

# Reallocations of Special Drawing Rights and Financing of the Economic Recovery in Senegal

Fanta Ndioba Sylla  
and  
Abdoulaye Diagne

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By

Fanta Ndioba Sylla

Consortium pour la Recherche Economique et Sociale (CRES)

and

Abdoulaye Diagne

Consortium pour la Recherche Economique et Sociale (CRES)

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# Contents

List of tables

List of figures

List of abbreviations and acronyms

1.	Introduction	1
2.	Macroeconomic situation of Senegal	2
3.	Debt, public investment and economic growth	9
4.	Strategies for Senegal to access SDRs	12
5.	Conclusion	22
	Notes	24
	References	25

## List of tables

1.	Distribution of the total debt into concessional and commercial debt in 2021	5
2.	Public debt statistics	5
3.	Public debt risk rating of Senegal	6
4.	Evolution of the current account transactions (in billion CFA francs)	6
5.	External position of Senegal (in billion CFA francs)	7
6.	Evolution of public revenues (as % of GDP)	14
7.	Use of SDRs by Senegal (in billion CFA francs)	19

## List of figures

1.	Evolution of public revenues and expenditures (in billion CFA francs)	3
2.	Budget balance as % of GDP	3
3.	Public debt as % of GDP	4
4.	Evolution of Senegal's terms of trade index	7
5.	Official exchange rate in units of domestic currency per US dollar	8
6.	Link between debt and public investment	9
7.	Debt payment schedule in billions CFA francs	10
8.	Link between debt and economic growth	11
9.	Official development aid and illicit financial outflows in developing countries (2003-2012)	17

## List of abbreviations and acronyms

ADB	African Development Bank
AFD	Agence Française de Développement (French Development Agency)
BCEAO	Banque Centrale des États de l'Afrique de l'Ouest (Central Bank of West African States)
COVID-19	Corona Virus Disease 2019
DAC	Development Assistance Committee
DPEE	Direction de la Prévision et des Etudes Economiques (Directorate of Forecasting and Economic Studies)
EPSI	Economic Policy Support Instrument
FDI	Foreign Direct Investment
FONSIS	Fonds Souverain d'Investissements Stratégiques (Sovereign Strategic Investment Fund)
GDP	Gross Domestic Product
ILO	International Labour Organization
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contributions
LDCs	Least Developed Countries
MDRI	Multilateral Debt Relief Initiative
MFB	Ministry of Finance and Budget
OECD	Organization for Economic Co-operation and Development
PSE	Plan Sénégal Emergent (Plan for an Emerging Senegal)
RST	Resilience and Sustainability Trust
SDRs	Special Drawing Rights
WAEMU	West African Economic and Monetary Union
WDI	World Development Indicators

# 1. Introduction

The Senegalese economy has recently been hit by a combination of multiple shocks, after a period of sustained growth of 6% on average for six years (2014-2019). In 2020, the COVID-19 pandemic led to the slowdown or even cessation of activities in several sectors, leading to a decline of more than three points in real GDP growth. Economic growth fell from 5.3% in 2019 to 1.5% in 2020 (Direction de la Prévision et des Etudes Economiques [DPEE], 2020, 2021). Geopolitical tensions in Ukraine have hard hit the Senegalese economy in 2022. This combination of external shocks has amplified the effects of climatic shocks which have worsened over the last decade.

After a major shock affecting the economy, it is imperative for the Senegalese authorities to undertake reforms in the policies in force, in order to put the economy back on a sustained growth trajectory. These new policies require substantial funding, while the resource needs for dealing with the COVID-19 crisis in the short term have already caused high strain on public finances. After many efforts to bring down the budget deficit to 3.9% in 2019, this deficit rose again to 6.4% in 2020 (DPEE, 2020, 2021). This public deficit is mainly financed by borrowing, which resulted in a rapid increase in debt, rising from 52.5% in 2019 to 67.4% of GDP in 2020. These high levels of debt and public deficit are likely to reduce the chances of mobilizing resources to finance the economic recovery, even in a context of suspension of the West African Economic and Monetary Union (WAEMU) convergence pact. Senegal thus finds itself in the situation of having to find innovative and flexible instruments of financing that would not worsen the public deficit and debt.

In response to the negative knock-on effects of the COVID-19 pandemic on the economies around the world, the International Monetary Fund (MF) has established a new mechanism for reallocation of the Special Drawing Rights (SDRs), called the Resilience and Sustainability Trust (RST), to enable vulnerable countries to finance their economic recovery policies. Senegal is one of the countries that have expressed an interest to benefit from the new resources, but their access is subjected to a host of conditionalities.<sup>1</sup>

To what extent could Senegal access SDRs reallocations to finance the economic recovery without leading to the deterioration of the deficit and the public debt rate? This research project proposal seeks to address this concern, which is at the heart of the country's economic prospects.

## 2. Macroeconomic situation of Senegal

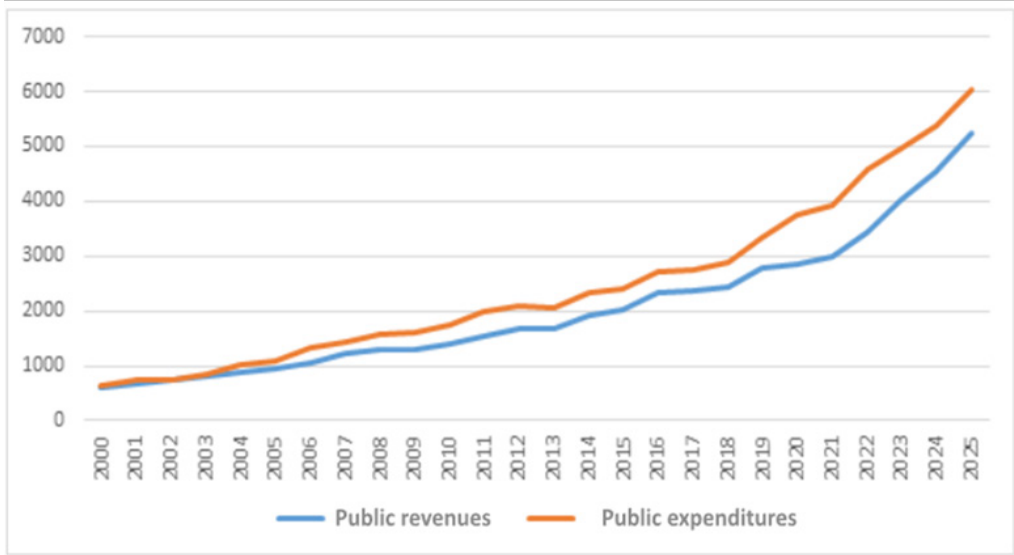
The Senegalese economy has experienced growth disruptions due to a combination of the COVID-19 pandemic shocks and geopolitical tensions in Ukraine. In addition to this unfavourable context, there were significant inflationary surges recorded since the start of 2022 which are estimated on average at 9.6% for 2022, against an inflation rate of 2.2% in 2021. They mainly result from the increase in food prices of 15% on average in 2022, against an increase of 2.9% in 2021 (World Bank, 2023). This situation translates into negative consequences on the country's budgetary and external accounts. Recent developments in public finances and the knock-on effects of the crises on Senegal's external situation over the period 2020-2025 will be examined in this section.

