# REFLECTIONS ON THE ESTABLISHMENT OF A STABILISATION FUND IN ECOWAS

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# Reflections on the Establishment of a Stabilisation Fund in ECOWAS

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## I. INTRODUCTION

Macroeconomic stability is one of the major concerns of political and economic decision-makers and means observing major macroeconomic indicators. In fact, since the recent crisis which began in 2008 in the United States, developed and developing countries have been finding it difficult to restore macroeconomic stability. In the OECD zone, the budget deficit reached unprecedented levels in 2009 before dropping to about 6% of GDP in 2011. In addition, for many countries, the level of indebtedness has increased considerably, worsening the vulnerability of public finance to the volatility of capital markets and reducing the room to manoeuvre and therefore the effectiveness of fiscal policy measures to stem the economic slowdown.

On the African continent, the crisis was also felt at various levels. In 2009, the growth rate recorded on the continent was 2.5%, representing less than half the rate achieved prior to the crisis. This led, for the first time in ten years, to a reduction in real per capita GDP. In the course of this year, Africa lost about 30 to 50% of its export revenues in 2008. In spite of some reduction in the import bill due to the decline in food and oil prices, the overall trade balance deteriorated significantly. From a surplus of 3.8% of GDP in 2008, the current account recorded a deficit of 2.9% in 2009. Within the ECOWAS space, compliance with the convergence criteria was seriously disrupted by the impact of the exogenous shocks on food and fuel prices which reflected in a net increase in inflation and the deterioration of public finances of oil importing countries. The crises intensified the volatility of exchange rates which is detrimental trade by increasing uncertainty and the cost of international trade. Most countries in the WAMZ experienced a depreciation of their currencies.

To address these crises that are seriously affecting macroeconomic stability, governments of developed countries (United States and European Union) deployed huge sums of public funds to ensure financial stability. In the European Union, all the twenty-seven Member States have set up a stabilisation fund to preserve the financial stability of the European economic and monetary union by offering financial assistance to Member States in difficulty. Greece and Ireland have already benefitted from this fund with relatively low interest rate. The EU's experience is instructive in several ways as it has just proven that if the community instinct prevails, financial stabilisation solutions can be found within regional groupings. Consequently, some organizations such ECOWAS could as well set up a stabilisation fund

that will enable Member States deal with exogenous shocks. It was against this appeal that the Committee of Governors recommended the launching of a Stabilisation Fund following the presentation of the document on the ECOWAS Exchange Rate Mechanism. This recommendation was also underscored by the Committee of Governors during its 40th Statutory meeting in Conakry.

The aim of this stabilisation fund will be, on one the hand, to protect ECOWAS Members States facing external shocks by stabilizing revenues, and on the other hand, shield national currencies against the risks of speculative attack.

Following this introductory section (I), the rest of the paper is structured as follows: II) theoretical and empirical approaches of stabilisation funds ; III) experiences of funds across the world; IV) Justification for a Stabilisation Fund in the ECOWAS Region; V) Mechanism and Operation of the fund; and VI) Conclusion

## II. THEORETICAL AND EMPIRICAL ARGUMENTS

### 2.1 Concept of Stabilisation Fund

Though there is not only one standard definition of stabilisation funds, we can retain the definition adopted by the international working group on sovereign funds which described them as "as funds or investment mechanism for a fixed purpose, owned by public administrations. Established by public administration for macroeconomic management purposes, stabilisation funds hold, manage and administer assets to achieve financial targets and resort to a series of investment strategies which include investments in foreign financial assets. Stabilisation funds are generally established with budget surpluses and/or revenues from commodity exports".

### 2.2 .Objectives of a Stabilisation Fund

The primary objective of stabilisation funds is to protect public finances and the national economy against fluctuations in commodity prices (generally oil). The accumulation of these resources constitutes a group of annuity for "primary commodity fund" which helps to manage mainly excess petroleum revenues. But they can result from a strategic exchange policy, followed by non-commodity fund, especially Asian funds.

Stabilisation funds are usually meant to address problems associated with the volatility and unpredictable nature of revenues (from oil and other commodities) and the need to save part of revenues from these commodities for future generations. The volatility of commodity prices affect the country's revenues, and this requires, in the case of a shortfall, budget adjustment (mostly a reduction in expenditures) or compensatory financing. Instead of reducing expenditures, the country can decide to finance the shortfall through the stabilisation fund.

### 2.3 Arguments in Favour of a Stabilisation Fund

Stabilisation funds are meant to address the issue of volatile and unpredictable revenues. The argument underlying these funds is as follows: when commodity revenues are high, a portion is kept to replenish the stabilisation, when they are low, the fund is used to finance the shortfall. It can therefore be said that the fund helps to achieve this smoothing objective. Though the operational objective of a stabilisation fund is to smoothen budget revenues, from a government policy perspective, the aim is to smoothen expenditures.

Stabilisation funds have proven to be the ideal solution to save countries from the effects of export revenue volatility (shocks) to protect their domestic economies. It is against this background that they give priority to investments in sectors that have weak links with commodity prices (finance, real estate and telecommunication). Thanks to this new recycling operation, the funds are able to stem inflationary pressures and avoid overheating of economies due to massive inflows of capital. In addition to their role of stabilising public finances, stabilisation funds can be set up to intervene on the financial markets. Several studies have shown that stabilisation funds constitute a source of financial stability.

Contrary to the hedge funds which intervene regularly through speculative operations with strong leveraging effect and can be compelled to liquidate their positions in order to replenish their treasuries at the slightest disruptions affecting the markets, stabilisation funds traditionally stick to the long term. They can help cushion financial shocks and ensure market stability. It is from this perspective that they can play the role of a lender of last resort by injecting liquidity into the markets and saving the world economy from the devastating effects of systemic risk.

### 2.4 Theoretical Arguments Against Stabilisation Funds

Theoretical argument in favour of stabilisation funds are not always convincing. The fund can have negative effects at the operational level. They can be poorly integrated into the budget, leading to loss of control over the whole budget situation as well as expenditure coordination difficulties such as duplication of expenditures or decisions to spend on equipment without considering the implications on recurrent expenditures in future. Public management, transparency and accountability may be compromised where there is a stabilisation fund. By their character, these funds are generally outside the budget system and are handled by the government, thus exposing them particularly to abuse and political interference. The rules of dissemination and audit of these accounts are often less stringent, and since they are not integrated into the budget, it is more difficult for parliament and the public to control the use of public funds in general.

