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Executive Summary

This paper analyzes the impact of Benin's public wage policy on medium- and long-term fiscal and debt sustainability.[1] From 2000 through 2009, the wage bill in Benin grew on average by 9.6 percent annually in real terms; meanwhile average real GDP growth was 4.2 percent. From 2007 to 2009, wage bill growth accelerated to an average of 14.7 percent per year in real terms. While Benin's wage bill as a share of tax income was for quite some time in the mid-range among the WAEMU countries, at 45.1 percent of revenue it is now in the upper range and well above the WAEMU convergence criterion of a 35 percent maximum.

The main findings of this study are that if the wage bill continues to increase in line with recent trends,[2] it would compromise debt and fiscal sustainability over the medium to long-run by generating excessive deficits or by crowding out growth-enhancing public investment. The study shows that with a fiscal policy guided by targets set in order to maintain debt sustainability, population growth, and the intent to progress towards the Millennium Development Goals, there will only be little space for civil service pay increases. Similarly, complying with the WAEMU convergence criteria will require a trade-off between the number of staff and real wage increases.

Limiting wage bill increases to maintain fiscal sustainability is only a first step in the authorities' broader objective of reforming the civil service.[3] Essential to more effective delivery of public services will be the ability to attract, retain, and motivate well qualified civil servants. This paper deals only with the fiscal sustainability effects of the total wage bill and the immediate need to contain total costs. However, in the medium term a comprehensive civil service reform will be necessary once the study of the civil service remuneration system commissioned by the authorities currently underway is completed.

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[1]This paper was presented to the Beninese authorities at a seminar in Cotonou on March 23, 2010, as part of the IMF Article IV consultations.

[2]2007–2009.

[3]For a background description of the Beninese civil service, see Annex.

CHAPTER

1 Background

Over 2007–2009, annual real growth in the wage bill averaged 14.7 percent. In 2009 in particular, wage costs in real terms increased by 21 percent and as a share of total tax revenue rose to 45.1 percent, well above the WAEMU convergence criterion of no more than 35 percent. Over the last decade, annual real growth in the wage bill averaged 9.6 percent[4]; meanwhile average real GDP growth was 4.2 percent. Albeit with large variation from year to year, this rise was driven by an annual average growth in the number of employees of 2.6 percent and real annual growth of average wages of 6.9 percent.

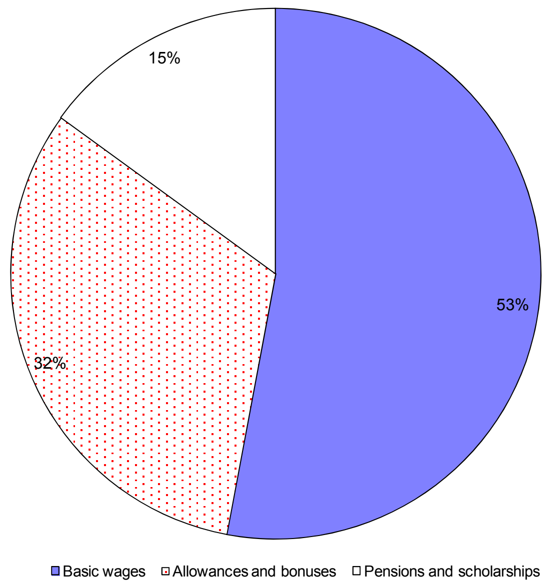
Basic wages account for 53 percent of total civil service staff costs (Figure 1). Total civil service staff costs are composed of two lines in the fiscal accounts: wages and salaries;[5] and pensions and scholarships. A closer look at the content of the wages and salaries line in the budget reveals that the ratio of the sum of different kinds of social contributions, allowances, and bonuses to wages and salaries is 38 percent. The pensions and scholarships line amounts to 15 percent of total staff costs. In the coming years costs for pensions and scholarships are set to increase because the number of civil servants claiming pension benefits is expected to rise from just over 10,000 in 2010 to nearly 30,000 after 2015.[6] It should also be noted that nominal budget figures may not give an exact figure of total staff costs because some types of compensation to employees may be incorporated into other items in the fiscal accounts.

[4]9.6 percent refers to 2000–2009. During 2000-2006 average real growth in the wage bill was 7.5 percent.

[5]*La masse salariale,* henceforth referred to as the wage bill, thus consist of basic wages; social contributions; allowances and bonuses.

[6]If no action is taken, the costs for pensions will increase dramatically in the years to come. However, a study on the financial viability of the Beninese national pension fund (FNRB) has recently been completed and a proposal for reform of the pension system is to be presented to the National assembly in December 2010.

