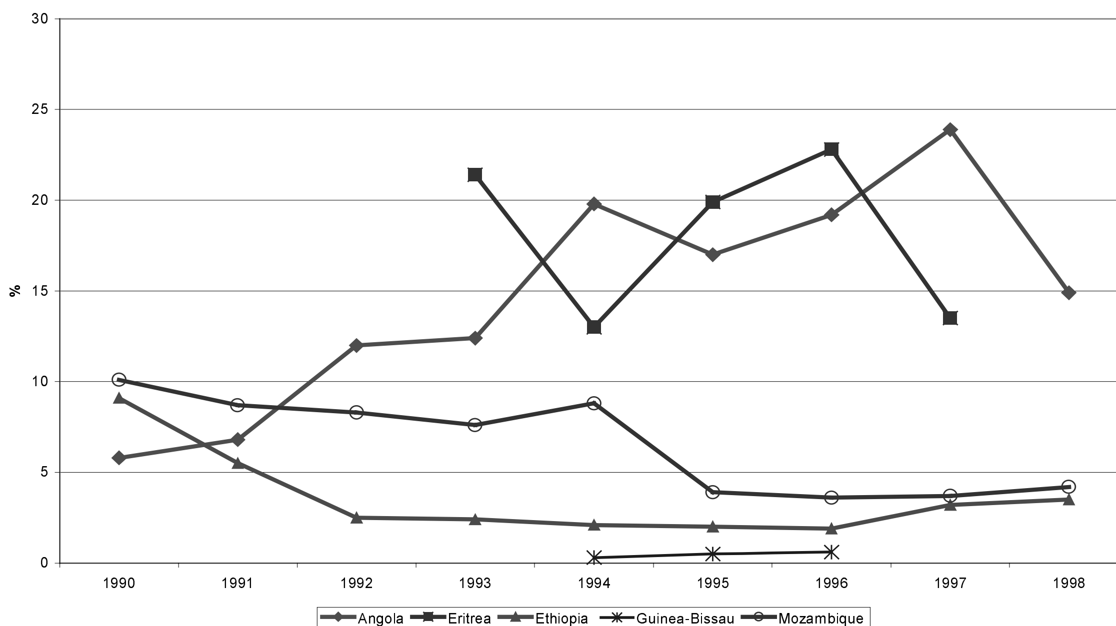
3 The fiscal impact of military spending and the peace dividend

Post-war governments hope for a large fiscal peace-dividend. But this is often limited in the early years of peace (Mohammed and Thisen 1996). Badly paid armies typically live off the land during wars, and civilians bear much of the cost, a 'tax' that is also highly regressive. The post-war state must take over these costs, otherwise they hinder community reconstruction. But demobilization and the creation of a smaller and professional military (often by merging the forces of former belligerents) are expensive and they limit the size of the fiscal peace dividend in the immediate post-war years—unless external aid is forthcoming (Bevan 1994). Figure 1 shows military spending over the 1990s in our case-study countries.[3]

The Eritrean government, for example, incurred large one-off extraordinary expenditures on demobilization, reintegration, and payments to families who suffered casualties in the war for independence. These expenditures peaked at 7.3 per cent of GDP in 1995, and payments to bereaved families alone accounted for 13 per cent of total recurrent expenditures. Establishing a new peace-time defence force was also expensive: the salary costs of this amounted to 2.9 per cent of Eritrea's GDP in 1996, including increased pay for the armed forces, and back pay for ex-combatants (IMF 1997: 7)—a politically-sensitive issue since former fighters demonstrated over delays. As a result of these war-to-peace transition expenditures, Eritrea's military spending averaged 15-23 per cent of GDP over 1993-97 (Figure 1). Table 1 shows military spending for a selection of countries.

Figure 1

Military spending for SSA case-study countries, as a percentage of GDP (1990-98)



Source: SIPRI data reported in Sköns et al. (2000).

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3 Although military spending declined in both Angola and Eritrea over 1997-98 it has subsequently risen with the return to civil war in Angola and the outbreak of the Eritrea-Ethiopia war.

Table 1
Total debt service, health expenditures, military expenditures, and health expenditures as a percentage of military spending (averages for 1990-98)

	Total Debt Service (US$ million)	Health (US$ million)	Military (US$ million)	Health as a % of Military Spending
Case-study Countries				
Angola	578.8	309.4 [m]	978.9	31.6
Eritrea	1.5 [m]	7.5 [m]	100.0 [m]	7.5
Ethiopia	156.7	68.8	218.9	31.4
(1990–1996)		*(59.9)*	*(219.6)*	*(27.3)*
(1997)		*(87.7)*	*(204.2)*	*(43)*
(1998)		*(111.9)*	*(229.0)*	*(48.9)*
Guinea-Bissau	10.4	2.5 [m]	1.2 [m]	209.6
Mozambique	111.3	84.8 [m]	164.3	51.6
(1991 and 1992)		*(91.3)*	*(235.4)*	*(38.8)*
(1997)		*(71.8)*	*(127.2)*	*(56.4)*
Other Conflict /Post-Conflict Countries				
Burundi	36.3	12.3	41.4	29.8
Congo-Brazzaville	261.3	50.3 [m]	----	----
DRC	83.5	73.3 [m]	----	----
Rwanda	19.1	44.4 [m]	77.5	57.4
Sierra Leone	48.6	12.2 [m]	14.4 [m]	85.1
Uganda	146.7	93.3 [m]	89.2	104.5
SSA Countries for Comparison				
Benin	42.4	30.8 [m]	33.2 [m]	92.6
Equatorial Guinea	3.8	4.2	3.2	128.0
Ghana	409.7	95.2	43.3	219.9
Guinea	130.9	39.9 [m]	53.9 [m]	74.0
Madagascar	122.4	40.9 [m]	39.3	104.0
Tanzania	214.6	83.8	81.6 [m]	102.7
Zambia	578.7	68.2 [m]	73.8	92.4

Source: World Bank (2000a and 2000b) and SIPRI data reported in Sköns et al. (2000).