### Public finance developments

The public finances of the Government of Senegal are characterized by public expenditures that are higher than revenues with a structurally negative budget deficit. At the start of the 2000s, public expenditures were slightly higher than public revenues, which resulted in a budget deficit that was close to zero. However, from 2004 onwards, public expenditures increased at a faster rate than public revenues. This resulted in a progressive deterioration of the public budget deficit. The gap between revenues and expenditures gradually narrowed between 2010 and 2017, bringing the budget deficit from 5% of GDP in 2011 to 3% of GDP in 2017 as shown in figures 1 and 2. This deficit started to deteriorate from 2018 before dropping suddenly in 2020 coinciding with the COVID-19 pandemic, to reach 6.4% of GDP. The 2020 fiscal year is characterized by poor performance in revenue collection and high public spending due to the substantial financing needs created by the outbreak of the pandemic. The policy measures meant to contain the COVID-19 pandemic were the main factors which impacted the economic activity and government revenues. The budget deficit was maintained above 6% in 2021 and 2022. The budgetary good performances achieved thanks to economic growth over the last two years have been accompanied by greater financing needs generated by the high budgetary costs of energy subsidies and investments in capital goods as part of the implementation of the Plan for an Emerging Senegal (PSE), which resulted in a progressive increase in the public deficit. The policy measures taken to mitigate the shocks due to the COVID-19 pandemic and

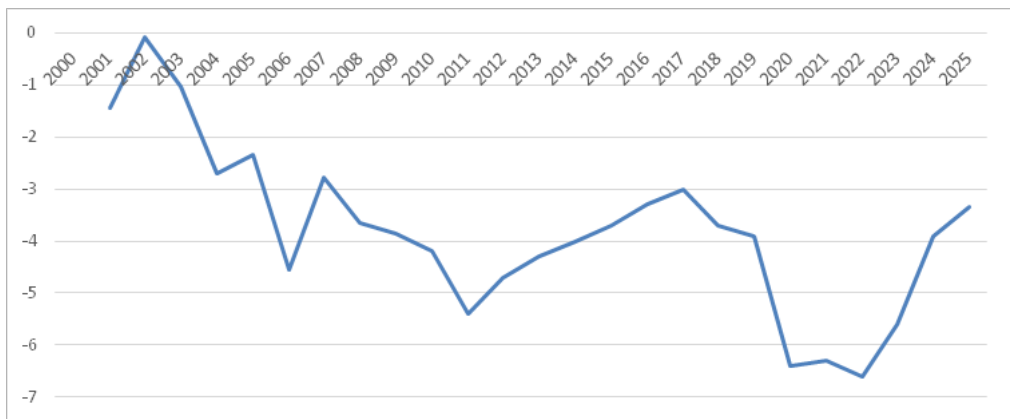
geopolitical tensions in Ukraine have aggravated this situation. Projections show that the budget deficit is expected to improve and reach -3% by 2025; this performance will be achieved notably through consolidation of public spending and sustained increase of public revenues.

Figure 1: Evolution of public revenues and expenditures (in billion CFA francs)



Source: IMF database.

Figure 2: Budget balance as % of GDP

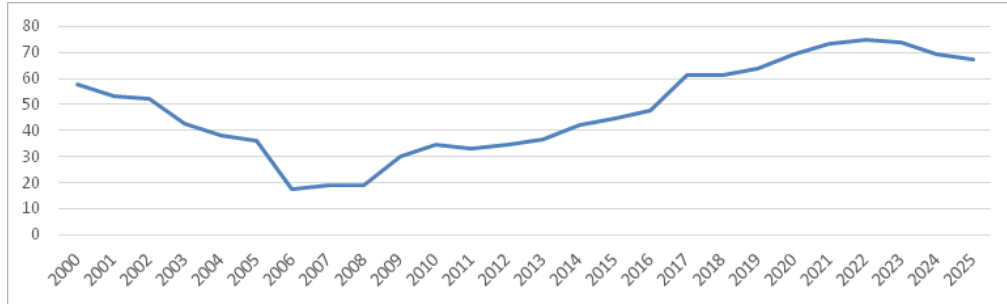


Source: BCEAO database.

The gradual surge in the public deficit has increased the recourse to public debt. Between 2000 and 2006, the outstanding debt dropped drastically from 73.7% in 2000 to 21.8% in 2006. Senegal had indeed benefited from the Multilateral Debt Relief Initiative (MDRI), which reduced significantly the stock of public debt in 2006. Over the following years, Senegal's outstanding debt increased again rapidly to reach more than 44% of GDP in 2015 and 61.5% in 2018, notwithstanding the revaluation of the

GDP by 30% in 2014. The issuance of a Eurobond worth US\$2.2 billion in March 2020, part of which was used to refinance onerous debts contracted, contributed to the rapid growth of Senegalese external debt between 2020 and 2022. The debt reached 73% of GDP in 2022, exceeding by three points the debt convergence threshold set at 70% by the West African Economic and Monetary Union (WAEMU). The debt is expected to revert to 65.7% of GDP in 2024, which is slightly below the WAEMU debt threshold. Hydrocarbon projects whose exploitation should begin in 2024 will make it possible to quickly reduce the debt/GDP ratio thanks to favourable economic dynamics.

Figure 3: Public debt as % of GDP



Source: IMF database.

In recent years, the increase in public debt has occurred through non-traditional channels. The structure of Senegal's external debt has witnessed two notable developments. First, the share of traditional creditors, namely the Organization for Economic Co-operation and Development (OECD) countries, has fallen significantly in favour of that of the so-called emerging countries, in particular China and Turkey. Further, we saw a rise in the debt issued in the international financial markets. The explanation for this trend is that strong growth in international liquidity and falling yields in OECD countries have led international investors to find new opportunities in some African countries that previously had no access to the international markets and whose debt level was low. Countries like Senegal have been able to access loans with maturities of five or even twelve years. In 2021, commercial debt predominates over concessional debt.

The total public debt is composed of 48% in concessional debt with a larger share of multilateral creditors (IMF, World Bank, ADB, etc.) compared to bilateral creditors (Paris Club, EXIM China, EXIM India, etc.) and 52% in commercial debt distributed equally between external creditors and domestic creditors (Table 1). The larger share of commercial debt increases the cost of the debt, as this type of borrowing is generally associated with high interest rates, and even higher than those of multilateral and bilateral creditors who lend at rates which are below the market rates. The government contracts little debt on behalf of public enterprises. Indeed, only 8% of the total public debt goes to public companies.

Table 1: Distribution of the total debt into concessional and commercial debt in 2021

Items	% of total debt
Concessional debt	48%
Of which:	
-Multilateral creditors	31%
-Bilateral creditors	17%
Commercial debt	52%
Of which:	
-External	26%
-Domestic	26%
Central administration	92%
Public enterprises	8%

Source: Statistic Bulletin of public debt of the Ministry of Finance and Budget (2022).