### 2.5 Empirical Arguments Against Stabilisation Funds

An empirical analysis of the experience of various countries in terms of stabilisation funds confirms these theoretical and operational problems. The econometric analysis suggests that stabilisation funds do not change the profile of public expenditures.

In a study of a sample of twelve countries[1] producing non-renewable resources, oil and others, including five that have stabilisation funds, three major findings:

- In countries that did not have a fund, public expenditures usually followed the trend of export revenues. Expenditures increased as the value of the exports rise and reduced when it declined.
- In some countries that have a fund, expenditures followed closely trends in export revenues, indicating that the simple existence of a fund does not modify significantly this linkage.
- In other countries where a fund is available, expenditures did not follow trends in export revenues and public expenditure but the situation remained the same before and after the establishment of the stabilisation fund.

In other words, these observations show that the establishment of a fund does not have any impact on the link between revenues from the export of resources considered and public expenditures.

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[1] These are: Russia, Dubai, Qatar, Malaysia, Singapore, Kuwait, Saudi Arabia, Abu Dhabi, Libya, Algeria, Norway and China.

In countries with revenues that are largely dependent on oil or other non renewable resources and that have not traditionally implemented prudent macroeconomic policies, the fund has led to very uneven results. Thus:

- The stabilisation fund for Papua New Guinea's mining resources hardly contributed to the stabilisation of budget expenditures and revenues and the authorities have recently closed it down.
- The rules of Venezuela's macroeconomic stabilisation fund, established at the end of 1998, did not prevent the implementation of an expansionary fiscal policy when oil prices escalated in 2000.

## III. EXPERIENCES WITH STABILISATION FUNDS

### 3.1. International Monetary Fund (IMF)

The IMF was established in 1944 and was originally meant to ensure the stability of the international monetary system whose collapse during the Great Depression in the 1930s had catastrophic effects on the world economy. The IMF therefore ensures the stability of the international monetary system and management of financial and monetary crises. To this end, it provides credits to countries facing financial difficulties to ensure the stability of their financial system (banks,) or international trade flows with other countries.

After 1976, following the abolition of the fixed exchange system, the IMF inherited a new role as a result of the debt problem in developing countries and some financial crisis. Since 1976, the role of the IMF is to primarily support countries experiencing financial difficulties. When a country is confronted with a financial crisis, the IMF provides it with loans in order to guarantee its solvency and avoid the spread of a financial crisis similar to what hit the United States in 1929.

IMF interventions multiplied in developing countries from the 1980s which saw the outbreak of the debt crisis in the developing world, especially from 1982 and the suspension of payments by Mexico. However, the IMF has intervened in some developed countries such as South Korea at end of the 1990s and in Greece in 2010.

### 3.2 ECOWAS Fund

The ECOWAS Fund was established in 1975 by Heads of States of the Community with the aim of ensuring the physical integration of the sub region. To this end, Member States came up with two major programmes. The first involved the construction of roads, leading to the building of 86% of the 8300 km road network linking Dakar to Lagos through the coast and trans Sahara network, stretching from Dakar through Nouakchott to Lagos through the Sahel crossing Mali, Burkina and Niger. The Fund also helped to establish a communication network connecting the capitals of Member States under its second major programme.

For a better adaptation to the new macroeconomic context and involve the private sector, the Assembly of Heads of States and Government decided during its twenty-second session held from $9^{th}$ to $10^{th}$ December 1999 to transform the fund into a Regional Holding Company known as ECOWAS Bank for Investment and Development (EBID) with two specialized subsidiaries, namely:

- ECOWAS Regional Investment Bank (ERIB) meant for private sector financing ; and

- ECOWAS Regional Development Fund (ERDF) which provide financing to the public sector especially for basic economic infrastructure development and poverty reduction.

EBID has a capital of 750 million dollars, with 2/3 or $500 million being held by ECOWAS Member States, the remaining 1/3 is opened to investors outside the region (any institution or country that is not a member of ECOWAS) like OECD countries, France United States to enable them participate in the integration strategy and economic development of the region. It became operational in January 2003.

### 3.3 Russian Stabilisation Fund

The Stabilisation Fund of the Russian Federation is a Russian sovereign fund established on 1st January 2004 to manage budget and trade surpluses from the export of natural resources. It is divided into two funds:

- **The Reserve Fund** which protects the country's economy in case of a drop in the price of a barrel of oil below a certain threshold. It had about 130 billion dollars as at

1st may 2008 and invested in only foreign bonds. Its assets are limited to 10% of the country's GDP ;

- **The National Wealth Fund**, which is meant to replenish the country's pension funds. It was managing about 33 billion dollars as at 1st May 2008 and can be invested in more risky assets compared to the Reserve Fund.

The Fund also helps to reduce inflationary pressures on the country, protect the economy against the volatility of commodity export revenues and absorb excess liquidity

### 3.4. European Stabilisation Fund (ESF)

The European Financial Stability Fund was established in May 2010 to preserve the financial stability of the European economic and monetary union by offering financial assistance to Member States in difficulty. Its main objective is to issue up to 440 billion worth of Euro Bonds, which could be given as loans to countries in difficulty within the Union (in reality only 250 billion are available). As these bonds are guaranteed by States, especially those whose sovereign debt have been rated as AAA by credit rating agencies, the EFSF can borrow from the bond market at a rate far lower that what has been imposed on Greece since end-2009. Consequently, any Member State of the Euro zone which finds itself in a similar situation can henceforth count on this fund which guarantees, through the pooling of risk, a more reasonable borrowing rate indexed to the AAA rating. However, assistance to these countries in difficulty can only be provided under certain conditions, especially compliance with budget restrictions and austerity measures at levels set by members of this Fund.

In addition to the 440 billion Euro Bonds issued on the market, the EFSF is financed to the tune of Euros 60 billion by the European Commission, which borrows in its name on financial markets under the guarantee of Member States. The IMF, on its part, is contributing to the tune of Euros 250 billion. Ireland was the first beneficiary of this system. Due to serious speculative attacks against its borrowing rates on the bond market, the ex "Celtic Tiger" was obliged to streamline its public finances, through increased budgetary efforts, and benefit from the Fund. The first instalment of this assistance totalling Euros 85 billion was disbursed in January 2011.