Figure 1. Composition of Total Civil Service Staff Costs

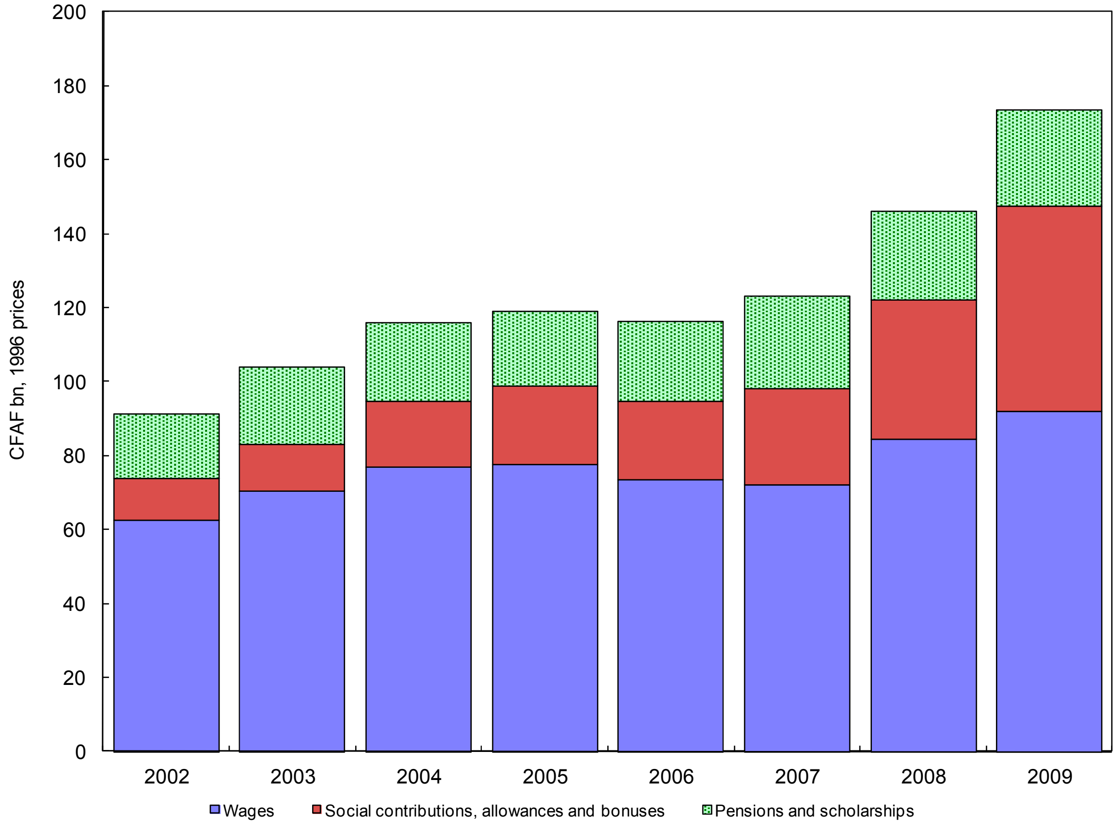


Sources: Ministry of Economy and Finance, and IMF staff estimates.

The surge in the wage bill in recent years has mostly been driven by increased bonuses (Figure 2). Basic wages in Benin were relatively stable from 2002 through 2007, and rose by an average of just 0.6 percent of GDP (CFAF 20 billion, 1996 prices) between 2007 and 2009. The most striking feature throughout the period is the continuous increase in the cost of social contributions, allowances and bonuses from an annual cost of CFAF 11 billion in 2002 (then 12 percent of total staff costs) to CFAF 56 billion in 2009 (32 percent). Pension costs remained stable throughout the period.

While bonuses should be more easily rationalized than wages, efforts to contain the growth of any part of the wage bill will be politically difficult. During the past two years labor unions have intensified their demands for improvements in compensation ahead of the 2011 presidential and legislative elections and continuous strikes among civil servants have had a negative effect on the provision of essential public services. The authorities have recently changed the law so that civil servants will no longer be paid for days on strike. Starting this year, they are also introducing a new framework for centralized wage negotiation which will help avoiding the situation of wage concessions to one sector triggering demands for wage increases in other sectors. It is also part of the government's economic program to implement a civil service reform in the next few years, including a revision of the remuneration system.

Figure 2. Civil Service Staff Costs by Category, 2002–2009



Sources: Ministry of Economy and Finance, IMF staff estimates.

A regional comparison shows wide diversity in wage costs. In 2009, only two of eight member countries, Niger and Senegal, fulfilled the WAEMU criterion of a wage bill no larger than 35 percent of tax revenue. Mali and Togo overshot the ceiling by a small margin, while the other four countries were well above it.

In the WAEMU region, Benin's wage bill is among the largest. The share of wages to tax revenue in Benin increased substantially to over 45 percent in 2009, well above the convergence criterion and only surpassed by Burkina Faso and Guinea-Bissau (the latter being a post-conflict country) among the WAEMU countries. Relative to GDP, except again for Guinea Bissau, Benin has the highest wage bill in the WAEMU region (Table 2). While the WAEMU convergence criterion and spending on wages in other countries in the region are useful points of reference, it is noteworthy that cross country comparisons of wage expenditures are complicated by a variety

Table 1. Wages and Salaries/tax revenue in WAEMU (≤35 percent)

	2005	2006	2007	2008	2009 Prel.
Benin	39.0	35.6	32.0	35.6	45.1
Burkina Faso	42.0	44.1	46.3	44.7	49.6
Côte d'Ivoire	45.0	42.1	43.6	43.4	40.6
Guinea Bissau	115.9	111.0	116.5	96.9	78.6
Mali	30.9	30.9	32.9	35.8	36.0
Niger	34.8	33.4	31.0	29.8	28.3
Senegal	30.0	31.0	30.1	32.0	32.9
Togo	30.4	33.1	32.8	32.7	37.3
WAEMU	38.0	37.2	37.2	38.2	38.9

Sources: National authorities and staff estimates.

Table 2. Wages and Salaries/GDP in WAEMU

	2005	2006	2007	2008	2009 Prel.
Benin	5.6	5.5	5.4	6.1	7.2
Burkina Faso	4.9	5.3	5.8	5.5	6.0
Côte d'Ivoire	6.5	6.5	6.7	6.8	6.9
Guinea Bissau	13.4	12.4	12.0	9.8	9.4
Mali	4.8	4.6	4.7	4.8	5.1
Niger	3.5	3.6	3.5	3.5	3.7
Senegal	5.5	5.8	6.1	5.9	6.2
Togo	5.1	5.4	5.3	6.1	6.1
WAEMU	5.6	5.7	5.9	5.8	6.2

Sources: National authorities and staff estimates.

of country specific conditions and ways of measuring wage costs.[7] With these caveats in mind, compared to all Sub-Saharan African countries Benin's spending on wages and salaries as a share of tax revenue and GDP is on the other hand not far above the average.[8]

[7]Comparisons of civil service wage costs and employment are inherently difficult, not only due to lack of data. When data is available comparisons are complicated by the fact that different countries use different definitions both for staff costs and number of employees. See for example Salvatore Schiavo-Campo (1998).

[8]For Sub-Saharan African countries, the unweighted average share of wages and salaries to tax revenue is 43 percent. The unweighted average share of wages and salaries to GDP is 7.4 percent.