The rapid increase of the public debt with a growing share of commercial debt has led to deterioration in the sustainability<sup>2</sup> of Senegalese public debt. The various debt sustainability ratios exceed the threshold levels defined by the IMF. The debt service ratio to public revenues increased rapidly and remained above the sustainability threshold level of 18% defined by the IMF from 2018. The same is true for the debt service ratio to exports, which exceeded the sustainability threshold level of 15% defined by the IMF from 2017. The outstanding debt ratio to exports is estimated at more than 200% between 2015 and 2022, which is clearly higher than the sustainability threshold level set at 180% by the IMF.

The level of these ratios calls for a budgetary consolidation programme; that is, a plan meant either to reduce public spending or to increase tax revenues (or both) in order to meet debt service requirements.

Table 2: Public debt statistics

	2015	2016	2017	2018	2019	2020	2021	2022
Outstanding debt/exports	211%	218%	260%	309%	282%	272%	275%	268%
Debt service /revenues	10%	9%	13%	18%	23%	20%	25%	23%
Debt service/exports	12%	14%	18%	22%	26%	29%	33%	38%

Source: BCEAO database.

The increase in public debt remains a significant source of risk for Senegal. The debt sustainability analysis conducted by the IMF and the World Bank shows a moderate risk of debt distress (external and global); however, it notes a very limited room for manoeuvre to absorb short-term shocks. The risk rating of the Senegalese public debt has exhibited relatively stable outlook since 2010, except in 2020 when the rating agency Moody's gave a rating with negative outlook to Senegal. These scores influence capital market financing conditions and lenders' investment decisions in international markets.

Table 3: Public debt risk rating of Senegal

Rating Agency	Rating	Outlook	Date
Moody's	Ba3	Stable	18 March 2022
Moody's	Ba3	Negative	07 August 2020
Moody's	Ba3	Under review	12 June 2020
S&P	B+	Stable	06 December 2019
S&P	B+	Positive	15 June 2018
Moody's	Ba3	Stable	13 April 2017
Moody's	B1	Positive	07 November 2014
S&P	B+	Stable	05 July 2013
Moody's	B1	Stable	09 March 2011
S&P	B+	Negative	27 May 2010

Source: Trading Economics.

## External situation of Senegal

Senegal's external situation is characterized by a structural budget deficit with a worsening trend over the last three years. This situation may be explained by the increase in the prices of raw materials in the international markets and the continuation of investments made as part of the development of oil and gas projects. The budget deficit, estimated at 12% of GDP, deteriorated further in 2022 due to higher-than-expected imports of services, linked to hydrocarbon exploitation projects financed by foreign direct investment (FDI). Projections (Table 5) show that the budget deficit is expected to improve and reach 5% of GDP in 2025 as a consequence of hydrocarbon exports which will begin in 2024.

Table 4: Evolution of the current account transactions (in billion CFA francs)

Items	2016	2017	2018	2019	2020	2021
Goods and Services	-1 237,4	-1 688,4	-2 040,1	-1 953,5	-2 626,9	-3 048,8
Goods	-1 164,7	-1 569,0	-1 886,4	-1 687,6	-1 609,7	-1 662,5
Services	-72,7	-119,4	-153,7	-266,0	-1 017,2	-1 386,4
Primary Income	-295,4	-340,9	-333,7	-383,7	-340,9	-367,6
Secondary Income	1 060,4	1 142,2	1 143,5	1 225,2	1 435,4	1 571,4
Current Account Balance	-472,5	-887,2	-1 230,4	-1 112,0	-1 532,4	-1 845,1
Nominal GDP	11 283,4	12 191,8	12 840,2	13 709,6	14 097,9	15 319,1
Current Account Balance as a ratio to GDP	-4,2%	-7,3%	-9,6%	-8,1%	-10,9%	-12,0%

Source: Report on the balance of payments and external global position of Senegal (BCEAO, 2021).

The common foreign exchange reserves of the West African Economic and Monetary Union declined due to high budget deficits in WAEMU countries and slowing capital inflows, but were high enough to cover 4.5 months of potential imports at the end of October 2022.

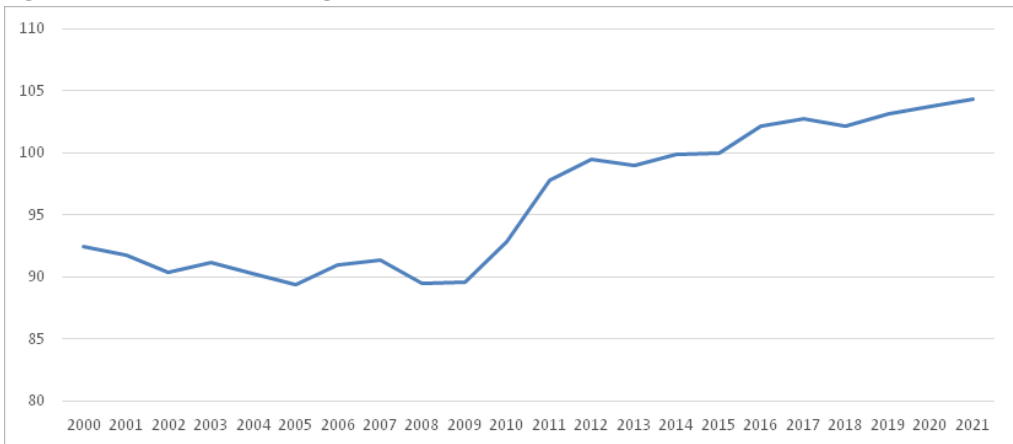
Table 5: External position of Senegal (in billion CFA francs)

	2021	2022	2023	2024	2025
Balance of current account transactions (as % of GDP)	-13,3	-15,7	-15,9	-11	-4,9
Change of foreign exchange reserves (in billion FCFA francs)	-341	-305	123	-128	-170

Source: Report on the economic and social situation of Senegal (World Bank, 2023).

The terms of trade are used to assess the competitiveness of a country in the international goods and service markets. In Senegal, the terms of trade have experienced increasing progress over the period 2010-2021. These improvements were explained by the competitiveness of certain exported products such as plastics and rubber, live animals, and other animal products, as well as mineral products, etc.

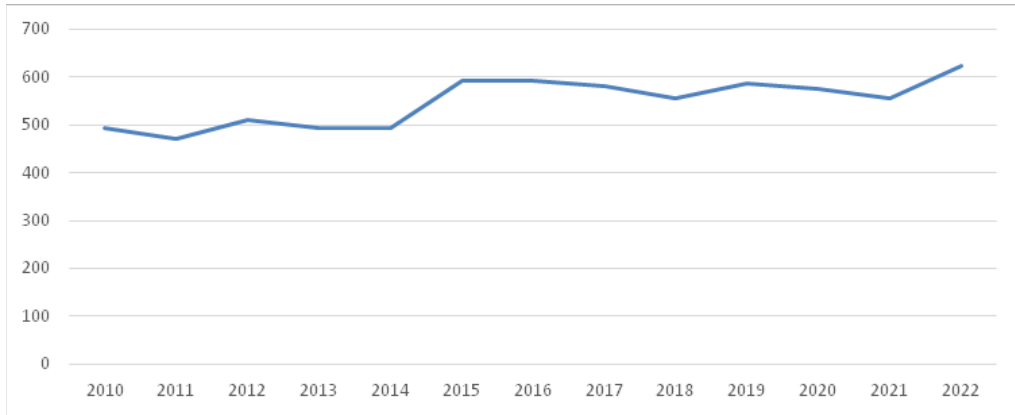
Figure 4: Evolution of Senegal's terms of trade index



Source: World Bank database.