Though EFSF is expected to operate for a fixed period, Germany, followed gradually by France and then the other members of the Euro, proposed the idea of sustaining the

experience by making the fund a permanent one. This is how on March 21 2011, Ministers of Finance of the Euro zone reached an agreement to establish a European Stability Mechanism (MES) that will ensure assistance to indebted countries on a permanent basis. The ESM which expected to be established by mid-2013 will be endowed with 700 billion (for an intervention capacity of 500 billion) 80 billion of which will be provided by countries in order to guarantee the AAA rating for the 620 billion worth of Euro Bonds that will be issued. While the terms and conditions of loans applied to Greece and Ireland have not been changed, interest rates on future loans to possible countries in difficulty are lower than those of the EFSF which were already below the bond market rates.

The funding of the 80 billion capital is shared among the countries based on their current assets with the ECB. Decision for granting loans will be taken unanimously by the Ministers of Finance still on condition that the country concerned make economic and fiscal adjustment after a joint study by the European Commission, IMF and ECB on the solvency of its debt.

### 3.5 Other Funds Across the World

Aside the above mentioned funds, others exist in the world. According to Sovereign Fund Wealth Institute's estimates (figure1), they are distributed as follows: 43% in the Middle East, 39% in Asia, 11% in Europe and the rest is shared between North America, Latin America and Africa.

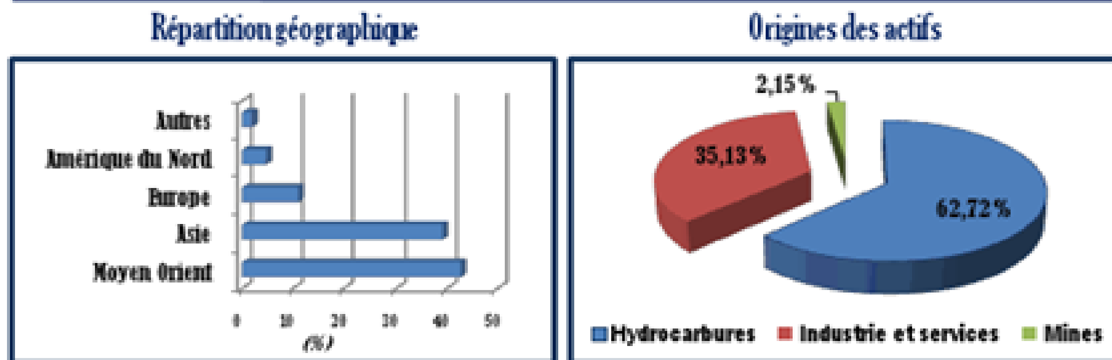
Figure 1

Geographical distribution and sources of sovereign Funds assets (%)

Répartition géographique = Geographical distribution

Origine des actifs = Sources of assets

Autres = Others, Amérique du Nord = North America, Europe = Europe, Asie = Asia, Moyen Orient = Middle East, Hydrocarbure = Hydrocarbons, Industrie et services =Industry and service, Mines =Mines




In spite of their relatively low weight, assets of these funds can reach a little less than 10 000 billion dollars in 2015, according to recent estimates published in November 2008 by Morgan Stanley. Besides, their weight on world stock exchanges continue to increase, the first investor of CAC 40 is the Norwegian sovereign fund with about 5 billion dollars invested.

The various experiences recounted give us a clear insight on the mission and role stabilisation can play, especially in controlling macroeconomic instability.

The funds:

- Protect the parity of a currency against a devaluation or depreciation of a currency ;
- Reduce inflationary pressures;
- Secure economies against the volatility of commodity export revenues ;
- Offer financial assistance to Member States of an Economic Union

**IV. JUSTIFICATION FOR A STABILISATION FUND IN ECOWAS**

There is no reason for which ECOWAS countries should not find a way of protecting themselves. In fact, this protection must involve the provision of additional resources to absorb exogenous shocks.

Vulnerability of economies of ECOWAS countries

Economies of ECOWAS Member States are outward-oriented. The bulk of these countries' resources come from the export of primary commodities. This characteristic of the regional

economy makes it very volatile and dependent on the international trade. These countries also depend, to a large extent, on petroleum products whose prices on the international market weigh heavily on their imports. Past experiences show that the effects of oil prices are very significant. A study commissioned by the IMF in 2000 estimated that a $5 increase per barrel of oil over a period of one year can widen the trade deficit of a country like Mali (among the group of the most affected countries) by 1.25%. This is in addition to the deficit at the time pegged at 15% of GNP (The Impact of Higher Oil Prices on the Global Economy; IMF; 2000).

ECOWAS countries pay a high price for the importation of their petroleum products. These countries allocate to these imports over 20% of their GNP. As a result, a 5% increase can seriously affect the balance of payments of these countries, reducing their GNP by more than one growth point. Due to their heavy debt burden, these countries cannot finance temporary increases in the trade deficits by borrowing on the international market. This could compel them to reduce rapidly their consumption, leading to an economic recession.

Table: Trade Balance of ECOWAS countries (as % of GDP)

| Countries | 2005 | 2006 | 2007 | 2008 | 2009 | 2010* |
|---|---|---|---|---|---|---|
| Benin | -3% | -3% | -4% | -4% | -4% | -3% |
| Burkina | -6% | -4% | -5% | -6% | -3% | -4% |
| Cote d'Ivoire | 7% | 8% | 6% | 6% | 9% | 8% |
| Guinea Bissau | -1% | -4% | -4% | -4% | -5% | -1% |
| Mali | -1% | 1% | -2% | -3% | -1% | -1% |
| Niger | -4% | -3% | -2% | -4% | -7% | -2% |
| Senegal | -7% | -7% | -10% | -12% | -7% | -6% |
| Togo | -12% | -7% | -6% | -6% | -6% | -6% |
| Nigeria | 20% | 21% | 18% | 28% | 15% | 18% |
| Sierra Leone | -7% | -4% | -5% | -9% | -9% | -7% |
| Gambia | -19% | -17% | -17% | -7% | -9% | -8% |
| Guinea | | | | -1% | 0% | 1% |
| Ghana | -24% | -24% | -27% | -34% | -17% | -21% |
| Cap vert | | | | -33.67 | -36.89 | -38.01 |
| Liberia | -30% | -45% | -42% | -60% | -52% | -53% |