CHAPTER

2 Scenarios

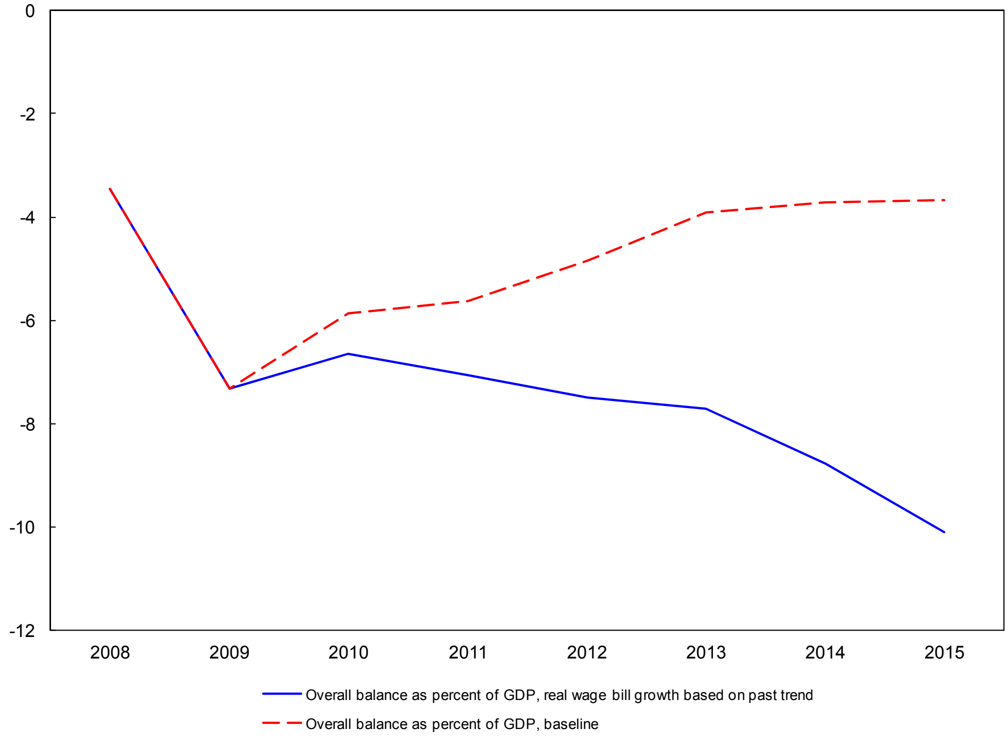
The objective of improving the productivity of the Beninese civil service could be addressed over the medium term through a comprehensive reform agenda. In the short term, however, the rate of growth in wages and salaries in Benin in recent years deserves immediate attention because of the threat to debt and fiscal sustainability and the risk of crowding out productive spending. In this section we examine the effects on debt and fiscal sustainability of different wage cost scenarios.

Baseline Scenario

After a decade of 9 percent annual average real growth in wage costs, the baseline scenario assumes that real wage growth moderates over the medium and long term to about 3 percent a year. This scenario is consistent with the macroeconomic framework of the 2010 Article IV Consultation. After a drop to 2.7 in 2009 and an expected 3.2 percent in 2010 due to the global economic crisis, real GDP growth is expected to recover to an average of 6 percent over the medium and long term. Fiscal policy will be guided by targets set in terms of debt sustainability with a primary deficit of about 1.0 percent of GDP over the long run. With these assumptions, the joint IMF-World Bank debt sustainability analysis (DSA) confirms that Benin faces a moderate risk of debt distress in the long term. However, this outcome is contingent on continued structural reforms to enhance growth, expand exports, and attract foreign direct investments, which would improve long-term debt dynamics. As highlighted in the World Bank 2009 Country Economic Memorandum (CEM),[9] investments in infrastructure will be critical to enhanced growth in Benin.

[9] Available at http://web.worldbank.org/external/default/main?pagePK=51187349&piPK=51189435&theSitePK=322639&menuPK=64187510&searchMenuPK=322668&theSitePK=322639&entityID=000333037_20090721001130&searchMenuPK=322668&theSitePK=322639.

Figure 3. Scenario I: Overall Fiscal Balance
(Real Wage Bill Growth Based on Past Recent Trend)



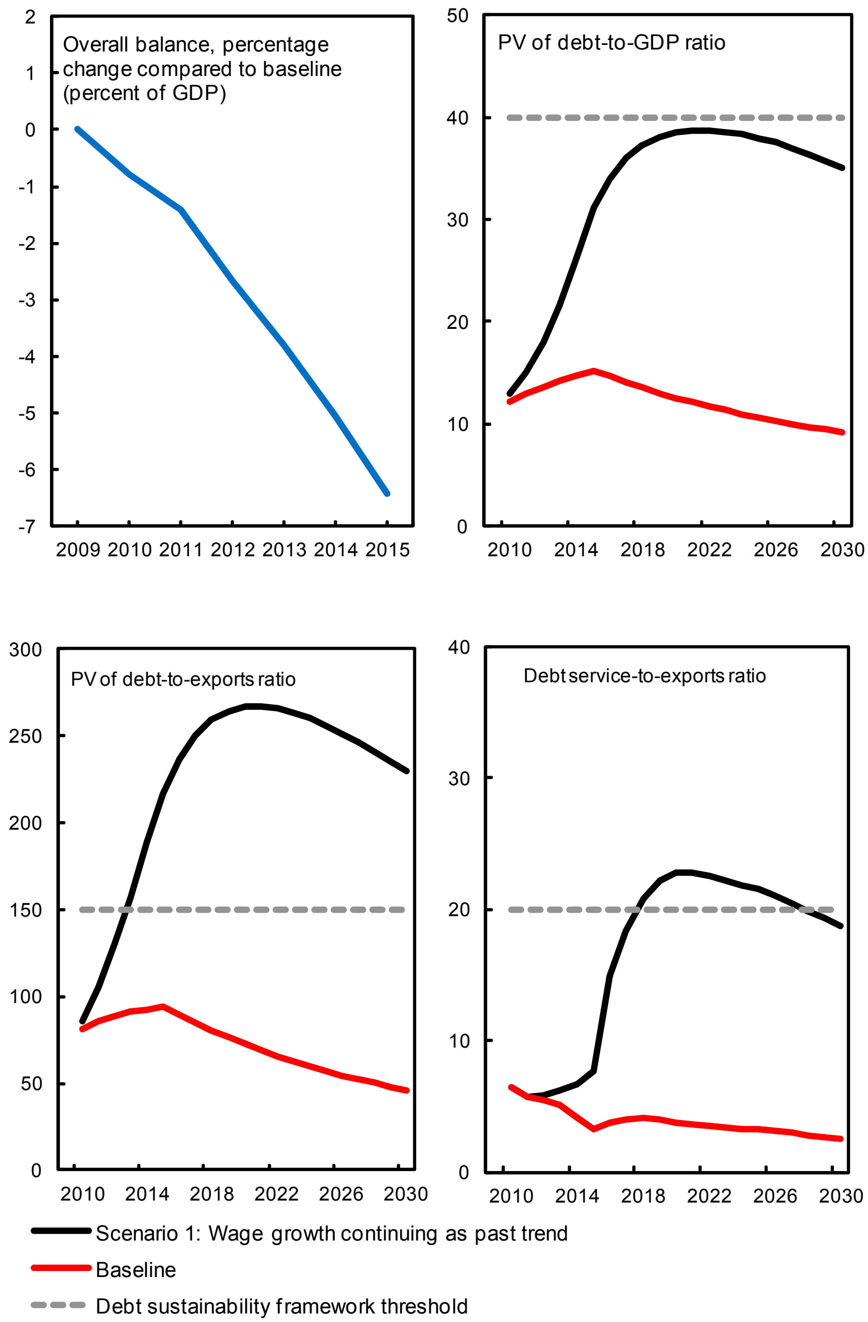
Sources: Ministry of Economy and Finance, and IMF staff estimates.