The CFA franc is the official currency of Senegal which it shares with the seven other WAEMU member countries. This currency is managed under a fixed exchange rate regime with the euro. In practical terms, this means that the value of this currency is pegged to the euro and does not experience autonomous changes from day to day. The exchange rate has been fixed at 655.957 CFA francs for one euro. On the other hand, the exchange rate of the CFA franc against the US dollar maintained an increasing trend over the entire 2010-2021 period, albeit with small increases in absolute value.

Figure 5: Official exchange rate in units of domestic currency per US dollar



Source: World Bank database.

Overall, the combination of multiple shocks experienced by Senegal resulted in an unfavourable macroeconomic situation with much strain on the country's budget and external account. This situation is even made more difficult by the heavy burden of public external debt. These pressures will persist over the coming years and will reduce Senegal's room for manoeuvre in the budget execution. The medium-term macroeconomic outlook is expected to be more favourable with the start of oil and gas production in 2024, provided that appropriate macroeconomic policies are pursued. Debt and deficit ratios are expected to be positively influenced by the jump in export earnings.

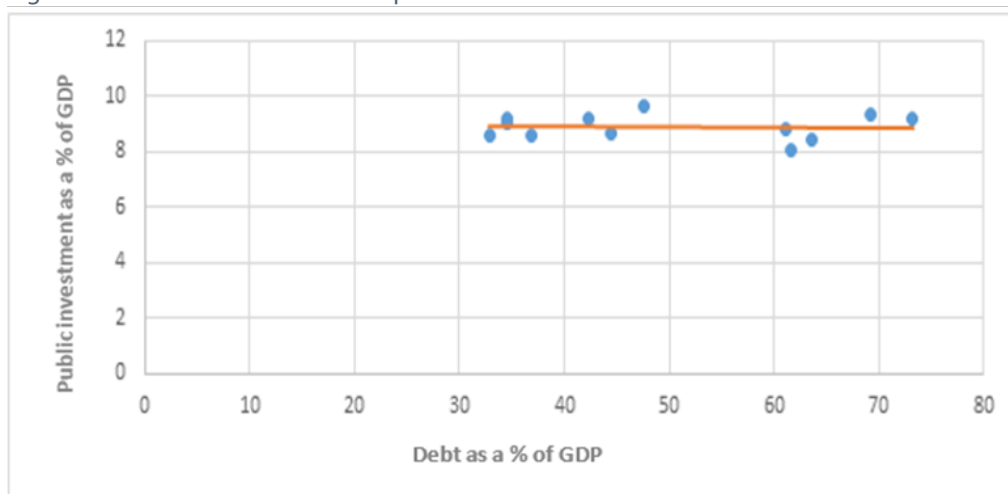
### 3. Debt, public investment and economic growth

Senegal's external debt burden constitutes a major obstacle to its ability to mobilize internal and external resources for development. The priority of the Senegalese Government for the coming years should be the reconstitution of budgetary room for manoeuvre which would help to ensure debt sustainability. To achieve this objective, it is essential to closely monitor the link between debt, investment, and the benefits of the resulting growth. Improving investment efficiency should ensure that debt is used to finance the most productive and growth-generating projects. In this section, we seek to highlight the link between debt, public investment, and economic growth in Senegal.

#### Debt and public investment

Public debt can support an increase in public investment in the sense that it constitutes a funding instrument to finance public expenditure when the government own revenues are insufficient. However, Figure 6 highlights a lack of correlation between debt and public investments in the case of Senegal. This means that the government does not necessarily allocate resources from debt to increase its public investments.

Figure 6: Link between debt and public investment

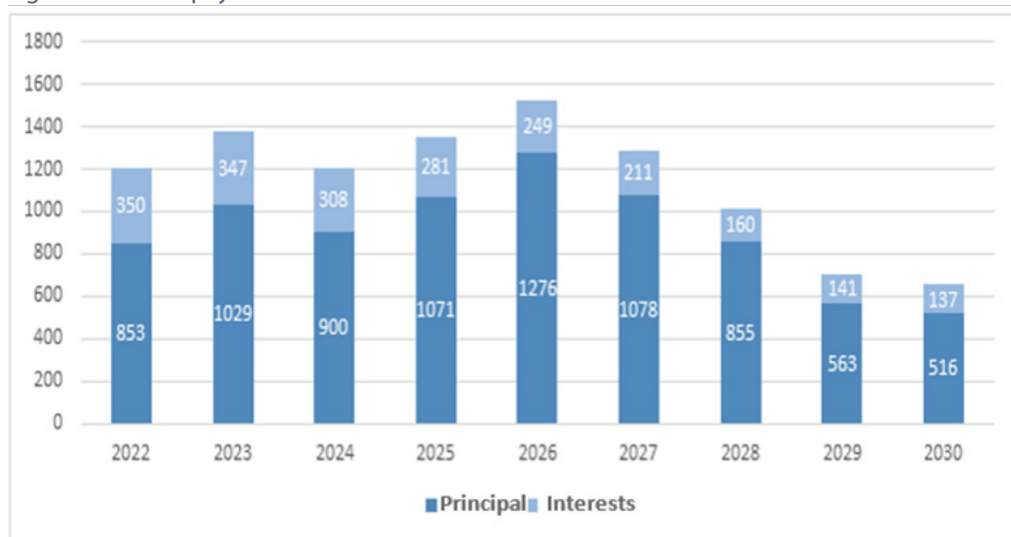


Source: Computed by CRES using IMF data.

Several factors can help to explain this lack of link between debt and investment. One of these factors is that we cannot identify the type of expenditures made possible through debt financing, because debt is fungible with government own revenues (taxes and fees) to finance all of the public expenditures. The government budget is subject to the principle of budgetary universality which assumes that total revenues (taxes and debt) cover the financing of all expenditures (investments and current expenditures), without any relationship being established between specific expenses and specific revenues.

Additionally, the debt could have been used to finance current expenses or debt service repayments. A relative importance of short-term debt compared to long-term debt could suggest that public debt has been used to finance current expenses. Indeed, long-term debt is generally used to finance investments in order to match repayment deadlines with future income flows (cash flows) generated by these investments (Boissinot and Waysand, 2012). Figure 7 illustrates the debt payment schedule over the period 2022-2030. As can be observed, the debt service gradually decreases from 2022 to 2030, with a peak in 2026, mainly due to the start of repayment of the 2028 Eurobond in euros for 218.65 billion CFA francs, before recording a decline until 2030. The payment of the principal represents on average 79% of the annual service. A substantial part of the debt stock will be repaid by 2026. We can therefore consider that the debt is short-term and that it mainly financed current expenditures, especially since the increase in public expenditures that led to the increased use of debt over the recent years is due to high energy subsidies and expenses linked to COVID-19 mitigation measures.