Source: Central Banks

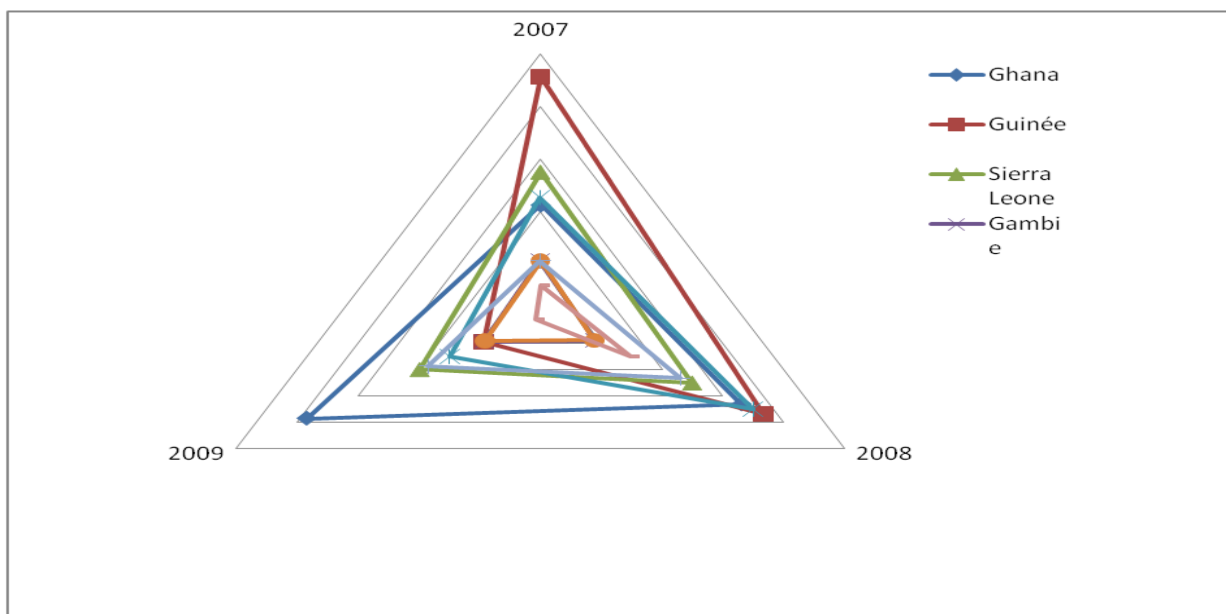
The study on the balance of trade of ECOWAS countries show a number of disturbing trends, except in the case of Nigeria and Cote d'Ivoire that are the dominant economies in the region. Nigeria is the leading exporter of oil in Africa and Cote d'Ivoire the leading cocoa exporter. The other countries depend on the export of raw agricultural products. In recent years, the

prices of these commodities have been on a downward trend while the price of crude oil has been rising, indicating the deterioration of the terms of trade.

Finally, the vulnerability of these countries to the escalation of the price of crude oil is worsened by their limited capacity to utilize energy resources less affected by sudden price hikes.

The combination of these factors adversely affected inflation in these countries and thereby weakening local currencies.

**Graph**: Level of inflation in ECOWAS countries during the 2008 crisis




In 2007, only Guinea had an inflation rate above 20%. However in 2008, at the beginning of the crisis, other countries also recorded high inflation rates, namely Liberia, Nigeria and Sierra Leone. Even the UEMOA zone which usually had low inflation rate was not spared from this inflationary pressure as the inflation rate rose to 7.4% in 2008, well above the criterion of 3% set by the zone.

This inflationary situation can lead to devaluation or depreciation of currencies thereby increasing debt servicing and the risk of defaulting in payments (debt crisis) as was the case in Greece. Even if the debt situation seems to be under control within the ECOWAS space, it must be recognized that the level of external debt of all countries in the region often exceed 50% of GDP, especially for the UEMOA zone where the rate of outstanding external debt fell from 51.9% of GDP in 2009 to 49.3% in 2010. In the WAMZ countries, the outstanding

external debt of Nigeria stood at US$ 4, 578.77 million, representing an increase of 16% compared to 2009. In Gambia, the total domestic debt went up by 18.9% in 2010 and accounted for 30.2% of GDP. The external debt grew by 8.7%, representing US$ 382.79 million. In the case of Ghana, public debt was to the tune of US$11,793.52 million with US$ 6,110.76 million being external debt and US$5,683 million being domestic debt. The stock of public debt of Sierra Leone accounted for 54% of GDP, with US $767.86 million being external debt. The debt rose by 23.8% in 2010. In Liberia, the debt stock stood at US$503, 3 million, 44.3% of which is domestic debt.

**Table - External debt indicators**

| | Total external debt | | | Debt servicing | | |
|---|---|---|---|---|---|---|
| | 2008 | 2009* | 2010 ** | 2008 | 2009 * | 2010 ** |
| **AFRICA** | **21.3** | **23.6** | **22.7** | **10.6** | **14.1** | **12.6** |
| **ECOWAS** | **17.4** | **19.3** | **17.6** | **2.4** | **3.2** | **5.5** |
| **UEMOA** | **47.5** | **51.9** | **49.3** | **6.0** | **6.9** | **9.7** |
| Benin | 12.1 | 15.2 | 16.7 | 2.9 | 3.7 | 3.5 |
| Burkina Faso | 19.6 | 24.1 | 26.7 | 6.1 | 6.0 | 4.7 |
| Côte d'Ivoire | 79.1 | 82.1 | 78.8 | 9.3 | 10.1 | 8.7 |
| Guinea Bissau | 225.5 | 238.1 | 91.2 | 3.0 | 2.6 | 221.0 |
| Mali | 21.2 | 24.5 | 25.2 | 3.0 | 3.4 | 2.8 |
| Niger | 14.0 | 16.4 | 16.9 | 1.9 | 2.0 | 2.0 |
| Senegal | 41.5 | 50.9 | 51.8 | 5.1 | 7.2 | 6.7 |
| Togo | 51.9 | 53.2 | 29.9 | 2.8 | 6.2 | 5.6 |
| **WAMZ** | **8.1** | **9.2** | **7.7** | **1.3** | **1.9** | **4.1** |
| Gambia | 37.1 | 43.6 | 44.6 | 31.0 | 32.8 | 33.8 |
| Ghana | 37.4 | 49.4 | 54.1 | 4.7 | 7.7 | 5.6 |
| Guinea | 66.3 | 64.8 | 19.9 | 9.5 | 7.9 | 147.6 |
| Liberia* | 432.6 | 290.1 | 14.7 | 0.0 | 0.0 | 0.0 |
| Nigeria | 2.2 | 3.0 | 3.0 | 0.7 | 1.2 | 0.8 |
| Sierra Leone | 33.1 | 36.0 | 36.9 | 2.3 | 3.5 | 5.4 |
| **Other** (Cape Verde) | 55.4 | 61.3 | 63.0 | 16.5 | 20.8 | 20.9 |

Sources: BCEAO, WAMZ and IMF

The economic situation within ECOWAS also worsened with the deterioration of overall budget balances. In fact, since 2006, the deficit continued to widen from 2.4% of GDP in 2008 to 3.2% of GDP in 2009 to 3.9% in 2010.