Scenario I

At the current pace, the growing wage bill will cause a significant deterioration in fiscal sustainability over the medium term. Scenario I assumes that the wage bill will continue to grow at the average real growth rate of 14.7 percent during the last three years over the medium term. All other expenditure items are assumed to stay unchanged except for an increase in interest payments as a result of the higher deficit. This would lead to a significant deterioration of the fiscal balance to over 10 percent of GDP by 2015 (see Figure 3), compared with under 4 percent in the baseline scenario.

Without corrective measures, surging wage costs will also significantly undermine debt sustainability in the long term. With the wage bill growing according to past trends through 2015 and by an annual rate of 3 percent in real terms thereafter, Benin would be downgraded from a moderate- to a high- risk country in terms of debt distress as early as 2018

Figure 4. Scenario I: Real Wage Bill Growth Based on Recent Trend



Sources: Ministry of Economy and Finance, and IMF staff estimates.

according to the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries.[10] [11]

Scenarios II and III

A continued increase in the number of civil servants is needed if Benin is to make progress toward the Millennium Development Goals (Scenarios II and III). The total wage bill has in the past been driven by a combination of average wage increases and a rise in the number of public employees. To take account of this, these two factors are separated: Scenario II assumes that the growth in health and education staff tracks population growth, while the number of other staff stays constant, and that average wages for all civil service staff increase according to past trend (Figure 5).[12] As a variation to scenario II, scenario III assumes that the total number of civil service staff, not just health and education staff, increases in line with population growth and that their average wages increase according to past trend (Figure 6). With these two scenarios debt sustainability would be substantially affected and in both cases one threshold in the Debt Sustainability Framework for Low-Income Countries would be surpassed. The fact that health and education staff together account for about 70 percent of the total number of civil service staff and that scenario II and III thus give similar outcomes also illustrate that the education and health sectors together are the dominant drivers of total staff costs.

Scenario IV

Population growth and increased demand for government services implies limited space for wage increases. Unless the utilization of civil

[10]This is under the assumption that half of this increase in wage costs would be financed by multilateral donors and half by commercial lenders.

[11]The latest Debt Sustainability Analysis for Benin (forthcoming) will be published at http://www.imf.org/external/country/BEN/index.htm. Debt sustainability is assessed in relation to policy-dependent thresholds for the net present value of external debt and the external debt service burden. Benin's CPIA rating for 2006-2008 was 3.57. A rating between 3.25 and 3.75 reflects medium performance; a rating below 3.25 corresponds to weak performance, and a rating above 3.75 corresponds to strong performance. Medium performance implies the following external debt sustainability thresholds: a present value (PV) of debt-to-GDP ratio of 40 percent, and PV of debt-to-exports ratio of 150 percent, an PV of debt-to-revenue ratio of 250 percent; a debt service-to-exports ratio of 20 percent and a debt service-to-revenue ratio of 30 percent.

[12]This thus mirrors the assumption that in order to make progress toward the Millennium Development Goals, the staff increase needs to be mainly to the benefit of priority social sectors.

Figure 5. Scenario II: Number of Health and Education Staff Increasing in Line with Population Growth, Average Wages Increase as Recent Trend