Figure 7: Debt payment schedule in billions CFA francs

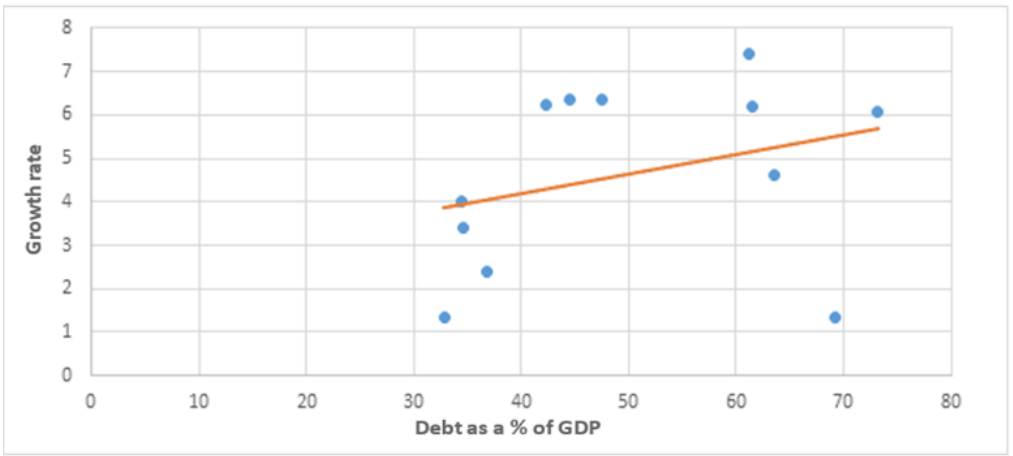


Source: Statistic Bulletin of the public debt of the Ministry of Finance and Budget (2022).

## Debt and economic growth

Figure 8 illustrates a positive relationship between debt and economic growth. Public spending, which is partly financed by debt, constitute an important component of aggregate demand in terms of share in total GDP. They can represent 20% or even 50% of domestic demand (Diagne et al., 2014). It should be noted that debt has supported economic growth through the aggregate domestic demand.

Figure 8: Link between debt and economic growth



Source: Computed by CRES using IMF data.

## 4. Strategies for Senegal to access SDRs

The Resilience and Sustainability Trust (RST) financing mechanism offers the opportunity to use cheap capital to make public investments, as it comes with a low interest rate and a long maturity period. However, these funds are subject to various conditionalities which make them difficult to access.

The access to these funds requires meeting the following conditions:

- Carrying out high-quality reforms addressing structural challenges related to climate change or pandemic preparedness;
- Carrying out at the same time an IMF supported programme comprising public policy measures whose quality gives access to higher credit tranches. The country must be at least 18 months away from the end of the parallel programme whose quality gives access to higher credit tranches; and
- Presenting sustainable debt and sufficient capacity to repay IMF loan.

Senegal meets the second condition since it is implementing an IMF supported programme under the Economic Policy Support Instrument (EPSI). However, in order to increase its chances of accessing RST funds, Senegal must on the other hand strengthen the sustainability of the public debt and its capacity to mobilize domestic resources through economic growth which demonstrate its sufficient capacity to repay the IMF loan.

### Public finances and conditions for access to RST

#### Public debt sustainability

Public debt has grown rapidly leading to the deterioration of its sustainability. The risk of over-indebtedness will quickly materialize if the debt maintains its current progression. This rate of progression then calls for a budget consolidation, which means setting up a plan either to reduce public spending or to increase tax revenue (or both) in order to meet debt service requirements. Another strategy would consist in an effective debt management in order to protect against vulnerabilities linked to public debt in terms of cost and risk.

Debt restructuring is one of the possibilities to improve its sustainability. This is a prudent debt management strategy aimed at minimizing the average cost of debt (possibly replacing very expensive short-term debt with less expensive, longer-term debt) that can help to expand fiscal space. There are three main debt restructuring tools in the case of a sovereign state:

- The extension of maturities;
- The reduction of interest charges; and
- The partial cancellation of an amount of the public debt.

A sharp reduction in new borrowing and indebtedness from international markets would ensure greater availability of public resources in the medium term. This option is in line with the medium- and long-term debt management strategy for the period 2022-2024, which consists in developing the domestic securities market.

Senegal has a medium- and long-term debt management strategy whose aim is to set up the best possible combination between domestic debt and external debt (concessional, semi-concessional, and non-concessional) to cover the financing needs at the lowest cost and risk. The current public debt composition at the end of June 2021 is exposed to three types of vulnerabilities. The first is linked to exchange rate risk because 76% of the public debt is denominated in foreign currencies, including 41% in dollars and other currencies, thus leading to a high exposure to exchange rate risk. The second vulnerability is related to the refinancing risk; approximately 10.9% of the domestic debt is expected to mature within a year with an average maturity of 3.6 years. The third is the interest rate risk. Indeed, 17% of the external debt and 10% of the domestic debt should be repaid in one year (Ministry of Finance and Budget [MFB], 2021). In the Ministry of Finance and Budget's (MFB) medium-term debt management strategy document, several strategies were evaluated to identify which one will reduce the exposure to interest and exchange rate fluctuations, and the risk of refinancing the debt portfolio while minimizing costs (MFB, 2021).

These strategies are:

- Strategy 1: Current financing policy unchanged;
- Strategy 2: Reduction of exposure to exchange rate risk;
- Strategy 3: Development of the domestic securities market; and
- Strategy 4: Strategy focused on the euro.

It turns out that Strategy 3 related to developing the domestic securities market would best help to mitigate the vulnerabilities linked, in particular, to the exposure to the exchange rate that the current portfolio is confronted with. It would present the best cost-risk compromise and improvement of the cost and risk indicators compared to other debt strategies.

## Senegal's tax effort

The efforts made in mobilizing domestic revenues in Senegal remain modest. Although Senegal has achieved significant performance in terms of tax collection, the tax pressure remains relatively low (between 18% and 20% of GDP over the period 2011-2020) compared to that of other developing or emerging countries in different regions of the world. The tax pressure reached 20% in two years only (2015 and 2018 during the 2010s decade). It is close to that of Burkina Faso but is lower than that of Mozambique and the Republic of Congo, which reached more than 30% of GDP in 2019 (Table 6). There are also developing countries in South Asia and Latin America where the rate of tax pressure is higher than that of Senegal. In developed countries, the tax levy can be 2.5 times higher than that of Senegal. The government's ambitions to make Senegal an emerging country, which is set out in the Emerging Senegal Plan, can only be achieved if Senegal's tax levy reaches at least 25% as in all countries which enjoy the status of emerging countries. This additional fiscal effort is also necessary to ensure the sustainability of the public debt.