**Table -** Budget deficit – including grants - ECOWAS (percentage of GDP)

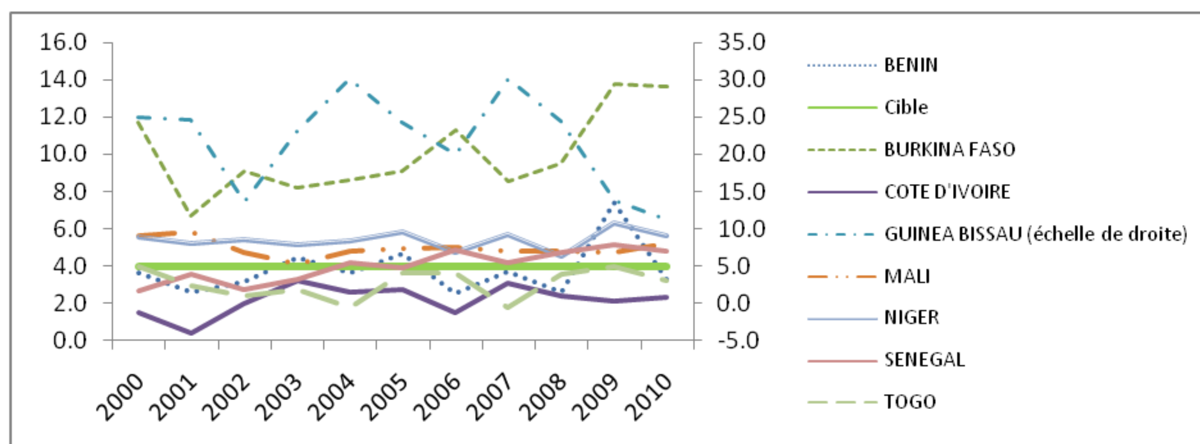
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010* | 2011** |
|---|---|---|---|---|---|---|---|---|---|---|
| **AFRICA** | - | - | - | - | - | - | **2.2** | **4.4** | **3.3** | **1.9** |
| **ECOWAS** | **5.4** | **3.8** | **3.2** | **3.0** | **2.8** | **2.9** | **2.4** | **3.2** | **3.9** | **3.6** |
| **UEMOA** | **3.8** | **4.4** | **4.8** | **5.1** | **4.8** | **5.0** | **4.5** | **2.5** | **3.2** | **3.2** |
| • BENIN | 3.1 | 4.4 | 3.6 | 3.6 | 2.5 | 1.8 | 3.5 | 4.9 | 2.5 | 2.6 |
| • BURKINA FASO | 9.1 | 8.2 | 8.6 | 8.6 | 10.5 | 12.1 | 8.3 | 6.2 | 7.5 | 3.5 |
| • COTE D'IVOIRE | 2.0 | 3.2 | 2.6 | 3.1 | 1.5 | 1.4 | 2.2 | -0.9 | 1.6 | 2.2 |
| • GUINEA BISSAU | 13.6 | 23.0 | 30.1 | 30.1 | 18.7 | 13.7 | 12.2 | -1.8 | 1.1 | 1.1 |
| • MALI | 6.9 | 5.3 | 7.0 | 7.0 | 7.1 | 7.9 | 5.6 | 2.8 | 4.4 | 3.8 |
| • NIGER | 8.5 | 7.8 | 8.4 | 8.4 | 6.4 | 6.7 | 4.2 | 5.7 | 2.8 | 0.7 |
| • SENEGAL | 1.8 | 3.2 | 5.5 | 5.5 | 6.8 | 7.1 | 7.2 | 4.9 | 4.6 | 5.8 |
| • TOGO | 1.0 | 1.8 | -0.6 | 0.6 | 4.0 | 2.3 | 2.3 | 0.6 | -0.6 | 2.7 |
| **ZMAO** | **6.2** | **3.4** | **2.4** | **1.8** | **1.7** | **2.3** | **1.8** | **3.5** | **4.0** | **3.7** |
| • GAMBIA | 9.1 | 5.2 | 9.9 | 8.4 | 2.7 | 1.0 | 2.7 | 4.0 | 2.9 | 8.6 |
| • GHANA | 8.3 | 7.5 | 8.1 | 6.9 | 12.9 | 14.5 | 19.5 | 4.3 | 4.1 | 3.9 |
| • GUINEA | 6.2 | 8.8 | 5.9 | 1.6 | 2.0 | 0.9 | 1.7 | 7.5 | 14.0 | 6.6 |
| • LIBERIA | 1.0 | 3.7 | 4.4 | 0.9 | -3.0 | 3.4 | 2.0 | -1.1 | -6.6 | 2.0 |
| • NIGERIA | 5.9 | 2.8 | 1.7 | 1.3 | 0.6 | 1.2 | 0.2 | 3.3 | 3.8 | 3.5 |
| • SIERRA LEONE | 16.5 | 19.4 | 14.3 | 9.5 | 8.5 | 5.0 | 7.1 | 2.7 | 6.1 | 8.4 |
| CAPE - VERDE | **10.5** | **9.1** | **8.4** | **11.4** | **10.4** | **3.6** | **6.5** | **6.8** | **12.0** | **13.6** |