Notes:

[m] signifies that some of the observations are missing.

A break down of the numbers for some of the countries is given in parenthesis.

World Bank (2000a) provides data on health expenditures expressed as percentages of GDP. These data are converted into current US$ by multiplying them by the respective GDPs in current US$. The same procedure was followed for military expenditures.

The total debt servicing data reported here is *ex post*.

Positive fiscal effects are eventually forthcoming if peace holds. In Mozambique, the share of the social sectors in total current expenditures rose from 27.2 per cent to 30.5 per cent between 1996 and 1999, helped by a reduction in military spending after the earlier expenditure on creating a national army out of Frelimo and Renamo forces (IMF-IDA 2000, Sköns et al. 2000: 270). The government's commitment to reducing the military burden is important. But Mozambique has also been fortunate in its geographical position. Since the democratic transition in South Africa in the early 1990s, and until the Zimbabwe crisis of 2000, Mozambique has not bordered countries in major conflict (unlike Uganda where military spending has recently increased).

Closer examination of Ethiopia highlights the consequences of failing to sustain peace. The Derg spent 9.5 dollars on the military for every dollar of military spending elsewhere in low-income Africa, and military spending and social spending are inversely related for the Derg period (Haile Kebret Taye 1997, and Mohammed and Suleiman 1994). Education and health budgets could have doubled over 1974-87 if military spending had remained at its 1973 level (Haile Kebret Taye 1997). Ethiopia benefited from a substantial peace dividend over 1991-98, once demobilization was over (Bevan 2001). In 1989-91, defence spending averaged 46.6 per cent of total current expenditures, whereas social spending accounted for 17 per cent. But in the first three years of peace (1992-95) the defence share fell to 16.4 per cent, and the social expenditure share rose to 23.5 per cent (Colletta et al. 1996: 20) and the latter's share continued to grow reaching 28.8 per cent in 1998 (Bigsten 1999). Military spending as a percentage of GDP therefore fell from 9.1 per cent of GDP in 1990 to a low of 1.9 per cent in 1996 (Sköns et al. 2000: 270).

The 1998-2000 Eritrea-Ethiopia war has reversed progress. The World Bank (1999a: ii) estimates that Ethiopia's military spending has risen to 7 per cent, defence taking at least 23 per cent of total spending—some Birr 3.4 billion (US$ 433 million at an exchange rate of Birr 7.85 = US$ 1) for fiscal year 1998/99 (World Bank 1999a: 73).[4] If the figures are to be believed (and off-budget military spending is unobtainable) then Ethiopia's military budget is over three times as high as its low point in the mid 1990s (1.9 per cent of GDP), but not yet at the level in the last year of the Derg (9.1 per cent), and the share of military spending in total expenditure is still only half the peak Derg level. But macro-economic stability has been maintained at the cost of progress in liberalization; Ethiopia imposed an additional 10 per cent tariff on most imports to raise revenue, thereby partially reversing the tariff reduction conducted under the economic liberalization of the 1990s.

The Bank report concludes that increased revenue mobilization and one-time financing measures such as the utilization of privatization receipts preserved the pre-war gains in real spending on core priorities (education, health and roads programmes) despite the rise in military spending—although the Bank also concludes, rightly, that the war represents a lost opportunity for faster growth in social-sector spending (World Bank 1999a: ii). But the Bank's simulations also show that whereas the fiscal damage has been contained over 1998-2000, the continuation of military spending at 1998-2000 levels will soon erode development spending and cause the unfinanced fiscal-deficit to

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4 The fiscal estimates in World Bank (1999a) were prepared in May 1999. Estimates of military spending were subsequently increased in late 1999, as new data became available (see Annex 2 in World Bank 1999a). We use the revised (higher) estimates.

surge. This is mainly because donors continued to disburse much of the aid committed before the war but are now reluctant to make new commitments until Eritrea and Ethiopia convert the present cease-fire into a peace agreement—without true peace military spending will remain high even in the absence of renewed fighting (and aid fungibility will result in aid-financed military spending: see Addison 2001b). The growth in real consumption per capita under this scenario will be less than half that of the baseline peace scenario in which military spending is cut back to pre-war levels (World Bank 1999a: 75). The effects are therefore dire if Eritrea and Ethiopia cannot achieve peace, especially for the poor. The data does not permit a similar analysis for Eritrea, but the fiscal impact is probably even worse given the scale of the country's mobilization (Hansson 2001, and Gilkes and Plaut 1999 discuss the war's effects on Eritrea).

The fiscal impact of inter-state wars is drastic as Ethiopia illustrates, but it pales in comparison to civil wars that disrupt and destroy state fiscal institutions themselves. In Guinea-Bissau tax collection ceased during the 1998 conflict and domestic revenue in 1998 fell to one-quarter of its pre-conflict level (EIU 2000 quoting the Banque de France). By depressing output—Guinea-Bissau's real GDP contracted by 28 per cent during 1998—conflict also reduces a country's tax base (particularly for sales taxes). This impedes the post-war recovery in public spending (Kovsted and Tarp 1999).

More broadly, high levels of military spending undermine the integrity of state institutions (Gupta et al. 2000 find that corruption is positively associated with high military spending), blocks the improvement of budgeting and planning institutions (since much military spending is kept off-budget: see Adauta et al. 2001 on Angola), and creates large external debt-burdens.[5] High military spending takes resources away from developmental spending, especially social spending (see Gyimah-Brempong 1989 on the SSA evidence). And it damages donor-government relations since partnership through a sectoral approach to budgeting (and a concomitant reduction in detailed policy conditionality) cannot develop when military spending is high, and aid is fungible.