Table 6: Evolution of public revenues (as % of GDP)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Sub-Saharan Africa										
Republic of Congo	46,4	49,1	50,6	48,1	32,6	34,1	27,9	29,2	31,6	29,5
Burkina Faso	18,4	19,9	21,7	19,2	18,3	18,6	19,2	19,4	20,9	19,5
Mozambique	25	25,2	29,6	30,4	26	23,9	27,1	26	30,4	28,5
Senegal	18,2	18,6	17,7	19,2	20,7	19,5	18,8	20,2	19,3	19,5
Southern Asia										
Nepal	17,8	18	19,6	20,4	20,8	23,3	24,1	25,3	26	25,3
India	19,3	19,8	19,6	19,1	19,9	20,1	19,9	20,2	19,7	19,5
Low-income countries	22,9	23,4	23,1	23,1	23,6	24,9	24,5	23,9	23,7	23,1
Latin America										
Developed countries										
France	51,1	52,1	53,1	53,3	53,2	53	53,6	53,6	52,8	51,7
Denmark	54,4	54,5	54,6	56,4	53,2	52,4	52,8	51,4	53,6	49,1
Italy	45,6	47,6	48,1	47,9	47,8	46,7	46,3	46,3	47,1	46,9

Source: IMF (2020).

## Options for expanding fiscal space

It is possible to expand the fiscal space through various sources and mechanisms, notably through taxation, increase in priority expenditures, borrowing, seigniorage, or through the mobilization of external resources.

### Option 1: Reallocation of public spending

Reallocation of public spending represents the most common solution to create fiscal space. It takes the form of two measures. The first is to shift resources from lower priority positions to higher priority areas. The second is to improve efficiency in resource collection or expenditure; or improve efficiency in order to obtain the same results with fewer resources and thus free up new resources. Increasing spending efficiency includes combating corruption and assessing current budget allocations through public expenditure reviews and thematic budget analyses. The possibility of transferring less priority expenditures to sectors with high growth potential consists in replacing costly investments, with low socioeconomic impact, by expenditures allocated to more productive investments. This type of measures has been applied in certain countries such as Costa Rica, Thailand, South Africa, Lesotho, and Iceland. Its implementation does not require creating a large fiscal space and is not linked to political constraints either. But its application is likely to cause delays. For example, in response to the Asian financial crisis of 1997, Costa Rica and Thailand reduced the military spending budget from 25% to 15% starting in the 2000s to finance universal health care. In the wake of the Arab Spring, Egypt created an economic justice unit within its Finance Ministry to review spending priorities. In Senegal, it is possible to mobilize more resources by reducing or removing energy subsidies. For example, in response to the food crises of 2008, the Government of Senegal adopted a food price subsidy policy aimed at protecting the poor from the adverse effects of the surge in food and fuel prices that occurred in Senegal in 2007. However, this policy of generalized food and fuel subsidies does not really reach the poor, since more than half (55%) of the gains accrue to the richest 40% of the population, and cost up to 3% to 4% of GDP in Senegal (Samson and Cherrier, 2009). In 2018 alone, the blocking of the increase in oil prices cost 105.309 billion CFA francs in compensation of commercial losses for distributors and a need for subsidies of 150 billion CFA francs for Senelec. The difficulty in ensuring good targeting of the beneficiaries of food or fuel subsidies militates in favour of their removal.

### Option 2: Increasing tax revenues

The mobilization of resources by increasing tax revenue rate involves modifying different types of direct or indirect tax<sup>3</sup> rates or strengthening tax collection methods and tax obligations (International Labour Organization [ILO], 2017). In sub-Saharan Africa, the weakness of the tax base resulting from the predominance of informal activity and the rural subsistence economy limits the capacity of economies to mobilize resources through direct taxation. Therefore, countries are making greater use of indirect taxation.

Another possibility of mobilizing resources is the development of the so-called “behavioural” taxes which are both likely to provide additional resources and to encourage “virtuous behaviour”, by leading players to internalize the costs linked to some of their practices (Elbaum, 2012). These taxes could be applied to products such as tobacco, sugar, certain oils, or alcohol. With regard to tobacco, some studies have clearly concluded that this type of taxation is effective in influencing, via price increases, the evolution of consumption (Diagne et al., 2019) while increasing tax revenues.

There is also room for manoeuvre in terms of rationalization or removal of specific exemptions, but these must be considered on a case-by-case basis, and while some of them are quantitatively limited (Elbaum, 2012), others can be important.

A large number of countries are increasing their taxes to strengthen public investment, not only through consumption taxes (which are generally regressive), but also through income taxes, taxes on corporate profits, taxes on ownership, and extraction of natural resources.

In Senegal, there is still room to generate additional resources not yet exploited, representing 11% of the total capacity and more than 2% of national income (Le et al., 2008). Moreover, the tax pressure rate in Senegal stood at 19.3% in 2019, which is below the floor of 20% set in the second-tier convergence criteria of the West African Economic and Monetary Union (WAEMU, 2019). Hence, there is still room available to mobilize resources through an increase in tax revenues.

### Option 3: Lobbying for more aid and additional transfers

Governments can consider three solutions to increase net international transfers and support domestic socioeconomic investments. The first consists in lobbying to strengthen North-South aid flows. In principle, official development assistance is one of the first solutions to consider when there is a need to expand fiscal space, particularly in low-income countries. It refers to all the financing provided by public players in the most advantaged countries to improve living conditions in low- and middle-income countries (Agence Française de Développement [AFD], 2019). Through this channel, donor countries that are members of the Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD) allocated US\$204 billion to recipient countries in 2022<sup>4</sup>. However, in addition to being very uncertain, these aid flows occur through unconventional channels. Donors often choose their best allies among developing countries and those in which they believe they have strategic interests given the scarcity of resources allocated to development and the increase in bilateralism. Between 2008 and 2012, countries such as Afghanistan, Ethiopia, the Democratic Republic of Congo, and Tanzania received aid flows corresponding to more than 2% of global aid while other low-income countries earners receive smaller aid flows ranging from 0.1% (Gambia, Guinea-Bissau, Eritrea) to 0.8% (Rwanda) of global aid (ILO, 2017). For Senegal, statistics have shown that public development assistance is in constant decline. Its share of gross national

income decreased from 30.26% in 2010 to 15.59% in 2017<sup>5</sup>. In addition, Senegal will receive at least nearly 307 billion CFA francs annually starting in 2023 from oil and gas royalties, without taking into account additional earnings from newly discovered oil and gas fields. Revenues from these royalties are likely to have a negative impact on Senegal's public development aid flows.