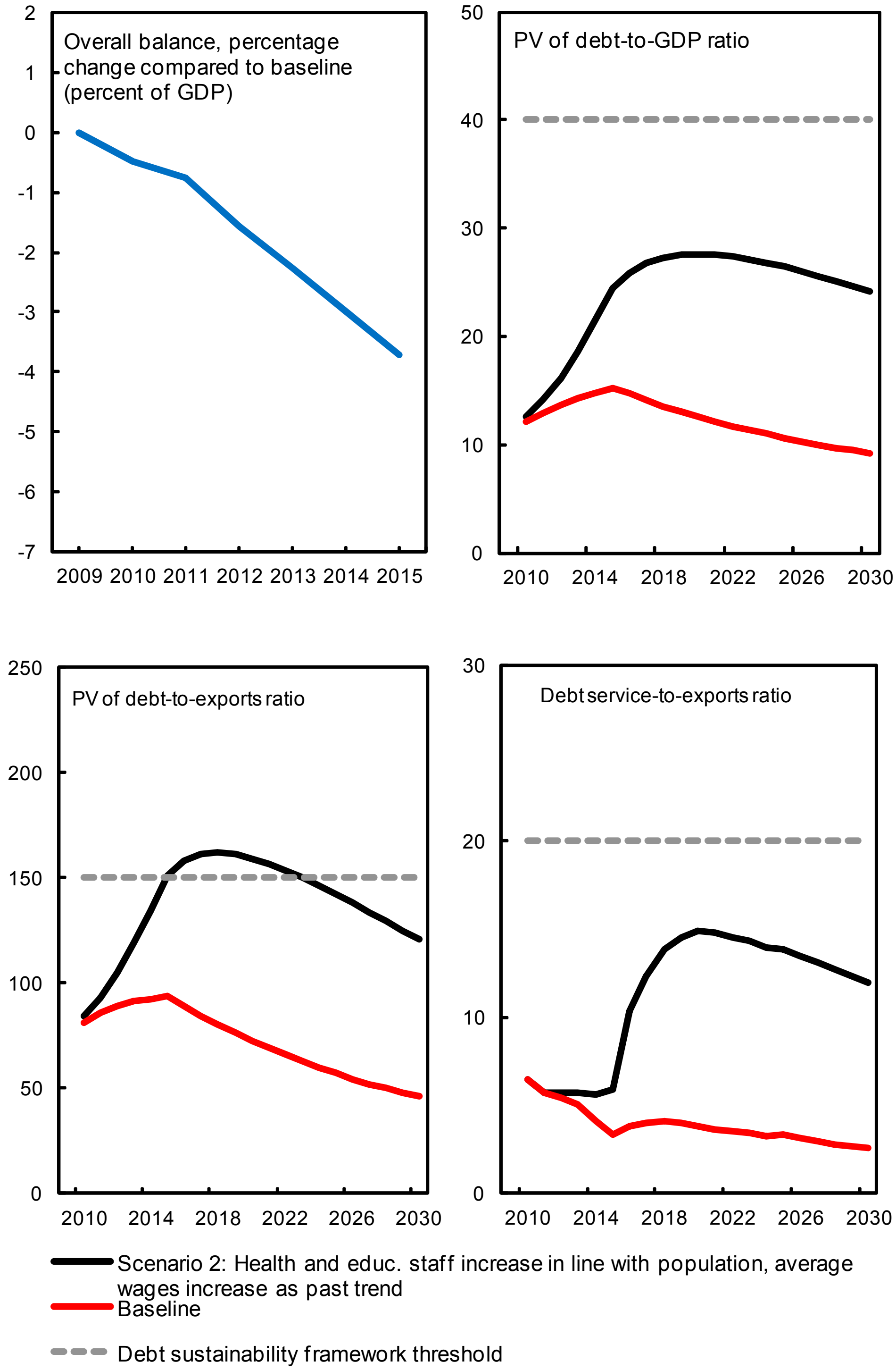
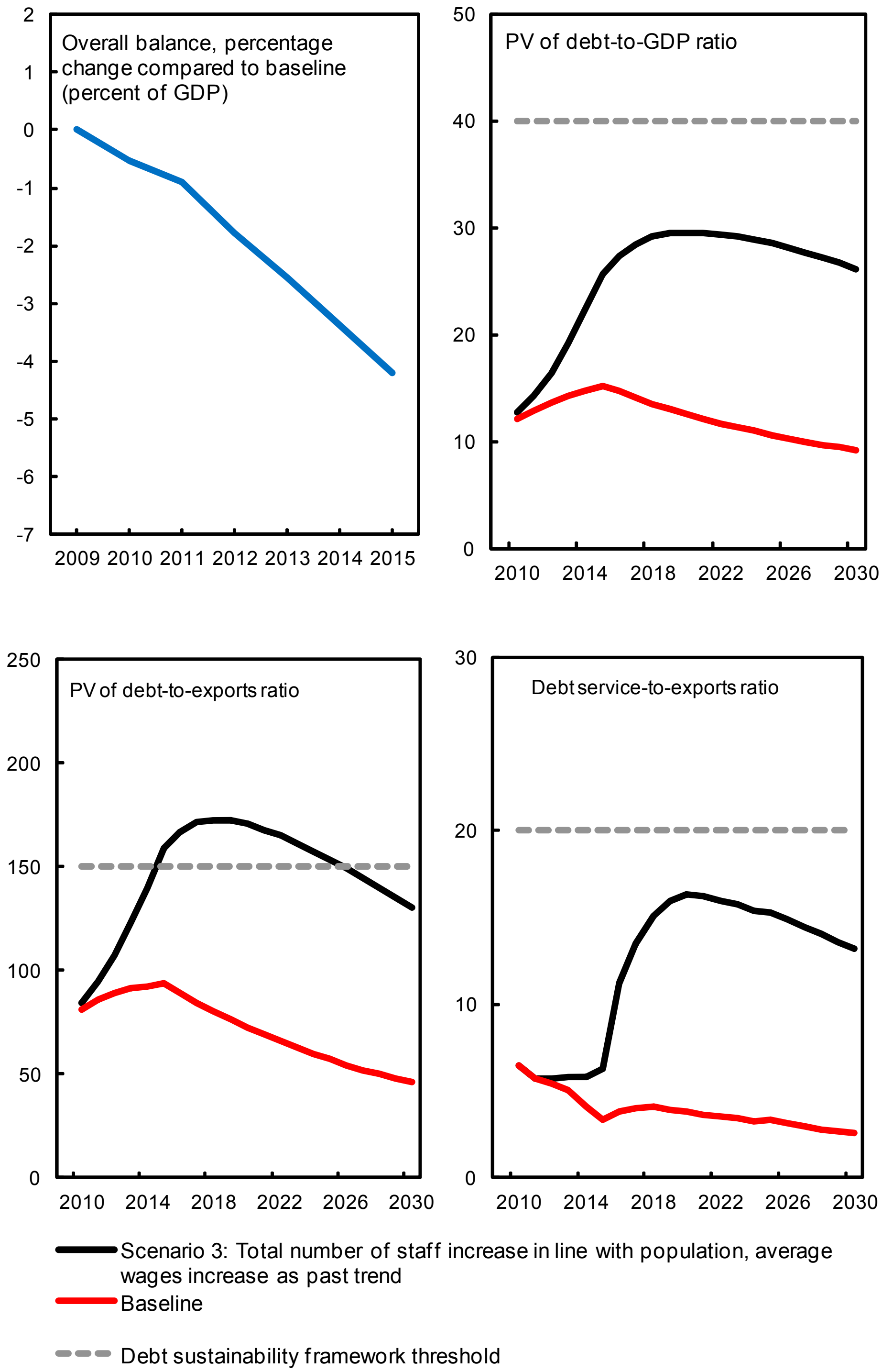


Figure 6. Scenario III: All Categories of Staff Increasing in Line with Population Growth, Average Wages Increase as Recent Trend



service staff becomes more efficient, maintaining the present level of services would require an increase of the number of civil service staff in line with population growth estimated by 2.8 percent a year.[13] The baseline projection of a 3 percent real growth of total wage costs thus leaves very little room for any real wage increase. This is illustrated by Scenario IV, in which the total number of staff increases in line with population growth throughout the projection period and average real wages are unchanged (Figure 7).

Scenario V

If spending on wages crowds out investment spending, long term growth will be negatively affected. The previous scenarios assumed that changes in the total wage bill would be accommodated with a corresponding change in total expenditure and the overall fiscal deficit. Assuming instead that total spending and the corresponding fiscal deficit would remain as in the baseline scenario, other non statutory expenditure, which consists mostly of capital spending, would have to be reduced. If wage costs continue to grow at past trend (see Scenario I) and the additional spending is financed by reducing capital spending, real GDP growth would be reduced on average by about 1.1 percentage points annually from 2010 to 2015[14], with the reduction increasing in the outer years.

