Benin—Assessment Letter for the World Bank

1. This letter provides an assessment of recent macroeconomic developments in Benin and an update on the discussions of Fund staff with the Beninese authorities on macroeconomic policies and structural reforms that could form the basis for the authorities' request for a new arrangement under the Extended Credit Facility (ECF). An earlier assessment letter to donors was issued in December 2009 and is available at http://www.imf.org/external/pp/longres.aspx?id=4399.

Background

2. The last three-year arrangement with Benin under the Poverty Reduction and Growth Facility (PRGF) expired on June 30, 2009. At the time of the approval of the sixth and last review under the PRGF arrangement on June 24, 2009, the IMF Executive Board approved the authorities' request for an augmentation of access of 15 percent of quota (equivalent to about $15 million) to help mitigate the impact of the global economic crisis on Benin. The authorities' program presented with the sixth review included quarterly indicative targets for 2009 and a plan to complete three outstanding structural benchmarks by end-2009. A copy of the staff report for the sixth review is available on the IMF website at http://www.imf.org/external/pubs/cat/longres.cfm?sk=23187.0. In addition, Benin received a total of SDRs 49.76 million (about $78 million) as a result of the general and special SDR allocations on August 28, 2009 and on September 9, 2010, respectively, in order to alleviate further the negative impact of the global economic crisis.

Recent Economic Developments and Near-Term Prospects

3. The global economic crisis continues to adversely affect the near-term prospects of the Beninese economy. Real GDP growth is estimated at 2.7 percent for 2009 and projected at 3.2 percent for 2010, a significant decline from 5.0 percent in 2008. The slowdown is mainly driven by weak prospects for cotton production and exports, and trade with neighboring countries, notwithstanding a significant fiscal expansion. Inflation continues to decline, averaging 2.2 percent in 2009, because of lower agricultural and fuel prices. Despite an improvement in terms of trade, the external current account deficit, excluding grants, is estimated to have widened to 10.8 percent of GDP in 2009, reflecting mostly a decline in cotton exports and mirroring the increased fiscal deficit.

4. The fiscal situation deteriorated significantly in 2009. The slowdown in economic activity resulted in fiscal revenues being broadly unchanged in nominal terms compared with 2008. In particular, customs collections declined by 7 percent. At the same time, the wage bill grew by 24 percent, mainly driven by a doubling of the cost of bonuses and other fringe benefits to civil servants. Domestic capital spending doubled compared to 2008, due in part to CFAF 113.2 billion carryover of expenditure commitments from 2008 without

corresponding financing. The overall fiscal deficit (on a payment order basis, excluding grants) increased to 7.3 percent of GDP, putting strong pressures on the treasury.

5. During the second half of 2009, the government started to redress the public financial situation to prevent a further accumulation of domestic payment arrears by end-2009. The adjustment measures introduced by the government in August 2009 included: 1) limiting bonuses and other benefits to civil servants; 2) regularizing exceptional payment procedures (*ordres de paiement*) for 2006, 2007, and 2008, and strongly limiting the use of these procedures in the future; 3) strengthening the monitoring of budget execution with the involvement of the Treasury Committee; 4) reviewing outstanding government bills before paying them; and 5) adopting an emergency plan to improve tax revenue.

6. Following an IMF mission to Cotonou in September 2009, the authorities took additional measures to contain public spending and mobilized additional donor support to cover the financing gap for the remainder of 2009. In particular, the authorities: 1) stopped most expenditure commitments for capital investment as of September 28, 2009; 2) scaled back pensions and scholarships by CFAF 5.3 billion; 3) reduced other expenditures and transfers; and 4) postponed about CFAF 50 billion in capital spending to the 2010 budget. Notwithstanding these efforts, the overall cash deficit (excluding grants) reached 9.1 percent of GDP, a fiscal deterioration of 2.4 percent of GDP compared with the authorities' program supported by the IMF Executive Board in June 2009.

7. The authorities mobilized the following additional resources totaling CFAF 108.6 billion (3.5 percent of GDP) to finance the deficit: 1) the domestic counterpart of the SDR allocation equivalent to CFAF 32.8 billion; 2) the bond refinancing guaranteed by the regional central bank of CFAF 36.5 billion; 3) the transfer of 17.5 percent of shares owned by the state in the ginning company SODECO to the strategic investor; 4) the reimbursement of unused grants for free nursery and primary education for the school year 2008/09; 5) the compensation of customs revenue losses by ECOWAS as part of the common tariff agreement; and 6) grants totaling CFAF 25.1 billion from the African Development Bank and the European Union following the issuance of the Fund staff's assessment letter in December 2009.