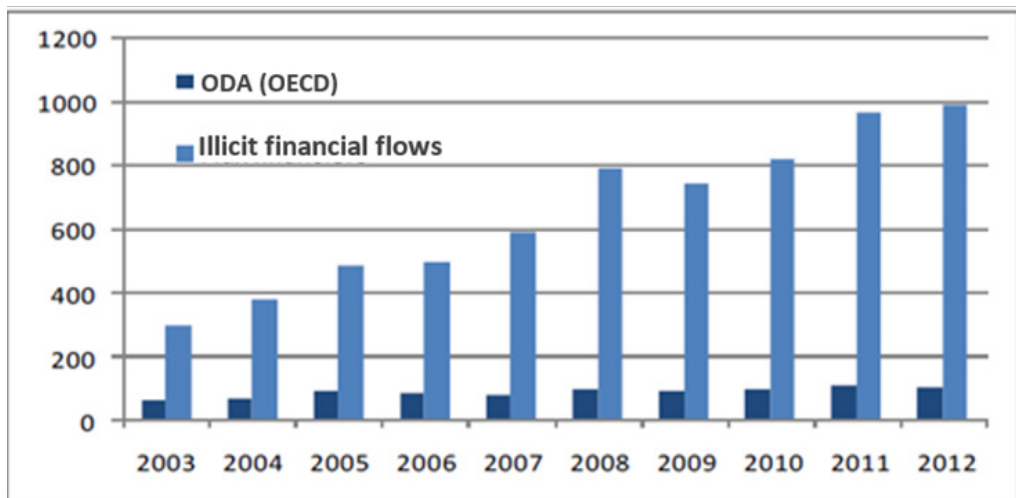
The second solution to increase international transfers consists in creating lobbying in favour of an increase in transfers and development assistance between countries of the South. Considered by governments as a solution to draw on regional and interregional resources to finance socioeconomic development, south-south transfers are increasingly important and are mobilized through three main channels: bilateral aid, regional integration, and regional development banks.

The third solution to boost international transfers amounts to reducing South-North financial flows, such as illicit financial flows (see option 4). In general, external resources (subsidies and aid) can alleviate the national financial constraints encountered by poor countries to finance social protection.

#### Option 4: Fighting against illicit financial outflows

In developing countries, there is a substantial volume of resources flowing out illegally every year. This, not only includes capital that is illegally obtained, transferred or used, but it also includes undervalued traded goods to avoid higher tariffs, tax evasion, and undeclared movements of cash (ILO, 2017). Through the manipulation of transnational trade prices, nearly a thousand billion US dollars in illicit financial flows left developing countries in 2012, nearly two-thirds of which were transferred to developed countries (Kar et al., 2010). The value of these financial flows can be equivalent to almost ten times the amount of total aid received by developing countries as illustrated in Figure 9.

Figure 9: Official development aid and illicit financial outflows in developing countries (2003-2012)



Source: Kar and Spanjers (2014).

Thus, for every dollar of official development assistance received by developing countries, they actually would return seven to rich countries through illicit outflows. The value of average annual illicit capital outflows reached 60% of GDP in Togo compared to 4.4% allocated to health expenditures (ILO, 2017). Given the large volume of resources flowing illegally out of developing countries each year, combating money laundering, corruption, tax evasion, trade price manipulation, and other financial crimes could release significant resources for financing social protection.

In 2016, the Economic Commission for Africa released a report on illicit financial flows which estimated that each year US\$30-60 billion flow out of Africa in the form of illicit financial flows through money laundering of crime proceeds, abuse of power, market/regulatory abuse, tax evasion.<sup>6</sup>

Countries like Senegal can eliminate illicit financial outflows by more vigorously combating transfer pricing manipulation, capital tax evasion and fraud, by revising agreements on double taxation with certain countries which are actually real tax heavens.

#### Option 5: Use of budgetary and foreign exchange reserves

This financing option involves drawing on budgetary savings and other government revenues deposited in special funds, such as sovereign wealth funds, or using excess central bank foreign exchange reserves for national and regional development (ILO, 2017).

For most developing countries, issues relating to transparency, as well as the difference in government and central bank accounting methods, make it difficult to identify the general level of fiscal reserves (Ortiz et al., 2017). However, since many governments channel at least part of their budgetary reserves into special funds, the most popular of which being sovereign wealth funds, some countries can access these resources to finance social and economic development. This is the way Bolivia, Botswana, and Brazil used this option to create fiscal space (ILO, 2017).

There are two categories of sovereign wealth funds: commodity funds and non-commodity funds. Nearly two-thirds of all developing country sovereign wealth fund assets are financed by commodity exports (oil, gas, copper, phosphates, etc.), thus justifying their denomination of “oil funds” or “natural resource” funds. Non-commodity sovereign wealth funds, on the other hand, can be financed by government budget surpluses, balance of payments surpluses, state-owned enterprise profits, official foreign exchange operations, revenues from privatizations, or foreign aid. Singapore is home to the two best-known non-commodity sovereign wealth funds (Temasek Holdings and Government of Singapore Investment Corporation) which since June 2014 have managed combined assets of US\$497 billion.

As evidenced by recent and projected sovereign wealth fund trends, 29 developing countries appear to be well-endowed with fiscal reserves. Three of the least developed countries (LDCs) feature also on this list. These are Kiribati, Mauritania, and Timor-Leste. In 2012, Senegal launched the FONSIS (Sovereign Strategic Investment Fund), which is a non-commodity sovereign fund with assets of US\$1 billion intended to finance projects with high potential for economic growth and job creation.

Overall, budgetary and foreign exchange reserves widen the scope of possibilities for governments to expand their fiscal space for social protection. But a careful ex ante assessment of their potential impact on monetary expansion or their impact on public debt is necessary.

## History and prospects for the use of SDRs

The SDRs, created in 1969 by the IMF, are foreign exchange reserve instruments in the form of cash advances which are matched by a debt counterpart vis-a-vis the IMF. Although not having a currency status, SDRs are a claim on the freely usable currencies of members of the International Monetary Fund (IMF). The SDRs are based on a basket of international currencies including the US dollar, Japanese yen, European euro, British pound sterling and Chinese renminbi.

The original purpose of SDRs is to reduce the external vulnerability of the countries that benefit from their use. However, the SDRs can also be used for other purposes such as reducing macroeconomic (or even systemic) vulnerabilities, reducing specific vulnerabilities linked to global public goods and financing development (Cabrilac and Guillaumont, 2022).

In August 2021, the IMF made the largest allocation of SDRs since 1969, an amount of US\$650 billion (65% of the total SDRs disbursed since their creation) to support the post COVID-19 global economic recovery. African countries benefited from only US\$33 billion through quotas within the Washington institution. Of these US\$33 billion, Senegal received US\$460 million equivalent to 246 billion CFA francs. These resources were partly used for the benefit of the health sector, social protection, and for the support of economic recovery. The evolution of the budgetary situation in Senegal in the first quarter of 2022 shows solid results in terms of revenues and rapid execution of expenditures.

Table 7: Use of SDRs by Senegal (in billion CFA francs)

Items	Amount
Allocation of SDRs	246
Percentage of GDP	1.60%
Uses	
Expenditures in 2021	141
Percentage of GDP	0.90%
Health sector	33
Response to COVID-19 pandemic	18
Production of vaccines	2
Investments in hospitals	13
Monetary transfers	5
Accelerating clearance of outstanding commitments	103
Additional financings	105
Financial operations	55
Financing 2022	50

Source: Senegalese authorities; computed by IMF services.