Debt sustainability in Benin is particularly vulnerable to slower growth of real GDP and exports. Lower public investments will suppress growth not least through reduced exports and foreign direct investment, given the implicit fall in competitiveness. Adjusting the debt sustainability analysis assumptions accordingly[15] (see Figure 9) would result in a significant deterioration in Benin's debt sustainability over the long term.

[13]World Development Indicators (WDI07), estimated population growth in Benin 2005–2015.

[14]Calculation is based on an estimated Incremental Capital Output Ratio (ICOR) of 2.8.

[15]GDP is assumed to grow by an average 4.0 percent per year in the long term.

Figure 7. Scenario IV: Total Number of Staff Increasing in Line with Population Growth, Constant Real Average Wages

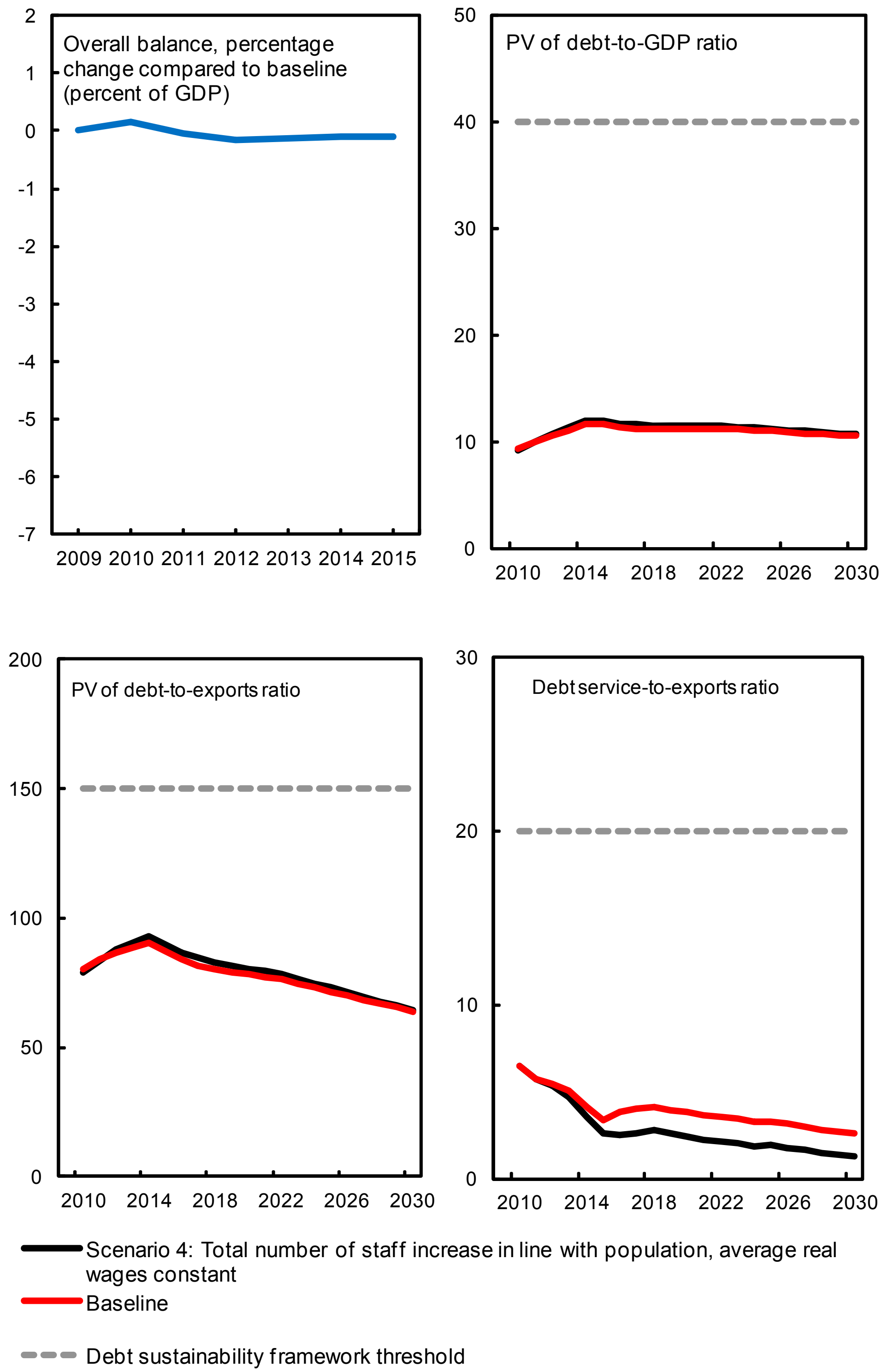
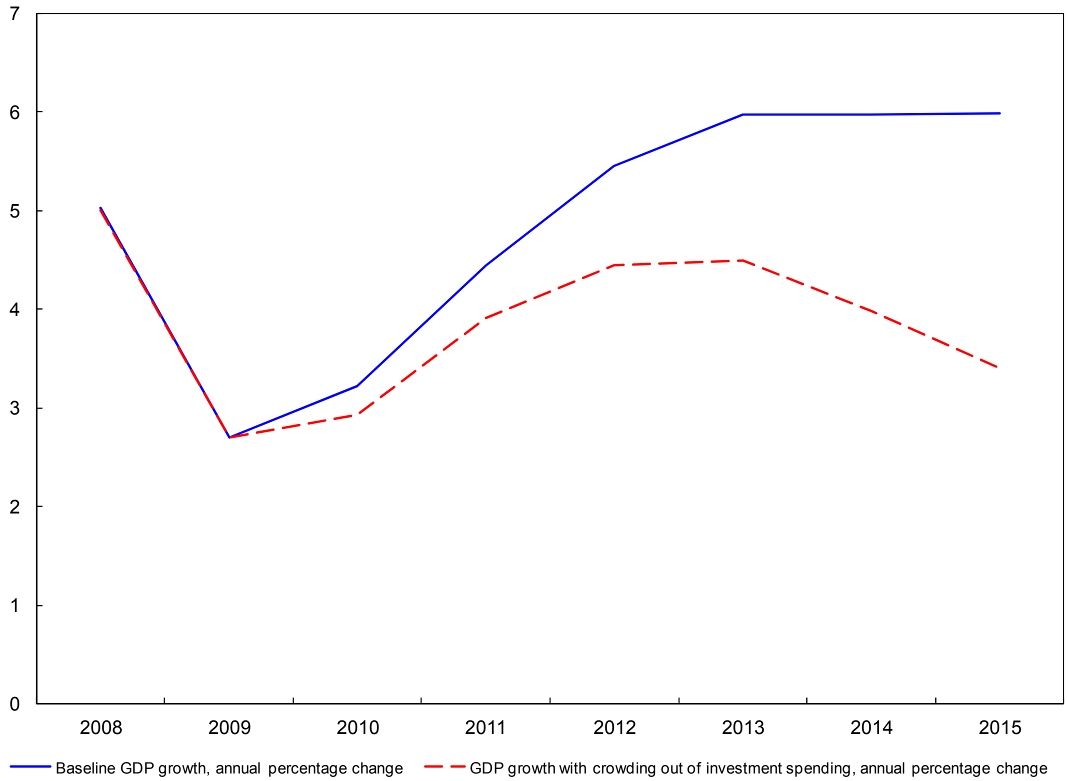


