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Benin: 2006 Article IV Consultation, First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Request for Waiver of Nonobservance of Performance Criteria—Staff Report; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Benin

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2006 Article IV consultation with Benin, first review under the three-year arrangement under the Poverty Reduction and Growth Facility, and request for a waiver of nonobservance of performance criteria, the following documents have been released and are included in this package:

- the staff report for the combined 2006 Article IV Consultation, First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Request for Waiver of Nonobservance of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on August 23, 2006, with the officials of Benin on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 10, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its November 27, 2006, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- a statement by the Executive Director for Benin.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Benin*
Memorandum of Economic and Financial Policies by the authorities of Benin*
Technical Memorandum of Understanding*
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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BENIN

2006 Article IV Consultation, First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Request for Waiver of Nonobservance of Performance Criteria

Prepared by the African Department

(In consultation with other departments)

Approved by Robert J. Corker and Anthony R. Boote

November 10, 2006

- Earlier this year, Benin successfully held presidential elections and effected a third consecutive peaceful transfer of power, passing another democratic milestone. The newly elected president has expressed a strong commitment to reforms, with a focus on fiscal discipline and resuming the stalled privatization of Benin's public utility companies and its cotton parastatal. Parliamentary elections are scheduled for March 2007.
- Benin's three-year Poverty Reduction and Growth Facility (PRGF) arrangement in an amount equivalent to SDR 6.19 million (10 percent of quota) was approved on August 5, 2005.
- The last Article IV consultation was completed on October 6, 2004, and Benin reached the completion point under the enhanced HIPC Initiative in March 2003.
- In January 2006, Benin received debt relief under the Multilateral Debt Relief Initiative (MDRI) from the Fund in the amount of SDR 36.1 million.
- Discussions on the first review under the PRGF-supported program were initiated in December 2005 and completed in Cotonou during August 9-23, 2006. The staff team met President Boni Yayi; Mr. Koupaki, Minister of Development, Economy and Finance, and other ministers; Mr. Daouda, the National Director for the Central Bank of West African States (BCEAO); and other senior officials. The staff team comprised Mr. Matungulu (head), Messrs. Youm, Samake, Gijon-Spalla (all AFR), and Yao (resident representative). It worked closely with parallel World Bank teams, and met with representatives of the donor community, the private sector, and Benin's main civil service labor unions.

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EXECUTIVE SUMMARY

- Program implementation during 2005 and 2006 was mixed. Five of seven quantitative performance criteria were met, but there were significant delays in implementing structural reforms, resulting in several benchmarks not being observed. The authorities are requesting waivers for the nonobservance of missed performance criteria.
- Macrobudgetary performance remains broadly satisfactory with the narrowly defined primary deficit (excluding grants) contained to a low level. However, economic activity has steadily decelerated in recent years owing to limited progress in addressing core economic vulnerabilities. Real GDP growth is expected to rebound to 4.5 percent in 2006 from 2.9 percent the previous year, mostly underpinned by developments in the cotton and trade sectors. Nonetheless, growth would fall short of the 6-7 percent range consistent with meeting the Millennium Development Goals (MDs).
- The new government has stated its determination to address Benin's economic challenges with Fund support. The authorities aim to preserve macroeconomic stability, foster economic diversification and good governance, and accelerate structural reforms, including measures to strengthen the judicial and land tenure systems.
- The macroeconomic objectives for 2007 include real GDP growth of 5.5 percent and twelve-month inflation remaining around 2.5 percent. A low narrowly defined primary fiscal deficit points to a broadly sustainable fiscal position in 2007.
- To reinvigorate stalled structural reforms, the authorities have approved strategies for state disengagement from the cotton, electricity and telecommunications sectors, including timetables for implementing related reform measures. Under these, the government is to withdraw from the cotton parastatal by mid-2007, and bring to point of sale the electricity and telecommunications companies by end-August 2007 and end-January 2009, respectively. Structural reforms are essential to stem the erosion of external competitiveness in the face of continuing appreciation of the real effective exchange rate. In fostering development of a supportive financial system, it will be important that most banks continue to meet key prudential norms.
- Creating fiscal space for more pro-growth public investment and pro-poor spending will require continuation of ongoing efforts to broaden the tax base. Limiting spending on wages will also be key to enabling spending priorities to be met. In the post-MDRI era, ambitious plans for major infrastructure spending would need to be subject to careful cost-benefit analysis and financed on concessional terms to preserve external debt sustainability.
- Staff recommends the completion of the first review under the PRGF arrangement.