Insecurity and war keeps military budgets at high levels—not only in countries at war, but also among their peaceful neighbours who have legitimate defence concerns. Such negative externalities thereby reduce development and aid effectiveness across Africa (Addison 2000). Peace is a public good, and better regional-peacekeeping together with more international commitment to UN peacekeeping would have substantial rates of return to development—by facilitating deep (and sustained) cuts in military budgets—in addition to the direct humanitarian benefits (Addison and Ndikumana 2000).

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5 For example, in Ethiopia under the Derg, arms imports averaged 158 per cent of total exports (indicating the accumulation of military-related debts to the Soviet Union), against an African average of 13.1 per cent (Haile Kebret Taye 1997).

4 Setting Expenditure priorities and reforming budgetary institutions

Public money must be spent on core pro-poor services: primary education, basic health services and safe water and sanitation. But hard choices still exist within these priorities. Until revenues increase, it may not be possible to simultaneously restore basic infrastructure and make entirely new investments in areas that never had infrastructure. One must be chosen over the other—an undesirable state of affairs. Easing the constraint entails finding savings elsewhere in the government budget, and mobilizing more aid.

In the face of these difficulties, governments and donors sometimes focus on highly visible social programmes which nevertheless have limited coverage, and avoid the hard choices necessary to resource basic services. This temptation should be resisted. Since public-expenditure reform must review the effectiveness of all spending, it can help to meet the objectives of community reconstruction and private-sector development (provided that the fiscal deficit target is not unduly restrictive—see section 6).

Investing in household and community data collection by means of household surveys and participatory assessment clarifies the social impact of reform and identifies the incidence of public spending. This information can be used to sharpen policy's poverty focus, reallocate spending towards the poor, and target post-war safety nets to replace war-time food aid (Addison 1997). Mozambique, for example, is building a good base of poverty information (Datt et al. 2000, de Sousa 1999). Making such data freely available strengthens democracy by informing civil-society debate. The data reveals politically unpalatable facts, such as inequality between regions (a potential source of conflict), but hiding the facts does not ease social tensions—instead it facilitates democratic pressure for their peaceful resolution.

4.1 Fiscal institutions

Having priorities is one thing, being able to implement them is another. Section 2 summarized the problems; planning systems produce 'wish lists' and frequently avoid necessary choices in resource allocation. This is compounded by off-budget projects that divert recurrent spending away from core programmes.

A sector wide approach is increasingly being adopted to improve budgeting and overcome co-ordination problems in key sectors; Mozambique's health sector is an example (Marshall 1998: 169). Under the sector wide approach '... all significant funding for the sector supports a single sector policy and expenditure programme, under government leadership, adopting common approaches across the sector, and progressing towards relying on government procedures to disburse and account for all funds' (Foster et al. 2000: 2). This improves the resourcing of the recurrent costs of capital investments, thereby raising the effectiveness of public investments, and improving the transparency of the budget structure, and its respective donor and government components.

Improper use of public funds is an issue in many countries; it undermines fiscal institutions, and it works against raising the share of basic social spending in total public spending. Mauro (1998) finds a robust negative relationship between corruption and the share of education spending, for example. Moreover, non-transparency in the use of

public funds is closely associated with a country's vulnerability to conflict, since it reduces economic growth, and declining living standards are a leading indicator of conflict (Nafziger and Auvinen 2000). In Somalia a non-transparent budget facilitated the diversion of public money and aid, both of which became political prizes in a process that destroyed the state; '... the structure of the budget of Somalia renders it essentially useless as a tool for analyzing government expenditures' commented a World Bank public expenditure review shortly before the civil war (World Bank 1991 cited in Coolidge and Rose-Ackerman 1997).

Budgetary non-transparency and corruption are common in countries that are rich in natural resources (Leite and Weidmann 1999). In Angola, Congo-Brazzaville, and DRC the revenues are traditionally kept outside the state budget; these countries have suffered severe civil wars in which resource revenues are the prize for capturing the state (Addison et al. 2000). Under its 2000 shadow IMF programme, the Government of Angola agreed to an independent audit to check whether oil revenues reach the central bank's accounts. But this depends entirely on information supplied by the Angolan government, and the use of the revenue once it reaches the central bank is not monitored (see also Adauta et al. 2001). Botswana is one of the few SSA countries to use its mineral rents to fund development; the country's long-standing democracy provides oversight of the budgetary process (Auty 2000). Consequently, democratization is especially important to improving fiscal management in resource-rich countries (Addison 2001a).

5 Debt relief

Public debt service represents a substantial claim on government revenues, which precludes their use for economic and social investment. Table 2 shows the debt profile of our case-study countries: they have debt-to-GDP ratios that are at least double the SSA average. Most of this debt is official, owed to bilateral and multilateral aid donors. Angola has substantial commercial debts, accumulated using oil revenue as collateral. The exception is Eritrea, whose reconstruction over 1991-98 was mostly financed by remittance inflows, rather than external aid (Hansson 2001).