The distribution of the SDRs according to the quotas of each country within the IMF worked in favour of industrialized countries and emerging countries which benefited from most of the financing. African countries only benefited from 5% of the amount distributed, which is considered very low by the African Union, but which African states cannot do without. This is why a consensus has emerged within the international community, expressed during the G7 meeting in June 2021, requesting industrialized countries to “recycle” on a voluntary basis a portion of these SDRs in favour of low- and middle-income countries. The G7 press release formulated in a confusing language an ambition to allocate 100 billion SDRs<sup>7</sup>. In addition, the declaration of the Heads of State and Government of the G20 in Rome on 31 October 2021 mentions a reallocation objective of US\$ 100 billion, for the countries “which need it most”, while noting at the same time the commitments already made to the tune of US\$45 billion. On the other hand, a lively debate is emerging on the modalities of this “reallocation”, a debate which eclipses that of the purposes of this reallocation. In response to this debate, the IMF created two financing schemes: the Poverty Reduction and Growth Fund and the new Resilience and Sustainability Trust (RST).

The RST funds were established by the IMF to provide long-term financing to strengthen economic resilience and sustainability by supporting reforms that reduce risks from climate change and pandemics with major macroeconomic impacts. These funds can also be used to increase fiscal space and financial reserves to mitigate the risks arising from these long-term structural difficulties.

In the case of Senegal, the reduction of public debt and the reconstitution of budgetary room for manoeuvre will be achieved using resources that will be generated from the exploitation of hydrocarbon projects. However, there are many challenges to be faced when it comes to financing reforms linked to climate change and returning to the pre-COVID-19 PSE growth trajectory.

The scope of the consequences of the pandemic requires a reorganization of public interventions and the redefinition of the composition of a priority investment plan. These actions are envisaged as part of the execution of the Accelerated Adjusted Priority Action Plan (PAP2A) of phase II of the Emerging Senegal Plan (PSE). Senegal relies on an endogenous development driven by a strong national private sector. This endogenous development will be accompanied by structural reforms in the business environment and the implementation of flagship measures to boost priority and sovereignty sectors, particularly agriculture, aquaculture, pharmaceutical industry, and digital development. The execution of PAP2, and more generally of phase 2 of the PSE, requires substantial financing resources which could be partially mobilized if Senegal benefits from the RST financing scheme.

When it comes to climate change, there are many challenges ahead regarding greenhouse gas emissions mitigation targets and climate change adaptation measures. Sectors targeted for the revival of the Senegalese national economy through the PSE (agriculture, livestock, fishing, tourism, health, and water) happen to be the most affected by climate change, hence the importance of taking up the fight against climate change as a priority in development policy. For example, manifestations of

climate change compromise agricultural yields through reduced precipitation and rising temperatures. Climate change also directly affects livestock breeding and pastoralism due to the decline in water resources and the scarcity of pastures.

Objectives for adaptation to climate change and mitigation of greenhouse gas emissions have been defined within the framework of the Intended Nationally Determined Contributions (INDC). At the COP19 meeting, countries agreed to publish their INDCs<sup>8</sup> ahead of COP21. A set of measures which is divided into mitigation actions and adaptation actions grouped by sectoral area has been established. Implementing adaptation options will require national commitment and external funding. The total cost for effective implementation of adaptation options by 2035 amounts to US\$14.558 billion. However, the sources of financing are not yet clearly identified. The RST funds therefore constitute an opportunity to mobilize resources for the fight against climate change.

## 5. Conclusion

This study aimed to examine the possibilities for Senegal to access IMF's SDR reallocations through its Resilience and Sustainability Trust (RST) instrument. An examination of the macroeconomic accounting framework was carried out, as well as the analysis of the link between debt, investment, and economic growth, and the identification of strategies for Senegal to access SDRs funding.

The examination of the macroeconomic framework showed that the COVID-19 pandemic crisis and geopolitical tensions in Ukraine have led to an unfavourable macroeconomic situation with additional pressures on the country's fiscal and external accounts. Senegal's budgetary room for manoeuvre was reduced and the external debt burden deteriorated. Forecasts have shown that this trend could be reversed, particularly with the start of oil and gas production in 2024, if appropriate macroeconomic policies are implemented. Public debt and budget deficit ratios are expected to be positively influenced by the substantial increase of export earnings.

Senegal's external debt burden reduces the possibilities of mobilizing resources to finance development. Thus, the country must rebuild its budgetary room for manoeuvre and ensure debt sustainability to increase its chances of mobilizing external resources with concessional conditions. One way to achieve this is to closely monitor the link between debt, investment, and economic growth. Under the PSE, debt financing made it possible to make public investments, which resulted in sustained progress in economic growth. Steady progress on structural reforms aimed at stimulating private investment would help to consolidate economic growth efforts.

The RST financing scheme offers an opportunity to use cheap capital to make public investments, as it comes with a low interest rate and a long maturity period. However, these funds are subject to a host of conditionalities which make them difficult to access. One of the conditionalities is related to the quality of the reforms which will be financed by these funds. Applicants must also carry out at the same time an IMF-supported programme comprising public policy measures whose quality allows the access to higher credit tranches. Finally, the applicants must have a sustainable debt and enjoy sufficient capacity to repay IMF loan. Senegal meets the conditionality relating to the IMF-supported programme, but must demonstrate its ability to repay the IMF loan and strengthen the sustainability of its debt. Strengthening debt sustainability can be done through a strategy aimed at developing the domestic securities market, on the one hand, and a strategy that is likely to reduce the risks and

costs linked to the volatility of interest rates and exchange rates, on the other hand. To demonstrate its ability to repay the IMF loan, Senegal must strengthen its capacity to mobilize resources through growth or create budgetary space through the different resource mobilization options within its reach. These options range from improving the efficiency of public spending, increasing public revenues, and adopting rigorous macroeconomic management.

In case Senegal obtains the RST financing, these resources can be used for the implementation of PAP2 and more generally the phase 2 of the PSE in order to return to the pre-COVID-19 growth trajectory. These resources could also be used to fight against climate change in order to strengthen measures aimed to mitigate greenhouse gas emissions, as well as measures to adapt to climate changes that affect the economic growth drivers. These two areas require substantial resources; however, the sources of funding are not yet clearly identified. The RST financing, therefore, would constitute an opportunity to finance these policies.

## Notes

1. <https://www.economie.gouv.sn/index.php/fr/articles/03-02-2022/cgdev-sur-les-droits-de-tirages-speciaux-dts>
2. Debt sustainability refers to a country's capacity to service its debt.
3. These include taxes on consumption, corporate profits, financial activities, personal income, property, international trade flows, and natural resource extraction.
4. <https://www.afd.fr/fr/actualites/8-choses-savoir-sur-laide-publique-au-developpement>
5. <https://donnees.banquemondiale.org/>
6. AU/ECA Conference of Ministers of Finance, Planning and Economic Development. "Report of the high-level panel on illicit financial flows from Africa". Addis Ababa, 2016.
7. <https://www.consilium.europa.eu/media/50361/carbis-bay-g7-summit-communique.pdf>
8. The term "contribution" is a compromise between the terms "commitment", used for industrialized countries, and "nationally appropriate mitigation measures", used for countries of the South.

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