Figure 8. Scenario V: Growth Effect from Wage Costs Crowding Out Investment Spending

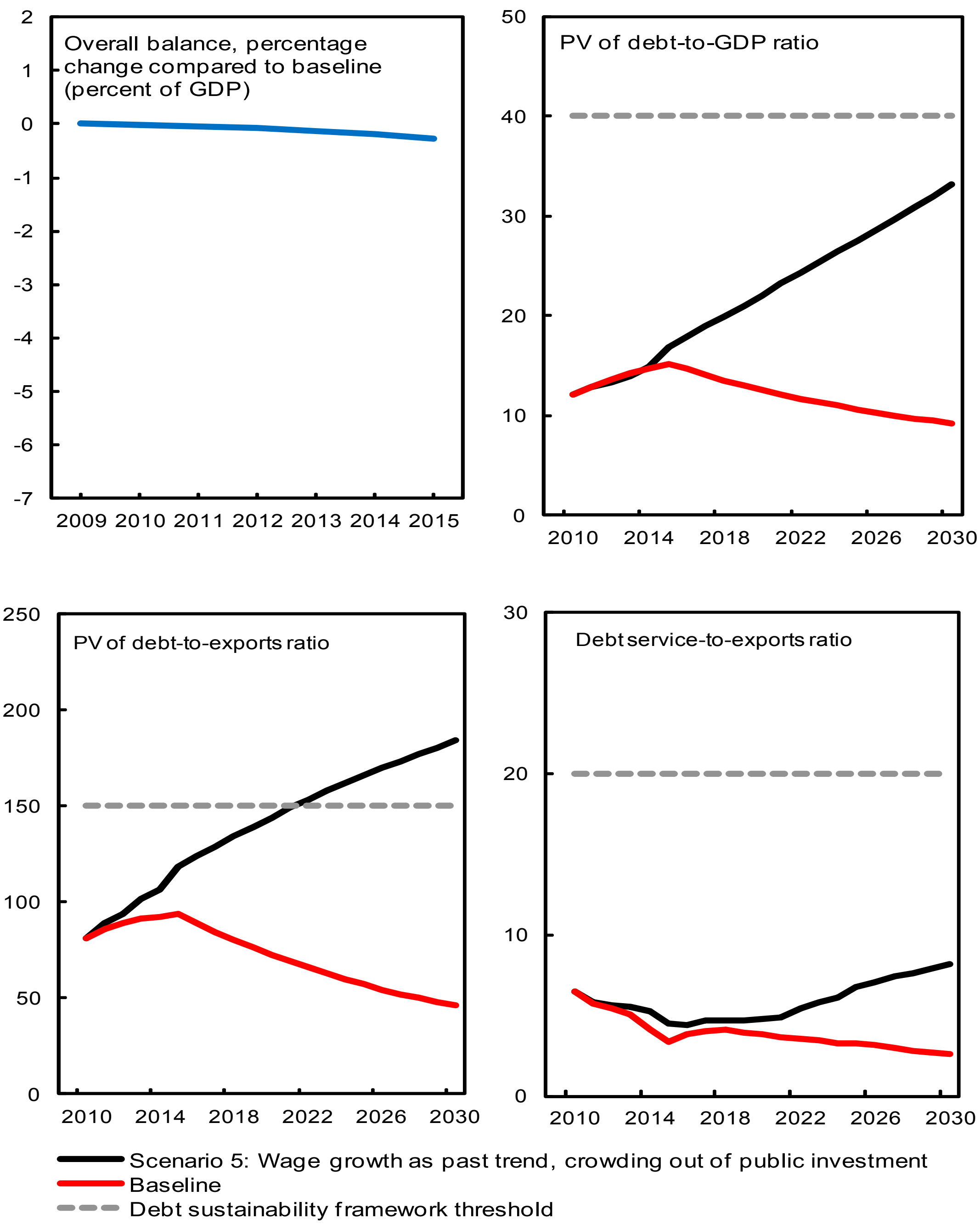


Sources: Ministry of Economy and Finance, and IMF staff estimates

WAEMU Convergence Criteria Scenarios

Compliance with the WAEMU convergence criteria would imply a trade-off between the number of civil service staff and real wage increases. The baseline scenario forecasts a gradual return to compliance by 2015. Again, this assumes an annual real increase in total wage spending just above population growth, leaving little room for real wage increases. Assuming a gradual return to compliance with the WAEMU criterion over the medium term and average wages continuing to increase in line with past trend, total staff in 2015 would have to be 20 percent fewer than in 2009. Assuming instead that the number of civil service staff would stay constant over the period, compliance with the WAEMU criterion would allow for average wages to increase by about 3 percent in real terms a year until 2015.

Figure 9. Scenario V: Wage Costs Crowding Out Investment Spending



Sources: Ministry of Economy and Finance, and IMF staff estimates.

CHAPTER

3 Conclusions

A continued increase in the wage bill in line with recent trends will compromise Benin's debt and fiscal sustainability in the medium- to long-term by generating excessive fiscal deficits or by crowding out growth-enhancing public investment. A fiscal policy guided by targets set in order to maintain debt sustainability, in tandem with population growth and the objective of progressing toward the Millennium Development Goals, will leave only little space for civil service pay increases. Similarly, bringing Benin into compliance with the WAEMU convergence criteria will imply a trade-off between number of staff and real wage increases. In the short- and medium term, in order to address these trade-offs and to keep wage costs in line with available budget resources, a framework for centralized wage negotiations and the introduction of multiannual labor contracts will be essential, not least given the dominance of two main sectors in driving civil service wage costs.