Angola, Ethiopia, Guinea-Bissau, and Mozambique are all 'Heavily Indebted Poor Countries' (HIPCs). Debt reduction has been slow in coming, reflecting a lack of commitment among major donors such as the United States, their public statements notwithstanding (Oxfam International 2000). Under the HIPC initiative, debt relief was finally approved for Mozambique in April 2000, totalling US$ 1.97 billion in net present value terms or US$ 4.3 billion in nominal terms (IMF 2000: 8). After relief, the debt stock will be about one-fourth of the amount that would otherwise have been owed without HIPC Initiative assistance (IMF-IDA 2000: 22). Ethiopia and Guinea-Bissau were on track to qualify for debt relief prior to their recent wars. Their need for debt relief is urgent otherwise the fiscal cost of debt-service will impede recovery, but Ethiopia is unlikely to obtain debt relief unless it makes peace with Eritrea. Angola is a HIPC country, but the IMF concludes that its debt position will achieve sustainability if debt relief is provided under traditional mechanisms (IMF 2000: 8). Angola's 2000 shadow agreement with the IMF is an attempt to cut its interest rate bill, by increasing the share of concessional finance in the country's external debt.

Table 2
External debt indicators for SSA case-study countries (1998)

	Total Debt (US$ billion)	Debt ratio (% of GDP)	Total Debt Servicing (US$ billion)*	Debt service ratio (% of GDP)	Debt service ratio (% of exports)	Public Debt (% of total debt)
Angola	12.17	162.90	1.35	18.10	34.42	87.21
Eritrea	0.15	22.97	0.004	0.58	1.45	96.52
Ethiopia	10.35	158.19	0.12	1.82	11.31	92.92
Guinea-Bissau	0.96	468.93	0.008	3.84	25.63	90.53
Mozambique	8.21	210.84	0.10	2.69	18.03	68.85
SSA	230.13	68.93	14.14	4.24	14.68	74.37
Low-Income Countries	721.59	38.37	65.71	3.49	15.38	70.90

Source: World Bank (2000a and 2000b).

Note: * actual levels of debt service.

The resources released by debt relief could provide a major boost to poverty reduction if wisely used (Addison 1997, Foster et al. 1999). Table 3 shows that even relatively small reductions in debt service can finance a significant proportion of health care—10 per cent of total debt service constitutes about a quarter of Ethiopia's average health expenditures—so a full write-off could give a major kick-start to human capital investment.

Such transfers will only occur if governments are committed to using debt relief for pro-poor public spending. And as with aid itself, debt relief may reduce the incentive to improve tax institutions, thereby damaging the ability to sustain pro-poor recurrent spending over time, if government's are weak in their commitment to raising the tax effort (see Franco-Rodriguez et al. 1998 on the evidence regarding aid and taxation). Poverty Reduction Strategy Papers (PRSPs), which are a pre-condition for debt relief, enable governments to signal their commitment to redirecting resources to the poor. Among our case-study countries, Mozambique has gone the furthest in developing its PRSP (GOM 2000). But although commitment is vital, it is not sufficient, since budgetary and planning systems capable of achieving the resource transfers to priority spending must exist (see section 4). With donor assistance, governments must improve their planning and budgeting systems, in particular through the adoption of Medium-Term Public Expenditure Frameworks (MTEFs). Otherwise the resources released by debt relief will fail to show up in better facilities and services at local level. Hence, a sizeable part of the debt relief (or other aid) will have to be committed to strengthening the state itself.

Table 3
Total debt service (TDS) as a percentage of health and education expenditure, 10 and 50 per cent of TDS as a proportions of health and education expenditures (averages 1990–98)

	Years[a]	TDS as % of Health	TDS as % of Education	10% TDS as a Proportion of Health	50% TDS as a Proportion of Health	10% TDS as a Proportion of Education	50% TDS as a Proportion of Education
Case Study Countries							
Angola	1990 & 1991	154.9	----	15.5	77.4	----	----
Eritrea	1997	2.6	----	0.26	1.3	----	----
Ethiopia	1990–1998	244.1	----	24.4	122.1	----	----
Guinea-Bissau	1990–1994	377.4	164.2	37.7	188.7	16.4	81.1
Mozambique	1990–1997*	107.3	----	10.7	53.7	----	----
Other Conflict Countries							
Burundi	1990–1998	313.3	123.8	31.3	156.6	12.4	61.9
Congo Rep	1990–1998*	685.9	----	68.6	343.0	----	----
DRC	1997	17.1	----	1.7	8.5	----	----
Rwanda	1990 & 1997	49.0	28.9	4.9	24.5	2.9	14.5
Sierra Leone	1992–1997	234.2	1678.3	23.4	117.1	167.8	839.1
Uganda	1993–1997	168.2	97.6	16.8	84.1	9.8	48.8
Non-Conflict Countries							
Benin	1990–1998	137.6	----	13.8	68.8	----	----
Equatorial Guinea	1990–1997	159.1	----	15.9	79.5	----	----
Ghana	1990–1998	428.5	154.2	42.8	214.2	15.4	77.1
Guinea	1990–1997	323.7	121.8	32.3	161.8	12.2	60.1
Madagascar	1992–1997*	256.2	347.1	25.6	128.1	34.7	173.6
Tanzania	1990–1998	276.4	----	26.7	133.7	----	----
Zambia	1990–1998*	901.6	291.0	90.2	450.8	29.1	145.5

Notes: [a] Years: the years over which the averages for the TDS/health/education ratios are computed. The choice of years is based on data availability for the period 1990–98.

Total expenditures refer to total public spending inclusive of net lending. For education expenditures the data are for the years 1990-94.

* Some of the data points in between the given years are unavailable.

The proportions are calculated as x% (10% and 50% respectively) of the total debt servicing expressed as percentages of the total health and education expenditures.

Sources: World Bank (2000a and 2000b). Data on public education expenditures are from the World Bank data base on Genuine Savings in World Bank (1999b).