Sources: BCEAO, ZMAO et FMI

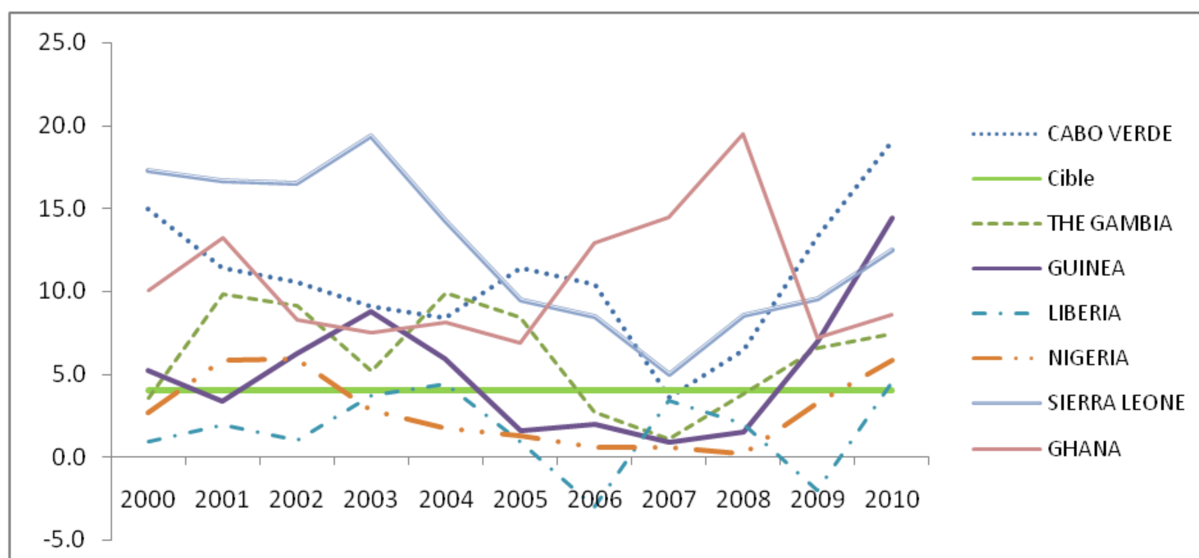
Excluding grants, the situation is more complicated, thus showing the dependance of our countries on grants. In the UEMOA zone, for example, in 2010, apart from Cote d`Ivoire, Benin and Togo, other countries recorded rates that are outside the (4% of GDP) limit. In the WAMZ zone, Nigeria has a more favourable position because of its economic potentials. Nigeria is specialized in petroleum products, while Liberia operates a cash-budgeting system.

**Graph: Trends in budget deficits of ECOWAS countries (2000-2010)**

**UEMOA Zone**



**WAMZ Zone**




On the whole, external shocks are very detrimental to growth. They worsen poverty and have a negative impact on fiscal and external balances. The establishment of a stabilisation fund is necessary to address the recurrent problems affecting member countries. This fund, just like those of other integration zones will help to lend money to ECOWAS countries in difficulty (through loans in the name of the Commission, member states guarantees and margins in the community budget). This fund may also be used to protect the currencies against risks of speculative attack, among others.

1. Impact of the fund on the macroeconomic stability in ECOWAS countries.

Economic and financial stability is a concern at both the national and international levels. As shown by recent experience in the various crises, economies have become increasingly interdependent. Problems that arise in an economy apparently isolated from another economy can affect the latter and extend beyond the borders. Worldwide economic and financial situation can have profound impact on the development of most national economies. In other words, with regard to economic and financial stability, there is no «island» country. The establishment of an exchange stabilisation fund in ECOWAS could lead to stability in the region.

a/ Impact on domestic viability

The establishment of a stabilisation fund can help resolve problems caused by exogenous shocks. Indeed, the issue of exogenous shocks and their impact on African countries

raises the problem of vulnerability of our economies. During the last three years (2007-2009), African countries were faced with a series of successive shocks, mainly, from external sources. The economies of these countries are fragile and vulnerable to such exogenous shocks which affect their economic performance significantly. According to economic analysis, there is a strong correlation between exogenous shocks and macroeconomic variables. Indeed, besides the destruction of capital and revenue losses, exogenous shocks can have indirect repercussions on an economy: decline in production and investment, macroeconomic imbalances, deterioration of public debt indicators.

To counter exogenous shocks more efficiently, stabilisation funds provide, based on specific criteria, assistance in the form of repayable loans at concessional rates. These forms of rapid assistance and financial compensation would help to respond to the most urgent needs and safeguard the macroeconomic stability needed to rebuild the economy after exogenous shocks. They can also intervene when a member country records a loss of revenue from its exports and a worsening of its budget deficit by providing additional financial support. A member state can also request from the stabilisation fund when it has difficulties coping with oil crisis as was the case in 2008 when most countries experienced inflationary pressures.

b/ Impact on external viability

External balance is one of the objectives of economic policy besides economic growth, lower unemployment and control of inflation. Indeed, the persistence of a deficit would result in loss of competitiveness of the economy which would in turn impede the achievement of three other economic policy objectives (growth, stability of prices, employment). The availability of stabilisation fund would offset losses in export of primary commodities that cause regular deficits in the trade balance in most Sub-Saharan African countries.

The fund can be used to intervene in the foreign exchange market so that the rates of the different ECOWAS currencies do not deviate from the parity set. In case an imbalance in the balance of payments of a country threatens the monetary balance on the foreign exchange market, the member may obtain funding (whose share would be determined by the authorities), to enable it deal with the situation through the purchase of its national currency. These loans are supposed to help the country concerned to defend the value of its currency[2] on the foreign exchange market

[2] This concerns WAMZ countries which have floating exchange rate regimes

## V. MECHANISM AND OPERATION OF THE FUND

### 5.1 Establishment and Principles of the Fund

A Regional Stability Fund (RSF) must be implemented in due course. The purpose of this intergovernmental instrument will be to refinance the ECOWAS Member States and will benefit for this purpose, from a guarantee of amounts contributed by all the member states. The FRS will have to cooperate closely with the International Monetary Fund, to jointly define the adjustment programs and coordinate arrangements for financial assistance, including pricing and maturity of loans. In addition, the intervention of the RSF must be accompanied by private sector participation, in accordance with IMF practices. To facilitate private sector participation, identical and standardized collective action clauses will be introduced in all sovereign bonds of the ECOWAS zone for maturities exceeding one year, counting from the date of purchase.

For the establishment of this fund, two schemes can be applied:

- The creation of a new entity by ECOWAS Member States to be known as RSF;
- The expansion of the ECOWAS Regional Development Fund of EBID by increasing the capital and redefining the objectives and areas of intervention.

