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Exchange rate regimes and revenue performance in Sub-Saharan Africa

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Abstract

It has been argued that the institutions of the CFA Franc zone may have reduced inflation but that they also induced misalignment of the real exchange rate and that this is the explanation for their dismal revenue performance. This paper uses a panel of 22 countries in Sub-Saharan Africa to estimate revenue performance over the period from 1980 to 1996. It finds that the poor cumulative relative revenue performance of the Franc zone countries is mainly attributable to differences in environmental and structural factors, and to their different responses to changes in the equilibrium real exchange rate, but that the misalignment of the real exchange rate also played a part. © 2001 Elsevier Science B.V. All rights reserved.

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1. Introduction

During the 1980s and early 1990s, the countries of the CFA Franc zone experienced a steady decline in the ratio of tax to GDP, from almost 15% of GDP in the early 1980s to only 11.5% in the early 1990s. By contrast, over the same

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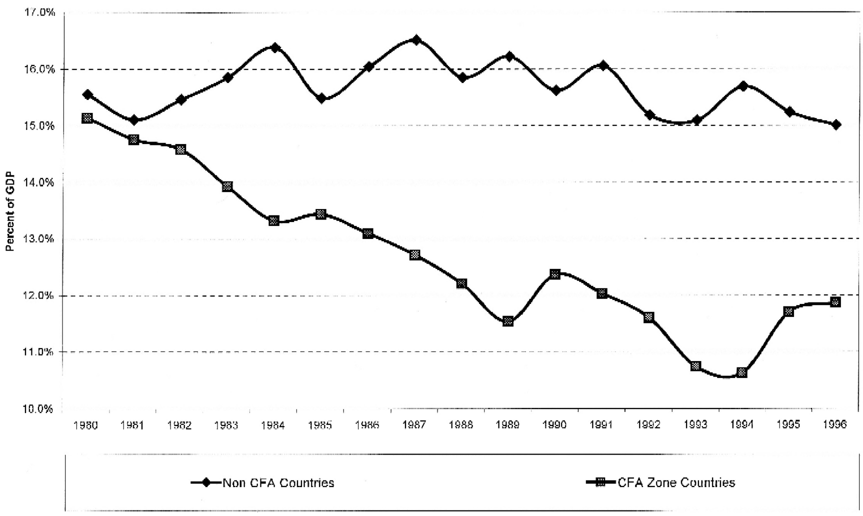

Fig. 1. Average tax yield by country grouping (percent of GDP 1980–1996).

period the tax yield in countries outside the zone remained remarkably stable at around 15.5%. Following the devaluation of the CFA Franc in January 1994, the decline in the tax ratio halted and there is evidence of a slight recovery by 1996. This pattern of relative decline in the CFA zone is repeated for each of the major components of total tax revenue, namely income taxes, domestic indirect taxes and taxes on international trade (see Fig. 1 and Table 1).[1]

A natural question is whether these differences can be explained solely in terms of a different evolution of the determinants of revenue productivity or whether the two groups of countries differ in a more fundamental sense. A substantial literature has explored how the institutional characteristics of the zone may have contributed to a distinctive macroeconomic response to external events. This literature argues that the mechanism guaranteeing the convertibility of the CFA Franc, the overdraft facility provided by the French Treasury, relieves the domestic economy of the obligation to adjust to external disequilibria, at least in the short to medium term. It has been suggested that whilst this structure successfully delivered low inflation and high growth in the early 1980s, the inflexibility it imparted to the domestic price system retarded adjustment to deteriorating external circumstances in the late

[1] Throughout this paper, we are basing our inference on a sample of countries in SSA, not on the population. This partly reflects data availability but we also intentionally exclude countries whose tax base is dominated by natural resources—notably the oil-producing countries. A complete description of the data and sample is provided in Appendix B.