8. The authorities continue to make progress on the implementation of their structural reform agenda. In the second half of 2009, they extended the use of the taxpayer identification number (TIN) to all importers and exporters and all large enterprises; they have appointed a unit for the management of reforms at the Ministry of Finance, charged with implementing the action plans for strengthening tax and customs administration; and they have completed a financial audit of the pension fund for civil servants (FNRB) which identified options for strengthening its actuarial balance. In September 2009, they awarded the concession for the operation of the container terminal at the Port of Cotonou to an international operator. In December 2009, they sold 65 percent of the state-owned wood company (*Office National du Bois*) to a private company. In March 2010, they sold their

51 percent stake in the Beninese-Nigerian cement company (*Société des Ciments d'Onigbolo*) to an international investor. At the same time, the government decided to improve the financial operations of the state-owned electricity company (*Société Beninoise d'Electricite et d'Eau)* by: 1) increasing electricity tariffs on average by CFAF 10 per KWh; 2) converting into capital about CFAF 14 billion in debt owed to the state; 3) rescheduling and guaranteeing the debt service on CFAF 15.7 billion of debt owed to the West African Investment Fund (SOAGA); and 4) securitizing CFAF 25 billion in debt owed to the power generation company CEB. Finally, the authorities have launched the sale of a majority stake in Benin Telecom.

Discussions on a new ECF Arrangement

9. Broad understandings were reached with the authorities during the March 2010 mission to Cotonou on the main elements of a program that could form the basis for the authorities' request for a new ECF arrangement. The understandings are subject to internal review by IMF staff and management, before they can be presented to the IMF Executive Board for consideration.

10. In terms of fiscal policy, Fund staff considers the 2010 budget adopted by presidential decree in January 2010 to be optimistic. The budget, which was not discussed with Fund staff before being presented to the National Assembly, is based on a 37 percent increase in revenues compared with the estimates for 2009. The increase in tax and nontax revenue is projected at 33 percent and 65 percent, respectively. On this basis, total revenue is expected to reach CFAF 788.2 billion (23.8 percent of GDP), compared to CFAF 575.8 billion (18.4 percent of GDP) collected in 2009. Part of this increase is explained by a new tax on international telephone calls, an increase in the tax rate on cement from 10 percent to 18 percent, a projected expansion of taxable transit trade induced by the reduction in the tax on re-export from 8 percent to 4 percent, and the planned sale of three 3G GSM licenses in 2010. Total expenditures would expand by 31 percent vis-à-vis the outturn of 2009, to CFAF 1,052.6 billion (31.8 percent of GDP), compared to CFAF 805.4 billion (25.3 percent of GDP) spent in 2009. Accordingly, the overall cash deficit (excluding grants) would be equivalent to 8.5 percent of projected GDP. In addition, the budget shows a financing need of CFAF 165 billion (5 percent of projected GDP), and does not take into account CFAF 50 billion in carryover spending from 2009.

11. In March 2010, the Beninese authorities and Fund staff reached understandings on a revised fiscal policy for 2010 and the medium term. In particular, the minister of finance will implement the budget in line with available resources. Revenue projections have been revised to a more prudent 18 percent increase from 2009, to CFAF 681.9 billion (20.6 percent of GDP); the overall expenditure envelope on a payment-order basis would be limited to CFAF 876.0 billion (26.5 percent of GDP), including the expenditure carryover of CFAF 50 billion from 2009. This is in line with the expected available financing, including CFAF 50 billion in financing which the authorities expect to cover through additional

budgetary support from the African Development Bank, the EU, the IMF, the World Bank and possibly other donors. Accordingly, the overall deficit on a payment order basis (excluding grants) is projected to decline to CFAF 194.1 billion (5.9 percent of GDP), from CFAF 229.6 billion (7.3 percent of GDP) in 2009. Expenditure could be further increased if the authorities are able to mobilize additional revenues or additional external concessional financing on top of what is expected to cover the CFAF 50 billion financing gap. Fund staff believes that this revised fiscal policy for 2010, if implemented as planned, will provide the adjustment required to avoid a recurrence of the financial problems experienced in 2009 and will constitute substantial progress toward bringing public finances on a sustainable path. For the medium term, the authorities and IMF staff have agreed on a gradual fiscal adjustment which would preserve fiscal and debt sustainability, while allowing the fiscal space for priority spending.

12. Faced with prolonged strikes and the risk of the cancellation of annual exams, the government granted additional wage concessions to the education sector in the first quarter of 2010. In particular, it agreed to increase salaries for professors starting in October 2010 at an annual cost to the budget of CFAF 12 billion (CFAF 3 billion for 2010), and to increase the housing allowances of primary and secondary teachers from October 2010 and their salaries (by 25 percent) from January 2011, at an annual cost of CFAF 7.4 billion (CFAF 0.4 billion in 2010). The authorities have restated their commitment to Fund staff to make the necessary cuts (CFAF 3.4 billion for 2010) in other expenditure items to preserve the agreed expenditure envelope. They also committed to implementing ongoing capital projects in 2010, before new ones are started.

13. On the structural reform side, the government will shortly be launching the bids for the implementation of the single stop window (*guichet unique*) at the Port of Cotonou. The decrees necessary to implement the new 2009 public procurement law will be adopted by September 2010. The two outstanding structural benchmarks from the last PRGF arrangement (the extension of the ASYCUDA++ to 12 additional customs posts and the adoption of a strategic information system at the tax department) are expected to be completed by end-2010. The government also intends to put in place a transparent regulatory system for the electricity sector by June 2011 with a view to opening up the capital of the state-owned electricity company to the private sector. Finally, it plans to adopt a global strategy for civil service reform by June 2011.