### 5.2 Purpose of the Fund

The aim of the RSF is to provide financial assistance to ECOWAS Member States that would be affected or threatened by severe financial difficulties in order to safeguard the financial stability of the ECOWAS region as a whole.

The most important decisions will be taken by consensus by a board made up of Finance Ministers in the ECOWAS region and Central Bank Governors. This consensus will be based on an analysis of debt sustainability of the Member State concerned. Each country must have a veto to ensure transparency in the management of the fund.

### 5.3 Mechanism for financing the Fund

The fund, once established, must have adequate financial response capacity to carry out its mission. Funding must come from Member States (capital) and private funds (issuance of

bonds). The distribution formula should be determined by the relevant authorities and according to the amount fixed.

- Concerning the funding of the capital, each member country will contribute to the capital of RSF based on its level of development (eg. GDP or GNP of the country).
- For private sector participation, the Regional Stabilisation Fund may issue bonds, through the stock markets in the region, which can then be lent to the ECOWAS member countries in difficulties. These bonds will be guaranteed by governments including those whose sovereign debt will be rated by rating agencies. However, it should be noted that not all countries have stock markets. In this regard, a legal agreement must be found to allow all major stock markets such as the Nigerian Stock Exchange, Ghana Stock Exchange, Bolsa de Valores, BRVM to issue bonds in all ECOWAS member countries to mobilize the funds.

**<u>Graph</u>: Financing plan of the RSF**

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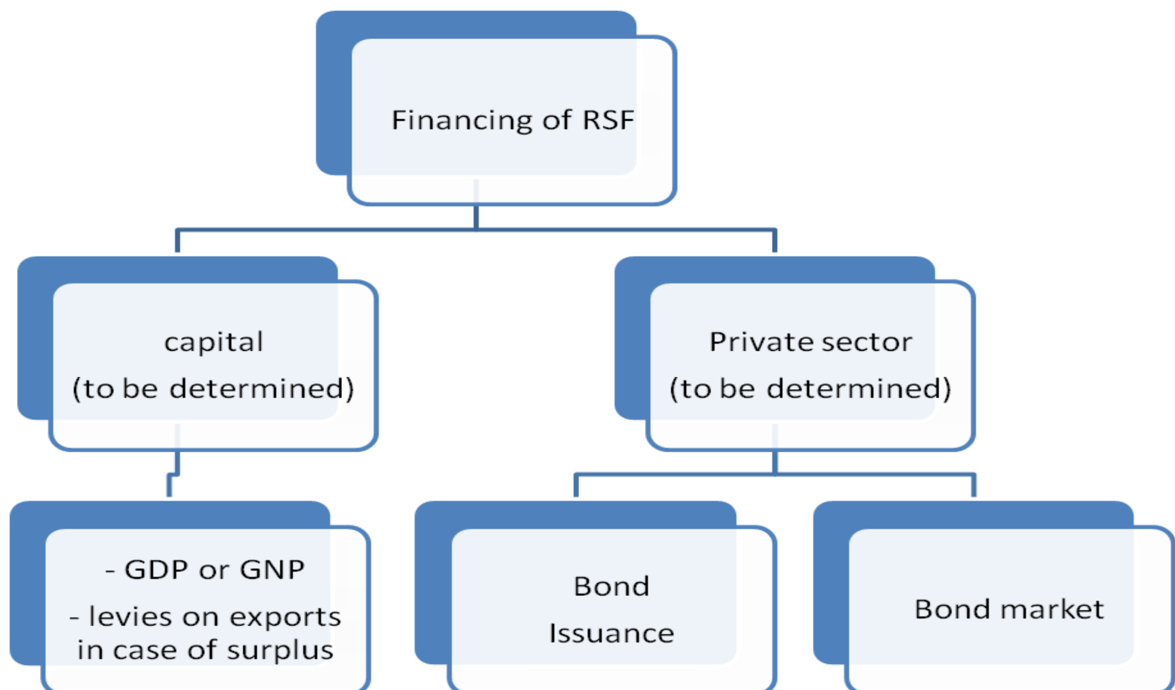


To determine the size of the fund and its calculation base, several factors may be considered:

- Country GDP;

- The total size of the ECOWAS financial sector;
- Costs of resolution of past shocks and size of funds proposed in other jurisdictions;
- Ease of implementation of the calculation approach, its transparency and ease of communication to stakeholders and the public.

#### 5.3.1 Capital formation

For the formation of capital, a rate of 0.5% may be applied to the GDP of each Member State. This gives for example in 2010, a total amount of contribution equal to 1453. 05 million US dollars (See table below).

**Table : Simulation of Annual Contributions to RSF (In millions of USD)**

| **ECOWAS member countries** | GDP in 2010[3] | Contributions 0.2% |
|---|---|---|
| Benin | 6,561.78 | 32.81 |
| Burkina | 6,647.77 | 33.24 |
| Cote d'Ivoire | 22,942.21 | 114.71 |
| Guinea Bissau | 828.34 | 4.14 |
| Mali | 9,370.05 | 46.85 |
| Niger | 5,579.60 | 27.90 |
| Senegal | 12,837.97 | 64.19 |
| Togo | 3,185.18 | 15.93 |
| Gambia | 960.11 | 4.80 |
| Ghana | 18,206.96 | 91.03 |
| Guinea | 4,713.06 | 23.57 |
| Nigeria | 194,319.82 | 971.60 |
| Liberia | 824.50 | 4.12 |
| Sierra Leone | 2,146.61 | 10.73 |
| Cape Verde | 1,487.98 | 7.44 |
| **Total** | 290,611.94 | **1453.05968** |

If the annual contribution collected is insufficient, contributions can be made over a given period of 3 years.

**This will give 1453.05 US dollars x 3 = 4 billion 359 million US dollars**

#### 5.3.2 Private Sector Participation

To ensure that the funds is operational immediately after its establishment and in order to prevent a situation where the total contributions to be provided by the members impede its operation, the following structure has been proposed:

[3] The choice of 2010 is indicative. Another year can also be chosen

- Each Central Bank shall grant at the onset a credit to the Fund to the tune of its total contribution requirements.
- Commercial banks shall, at the same time, issue bonds the tune of the credit above. These bonds will be fully underwritten by the stabilisation fund and advance the respective amounts to the member states in difficulty ;
- It is important to ensure that the initial appropriations and the bonds issued by the commercial banks form an economic unit and can thus be compensated for if necessary ;
- Moreover, in terms of prudential supervision, the processing of this transaction (credit and issuance of bonds) within the rules of liquidity, solvency and important credits will be fixed. In addition, the interest rates applicable to both sides of the transaction will be determined at the opportune time.