6 The macro-fiscal framework

Fiscal deficits are generally very high in conflict countries (due to the burden of military spending and the collapse of the revenue base) and 'post-conflict' countries (due to the size of reconstruction spending). Therefore, Mozambique's fiscal deficit excluding grants was between 15 and 19 per cent of GDP over 1990-95 (Figure 2). Many post-conflict countries are very dependent on programme aid for budget support (Table 4 and Figure 3). Aid inflows allowed Mozambique to reduce its fiscal deficit including grants to a manageable average of 3-6 per cent of GDP over 1990-95 (Figure 2). The exceptions to aid-dependence are Eritrea (by choice) and Somaliland (which is not an internationally recognized state).[6]

IMF fiscal conditionality remains controversial (Killick et al. 1998). The present debate mainly centres on economies that have achieved stabilization by bringing inflation under control. Some SSA countries have yet to complete stabilization and reduce inflation below growth-damaging levels—notably Angola and the DRC. But SSA as a whole has shown progress; the average fiscal deficit (including grants) fell from 5 per cent of GDP in the first half of the 1990s to 3 per cent in 1995-98, and the average inflation rate fell from 29 per cent to 21 per cent (IMF 1999: 142).[7] Growth, rather than further inflation reduction, is therefore the urgent priority for post-stabilization economies. The Fund's critics argue, however, that IMF advice and conditionality remain too demanding in the post-stabilization period; specifically the Fund is overzealous in seeking reductions in the fiscal deficit excluding aid (and may, indeed, insist on a primary surplus). This is one of the conclusions of the review of the IMF's Enhanced Structural Adjustment Facility (ESAF) by a group of independent expert economists (IMF 1998: 31).[8]

An over-tight macro-fiscal policy has four undesirable consequences for a post-stabilization economy. First, it limits the public investment budget, and thereby the supply of public goods that are essential to private sector growth. Many investment projects with potentially high social returns may be left on the shelf if the fiscal deficit excluding grants is cut too severely, thereby impeding reconstruction and poverty reduction. Moreover, if two projects are complementary (for example, a basic health care project and a primary education project), but the budget constraint permits only one investment, then the social rate of return for the single project is lower.[9] This implies both lower growth and slower social recovery.

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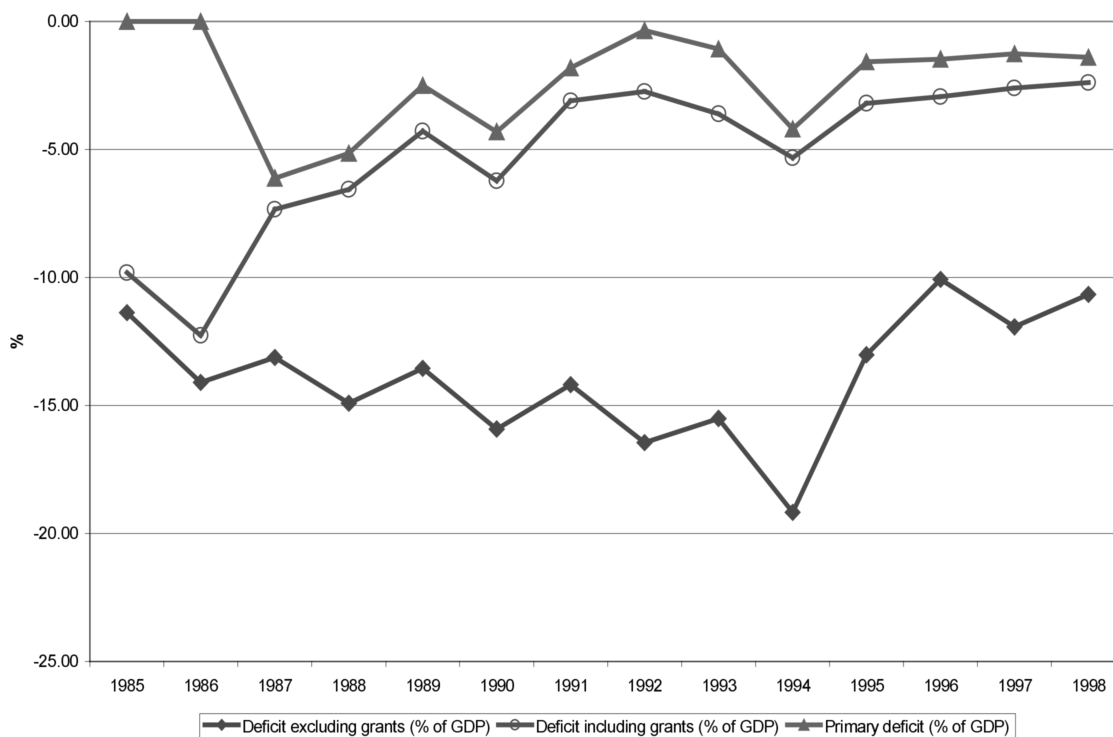
6 Somaliland unilaterally seceded from Somalia in the early 1990s.

7 The SSA median inflation rate declined from 11 per cent to 8 per cent from the early to the later 1990s (IMF 1999: 142).