To meet the challenge of maintaining fiscal sustainability while strengthening public service delivery to meet development objectives, civil service reform will be critical. In the medium- to long-term, the ability to attract, retain, and motivate well qualified civil servants will be essential to strengthen public service delivery. This could be achieved by means of a comprehensive civil service reform oriented toward a more transparent and results-oriented remuneration system, a staff structure that adequately reflects skills and responsibilities and more efficient utilization of civil service staff. Toward this end a detailed study of the Beninese civil service remuneration system which will inform future reforms is now under way.

Annex. The Civil Service in Benin

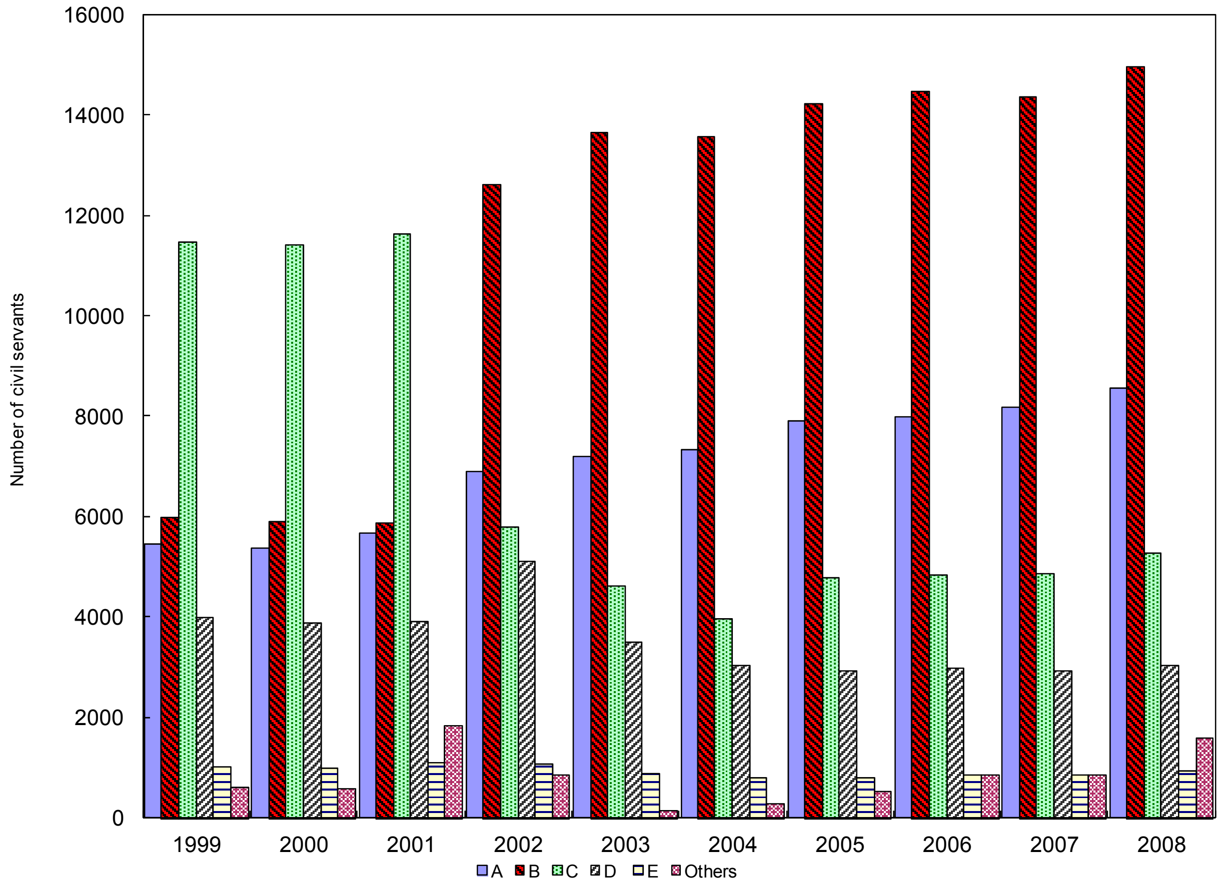
The structure of the civil service in Benin today reflects the country's pre- and postcolonial history. After independence in 1960, Benin continued to be operated according to pre-colonial ethno-regional divisions that were reflected in public institutions. In 1974, the Marxist-Leninist regime introduced a policy of 'full employment' that steeply increased the number of civil servants and resulted in widespread gaps between capacities, positions, work performance, and remuneration. In 1989 the oversized wage bill was the direct cause of a fiscal crisis that led to a large accumulation of domestic wage arrears. Part of the structural adjustment package that was introduced to redress the situation was a freeze in recruitment and in salaries.

This skewed the age structure of the civil service and resulted in a large proportion of staff in the upper staff categories and a high proportion of contracted personnel[1] (figure 1). Data from the Ministry of Civil Service show that the number of civil servants reaching retirement age is rapidly increasing; the number of retired staff is expected to rise from about 10,000 in 2010 to nearly 30,000 as 2020 nears. This will put increased pressure on the civil service pension fund, an issue that the authorities are now addressing through a new strategy to close its actuarial deficit. The rate of retirement is especially pronounced for the highest staff categories, A and B, which together account for 69 percent of total permanent civil service staff. This top-heavy structure is another notable characteristic of the Beninese civil service. This is a reflection not of an unusually skilled workforce, but of a system of automatic promotion policy to compensate for the wage freeze in recent years.

Earlier attempts to reform the civil service failed, despite considerable efforts and support from bilateral and multilateral institutions. Following a national conference on Civil Service and Public Sector Management Modernization in 1994, a new pay scale and performance-based compensation mechanism was presented to the National Assembly in 1998.

[1]Higher staff categories here refers to categories A and B.

Figure 1. Civil Servants by Category



Source: Ministry of Labor and Civil Service.
Remark: A is the highest pay scale category of staff, E the lowest.

The initiative was, however, stalled by resistance from trade unions, public officials, and National Assembly representatives, many of whom were themselves civil servants. At the request of Beninese authorities, earlier PRGF arrangements with Benin included indicative targets on the government wage bill. More recently, the Fund has instead recommended that the authorities enter into multiannual contracts with trade unions and undertake a comprehensive civil service reform to contain the wage bill.

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