If these funds are insufficient in case there is funding problem for a country a second option will apply. To this end, the RSF should put in place alternative funding mechanisms that will enable it to raise funds in future, to enable it to honour its commitments. A guarantee of states will facilitate the ability of refinancing on the markets.

### 5.4 Operation of the Fund

Operationally, the Fund would be managed by Director General who will report to a management board comprising of senior officials representing the 15 members of the ECOWAS region, including ministers of Finance and Central Bank Governors. In addition, the Fund may also call on experts in corporate management in the banking system, to better attract the private sector into the project.

## VI. Conclusion

Stabilisation Funds have become key players in the preservation of the financial stability of a country or a given region. Most studies consider that the fund plays a major role in financial balance. Funds are usually set up in times of crisis as was the case in the euro area. They are also created to fight against exogenous shocks. However, a stabilisation fund must be an « independent » entity with a specific mandate and a strong institutional framework. In the ECOWAS zone, it is urgent to create this fund to address financial problems the member countries may face. These countries have embarked on a dynamic process of economic and

monetary integration which, invariably, requires compliance with certain number of convergence criteria in order to lead to the creation of a single currency by 2020. Among these countries, some have a fixed exchange rate regime[4], while others have flexible (or managed float) regimes. The establishment and effective operation of a stabilisation fund will enable member countries of the zone absorb the effects of external shocks and thus maintain macroeconomic stability which is also critical for a viable monetary union. This would be an opportunity to not only correct past mistakes/pitfalls experienced in the operation of earlier funds such as the Credit Guarantee Fund of the former Clearing House, but to also take advantage of current positive financial system developments.

[4] UEMOA zone countries (Benin, Burkina Faso, Cote d`Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo) and Cape Verde

## APPENDICES

**Table: Budget Deficits (Excluding Grants) of ECOWAS Countries**

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **BENIN** | 3.6 | 2.6 | 3.1 | 4.4 | 3.6 | 4.6 | 2.5 | 3.6 | 2.5 | 7.4 | 3.3 | 5.9 |
| **BURKINA FASO** | 11.7 | 6.7 | 9.1 | 8.2 | 8.6 | 9.1 | 11.3 | 8.6 | 9.5 | 13.8 | 13.6 | 9.1 |
| **CABO VERDE** | 15.0 | 11.4 | 10.5 | 9.1 | 8.4 | 11.4 | 10.4 | 3.6 | 6.5 | 13.3 | 19.0 | 19.2 |
| **COTE D'IVOIRE** | 1.5 | 0.4 | 2.0 | 3.2 | 2.6 | 2.7 | 1.5 | 3.1 | 2.4 | 2.1 | 2.3 | 2.5 |
| **THE GAMBIA** | 3.6 | 9.8 | 9.1 | 5.2 | 9.9 | 8.4 | 2.7 | 1.1 | 3.8 | 6.6 | 7.4 | 5.0 |
| **GHANA** | 10.1 | 13.2 | 8.3 | 7.5 | 8.1 | 6.9 | 12.9 | 14.5 | 19.5 | 7.2 | 8.6 | 6.4 |
| **GUINEA** | 5.2 | 3.4 | 6.2 | 8.8 | 5.9 | 1.6 | 2.0 | 0.9 | 1.5 | 7.0 | 14.4 | 5.1 |
| **GUINEA BISSAU** | 24.9 | 24.7 | 13.6 | 23.0 | 30.1 | 24.2 | 19.9 | 30.1 | 24.5 | 13.8 | 11.2 | 11.3 |
| **LIBERIA** | 0.9 | 1.9 | 1.0 | 3.7 | 4.4 | 0.9 | -3.0 | 3.4 | 2.0 | -2.0 | 4.5 | 4.5 |
| **MALI** | 9.0 | 9.6 | 6.9 | 5.3 | 7.0 | 7.3 | 7.6 | 7.0 | 7.1 | 6.9 | 8.1 | 8.0 |
| **NIGER** | 8.9 | 8.0 | 8.5 | 7.8 | 8.4 | 9.6 | 6.8 | 9.3 | 6.4 | 10.7 | 9.0 | 7.2 |
| **NIGERIA** | 2.7 | 5.8 | 5.9 | 2.8 | 1.7 | 1.3 | 0.5 | 0.6 | 0.2 | 3.3 | 5.8 | 5.8 |
| **SENEGAL** | 1.6 | 3.8 | 1.8 | 3.2 | 5.5 | 4.7 | 7.3 | 5.5 | 6.8 | 7.9 | 7.1 | 8.1 |
| **SIERRA LEONE** | 17.3 | 16.7 | 16.5 | 19.4 | 14.3 | 9.5 | 8.5 | 5.0 | 8.6 | 9.6 | 12.5 | 12.7 |
| **TOGO** | 5.0 | 2.3 | 1.0 | 1.8 | -0.6 | 4.1 | 4.2 | -0.6 | 4.0 | 5.0 | 3.1 | 6.5 |
| **UEMOA** | **5.0** | **4.3** | **3.8** | **4.4** | **4.9** | **7.8** | **5.0** | **7.9** | **5.2** | **6.5** | **5.9** | **6.1** |
| **WAMZ** | **3.4** | **6.4** | **6.2** | **3.4** | **2.4** | **1.8** | **1.6** | **1.7** | **1.8** | **3.7** | **6.2** | **5.9** |
| **WAMZ excluding Nigeria** | **8.9** | **10.3** | **8.3** | **8.7** | **8.0** | **5.5** | **8.8** | **9.1** | **12.5** | **7.3** | **10.6** | **6.4** |
| **ECOWAS** | **4.0** | **5.7** | **5.4** | **3.8** | **3.3** | **3.8** | **2.7** | **3.7** | **2.9** | **4.6** | **6.2** | **6.0** |
| **ECOWAS Excluding Nigeria** | **6.1** | **5.9** | **5.0** | **5.6** | **5.7** | **7.2** | **6.0** | **8.1** | **7.1** | **6.7** | **7.3** | **6.4** |

Source: WAMA

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