8 The IMF's ESAF is now the Poverty Reduction and Growth Facility.

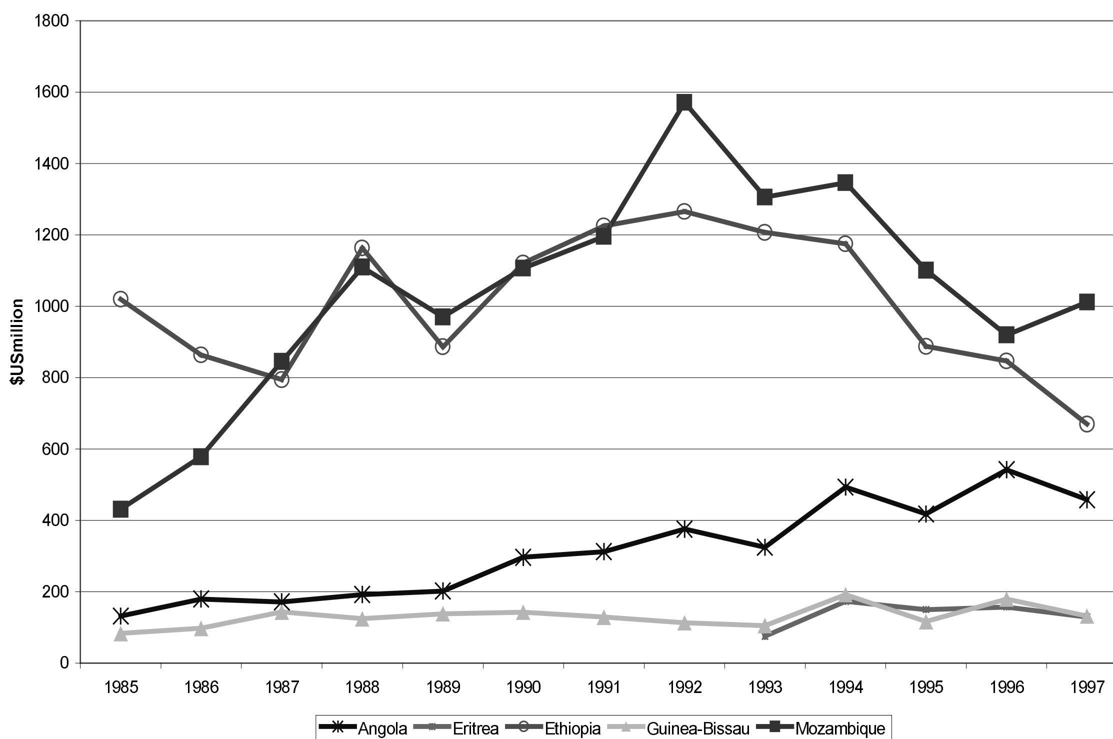
9 There is considerable evidence that social sector projects are complements to each other. For instance improving female education raises the effectiveness of health care services because women are the main health care providers in the household.

Figure 2
Mozambique: measures of the fiscal deficit as percentages of GDP, 1985-98



Source: World Bank (2000b).

Figure 3
Net ODA disbursements for SSA case-study countries at constant prices



Source: World Bank (2000b).

Second, an over-restrictive fiscal-deficit target can cause a shortfall in the recurrent expenditures necessary to match donor-financed capital expenditures, thereby reducing the private and social returns to infrastructure investment. For example, donor funded schools are left with insufficient teaching materials and unpaid teachers, so neither children nor society reap the full benefit of schooling. Aid disbursement can also be derailed. Mozambique is a case in point. Inflation was reduced from over 150 per cent in the late 1980s to less than 50 per cent by 1996, as increased aid reduced the unfunded (monetized) deficit and as output started to recover (see Ubide 1997). This was a good performance for a country coming out of civil war (as compared to Angola or DRC for example), and inflation is now just 6 per cent. But the fiscal deficit excluding grants rose from 15.92 per cent of GDP in 1990 to 19.17 per cent in 1994 (Figure 2). This reflected expenditures on resettlement, demobilization and the elections in the period between the 1992 peace accords and the 1994 elections, as well as the increase in aid flows and the resulting surge in recurrent spending to match aid-financed capital spending (the fiscal deficit including grants fell from 6.22 per cent of GDP to 5.33 per cent). In 1995, however, the IMF threatened to suspend lending unless the deficit excluding grants was radically cut (Addison and de Sousa 1999). The World Bank and the Scandinavian bilateral donors challenged and overturned this overly short-term view by arguing that aid disbursement and reconstruction would stall if the Fund persisted

Table 4
Aid inflows for case study countries and comparison countries

	Total net official development assistance (ODA) received, 1998 (net disbursements)		
	US$ millions	As % of 1998 GNP	Per capita (US$)
Case Study Countries			
Angola	335.2	9.7	27.9
Eritrea	158.2	20.6	40.8
Ethiopia	647.5	10.0	10.6
Guinea-Bissau	95.7	50.5	82.4
Mozambique	1,039.3	27.9	61.3
SSA Countries for Comparison			
Senegal	502.1	10.6	55.6
Tanzania	997.8	12.9	31.1
Uganda	470.8	7.1	22.5
Group Averages			
Average for Low Income Countries	--	1.4	6.9
Average for UNDP Low Human Development Group	--	6.7	18.6

Source: UNDP (2000).

with over-tight fiscal conditionality (Hanlon 1996). The IMF has been more flexible over Mozambique's fiscal policy during the last five years.

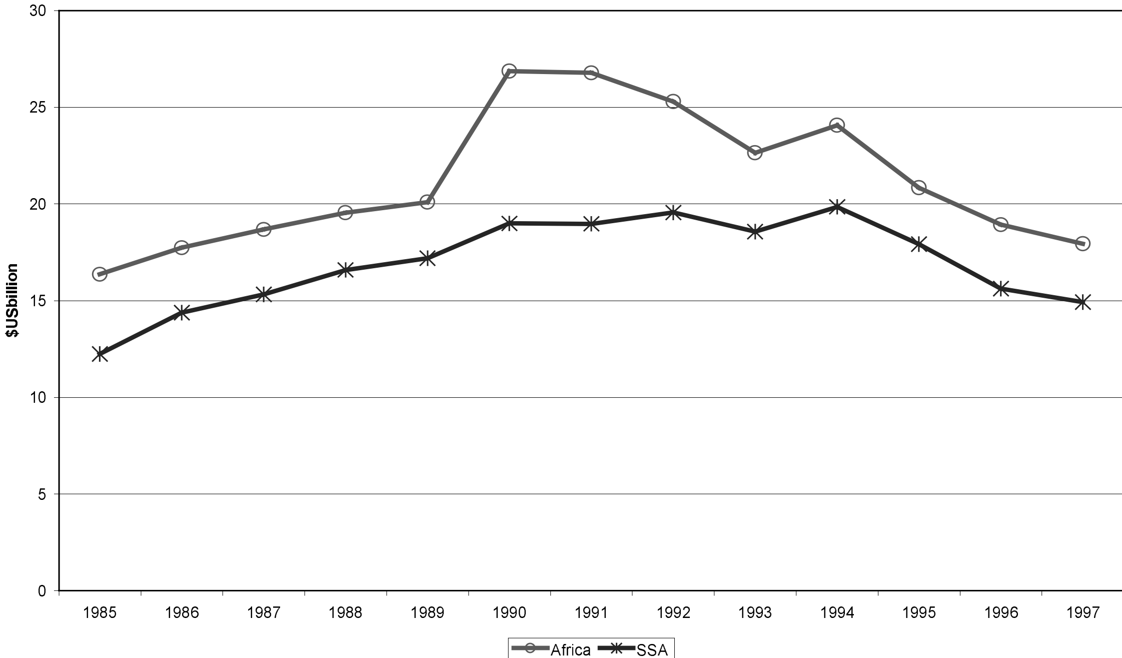
Third, until investments in improving customs and tax institutions take full effect, an over-restrictive fiscal target can force governments into imposing greater taxation on the existing tax base in ways that harm growth. Trade and petroleum taxes are the main culprits; higher tariffs raise the cost of key imports thereby reducing private investment while petroleum taxes raise transport costs—therefore constraining the revitalization of rural trade, agricultural marketing, and food security (see for instance IMF 1998: 32, on Uganda).

Finally, a very tight target for the fiscal deficit may encourage governments to keep expenditures off budget, and bilateral donors may collude if they conclude that the IMF's fiscal framework is an impediment. This undermines better budgetary management (and the adoption of sector wide and MTEF approaches), and thereby reduces the focus of public money on core expenditures. In general, the evidence shows that over-rigid fiscal rules act as a disincentive to investments in improving budgetary institutions (Alessina and Perotti 1996).

6.1 Aid financing

The question of whether the IMF's fiscal conditionality is too tight or not partly depends on our view of how much aid is available to finance budgets. The IMF argues that a large fiscal deficit excluding grants leads to the risk of being unable to finance core expenditures if a sudden downturn in aid occurs (or if aid is on a downward time trend).

Figure 4
Net ODA disbursements for Africa Region and Sub-Saharan Africa at constant prices



Source: World Bank (2000b).

Aid can cause a decline in government spending or a widening of the unfunded fiscal deficit if, for example, donors fail to disburse after commitment. The IMF therefore advises governments to eventually try and match their recurrent revenue (which excludes the one-off proceeds of privatization) to their recurrent expenditure. Any aid shortfall will therefore reduce public investment and economic growth but not recurrent spending and core state functions.

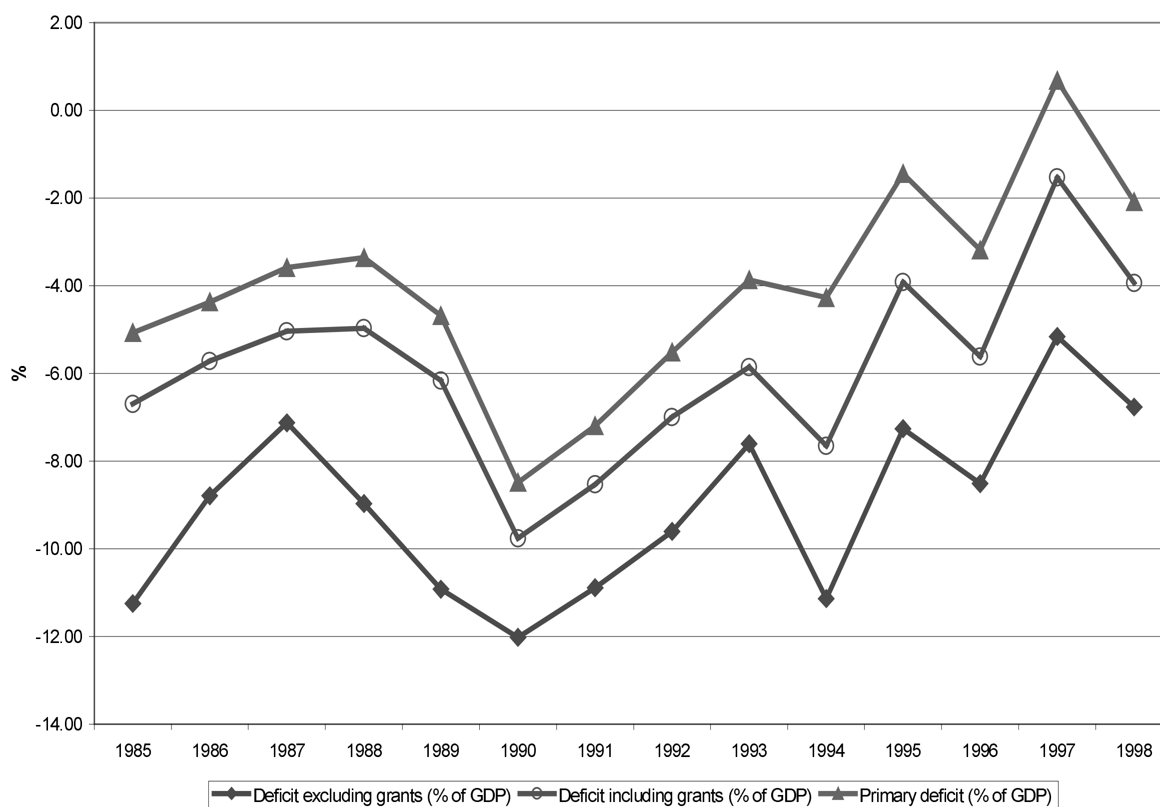
Aid is certainly in aggregate decline; net official financing for development fell from US$ 63.5 billion in 1990 to US$ 52.2 billion in 1997, and aid to SSA fell from US$ 26.7 billion (at constant prices) in 1991 to US$ 17.94 billion in 1997 (see Figure 4, Randel et al. 2000 and UNCTAD 2000). And aid has been a relatively unstable form of government finance (see Gemmell and McGillivray 1998 on the evidence).

Critics of the Fund argue that it is being unduly pessimistic about the prospects for aid inflows. Aid to post-stabilization economies may rise as donors increasingly focus on countries with good policies and a commitment to poverty reduction (for a statement of this argument see the report of the independent panel of experts for the ESAF evaluation in IMF 1998: 32). Certainly, the evidence of Burnside and Dollar (1997) suggests that aid is only effective when the policy environment is supportive. In 1998 Joseph Stiglitz (the World Bank's chief economist at the time) took the case of Ethiopia—the largest recipient of Bank lending in SSA—to mount a thinly disguised critique of the IMF position on fiscal policy:

> 'For the last several years Ethiopia has run a deficit of about 8 per cent of GDP. Some outside policy advisers would like Ethiopia to lower its deficit. Others have argued that the deficit is financed by a steady and predictable inflow of highly concessional foreign assistance, which is driven not by the necessity of filling a budget gap but by the availability of high returns to investment. Under these circumstances—and given the high returns to government investment in such crucial areas as primary education and physical infrastructure (especially roads and energy)—it may make sense for the government to treat foreign aid as a legitimate source of revenue, just like taxes, and balance the budget inclusive of foreign aid' (Stiglitz 1998: 10).

Indeed, as Figure 5 shows, the time-trend of Ethiopia's fiscal deficit excluding grants has consistently fallen from 1991 to 1997, continuing the impressive fiscal adjustment of the first five years of reconstruction (Bevan 2001). Nevertheless, despite the strength of Stiglitz's perspective, fiscal policy has been overtaken by the events of war which have endangered the sustainability of large aid inflows to Ethiopia (see section 3). Sustaining peace is therefore essential to maintaining aid inflows, which are in turn essential to avoiding an unduly restrictive fiscal policy.

Figure 5
Ethiopia: measures of the fiscal deficit as percentages of GDP, 1985-98



Source: World Bank (2000b).

7 Conclusions

An effective development state is essential for recovery from war. Community and private-sector development will remain stunted, and poverty will remain high, without a state capable of designing and implementing broad-based development strategies, and within the framework of a democracy which ensures independent oversight of the state's actions. This paper has argued that the new state agenda will remain a wish list unless it is properly financed, which it is not present. Reconstruction expenditures are high and revenues are low. Africa's conflict countries are severely indebted, and debt-service imposes its own fiscal burden.

The construction of a development state therefore requires reform to take place alongside reconstruction. This is especially evident in the area of fiscal policy, since more revenue must be mobilized to fund basic services, and the structure of public spending must be comprehensively reviewed and altered for communities and the private-sector to get the services and infrastructure that they most need. And, reform provides the opportunity to remove discrimination in public spending (by ethnicity and region) that may have caused conflict (Ndikumana 2000). But although reform is necessary, it must be well-designed. We have argued that IMF fiscal-policy conditionality can be over-restrictive for post-stabilization economies, and may slow recovery and impede the efforts of other donors to assist governments. We must ensure

that the macro-economic framework is supportive of the reconstruction and poverty-reduction objectives.

Ideally, this means designing fiscal policy from the 'sector-up'—identifying and costing development expenditures for fast recovery and poverty-reduction and then mobilising domestic revenue, aid and debt relief for the necessary resources—rather than proceeding from the 'macro-down' in which the fiscal-deficit target is set with insufficient regard for its development consequences. This implies greater co-ordination between donors and governments—especially between the IMF and the other actors. It also requires that fiscal policy be placed in a growth framework. Consequently, starting from a point of low post-war investment, and provided that sound public investments are chosen, their realized returns should exceed the cost of finance (grant aid and concessional borrowing). The tax base rises with growth, and more revenue can be mobilized as investments in tax institutions take effect. Budget balance (or surplus) excluding grants in future years can then offset a high fiscal deficit in the early years of reconstruction, so that public-debt does not reach unsustainable levels. To put in place such a longer-term fiscal framework we need to move beyond the restrictive time-frames of traditional IMF lending. Moreover, the IMF's financial-programming framework is largely a set of accounting identities rather than a true forecasting model (Tarp 1993). It is therefore very limited as a means for devising a fiscal framework for reconstructing economies when much of the future fiscal position will be driven by the rate of return on post-war investment and the recovery of the tax base (i.e. dynamic effects). Hence, methodological innovation is needed to build better fiscal frameworks for post-conflict economies.

But of course putting in place a longer-term policy framework is only possible in countries whose governments are committed to fiscal responsibility, and in which appropriate institutions are being built. As Addison (2001a) argues, countries characterised by conflict suffer from rising uncertainty in which the incentives to build better institutions—including the incentives of state actors—are eroded. Therefore the economics of fiscal policy cannot be seen in abstraction from the political measures necessary to secure democratization and to end war. For donors, this implies a closer integration of aid to economic reform with assistance to democratization, a greater focus on peacekeeping to lower insecurity and thereby increase the effectiveness of development aid, and more aid and debt relief for states that are committed to broad-based reconstruction and poverty reduction.

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