I. INTRODUCTION

1. **In recent years, Benin has experienced a steady deceleration of real GDP growth owing to limited progress in addressing core economic vulnerabilities and delays in implementing crucial growth-supporting structural reforms.** The weakening of growth has taken place against a backdrop of an appreciating real effective exchange rate and, more recently, a large deterioration in the terms of trade. In the structural area, privatization of the public utility and cotton companies is still pending. Only in the transport sector have steps been taken to begin improving the competitiveness of the Port of Cotonou (Box 1).

2. **Against this background, Benin's macroeconomic situation remains fragile.** Dependent on cotton and reexport trade with Nigeria, the economy remains vulnerable to exogenous shocks. Wage pressures, the pension fund's rising deficit, and the government's debt to civil servants could further strain macroeconomic stability. Public administration reform is overdue.

3. **The new government has stated its determination to address Benin's economic vulnerabilities with Fund support.** Proposed reforms focus on fostering an environment conducive to private sector-led growth and poverty reduction, with emphasis on strong revenue collection, prudent spending and wage policies in the post HIPC/MDRI-era, and resolute implementation of structural reforms. Initiatives in these areas constitute pivotal components of the economic program for 2006 and 2007.

4. Conclusion of the first PRGF review has been delayed due to lack of progress on cotton and public utility sectors reform in the run-up to the recent presidential election. All quantitative performance criteria for end-September 2005, the test date for the first review, and most benchmarks for end-September and end-December 2005 were met (MEFP, Tables 1 and 2).

Box 1. Benin: Key 2004 Article IV Recommendations	
Advice	**Status**
• Implement structural reforms to reverse the decline in external competitiveness and lower vulnerability to external shocks	The divestiture program for public utilities and the cotton sector has been considerably delayed. The new government has, however, committed to completing the bulk of needed reforms by year-end 2007. Steps are also being taken to accelerate reform of the judiciary and land tenure, notably with US Millennium Challenge Account (MCA) assistance. An Investors Council is being set up.
• Introduce revenue and expenditure measures to limit the deterioration of the fiscal position	Fiscal consolidation efforts have continued, and appropriate spending cuts are routinely made to offset revenue shortfalls. Enhancing revenue mobilization remains a key medium-term objective.
• Strengthen the institutions in charge of seed cotton and input commercialization	The government recently introduced legislation rationalizing the National Councils of (i) Cotton Producers; (ii) Cotton Fertilizer Importers and Distributors; and (iii) Cotton Ginners.
• Pursue discussions with Nigeria to resolve outstanding trade issues	Trade restrictions with Nigeria are declining. President Boni Yayi recently signed agreements with his Nigerian counterpart that aim to further reduce obstacles to trade between the two countries.
• Improve customs and tax administration	A one-stop shop for customs and other port transactions has been set up; ad hoc customs exemptions have been reduced; the large- and medium-sized taxpayer units of the Tax Department are being strengthened; and fiscal control programs have improved to enhance tax revenue mobilization.
• Complete the first annual progress report (APR) on the implementation of the PRSP; integrate the PRSP into a sound multiyear macroeconomic framework	The first APR was completed and circulated to the IMF Board in 2005. A second APR for the PRSP has been issued; a third APR is about to be finalized. The 2002 PRSP is being updated, consistent with Benin's medium-term macroeconomic framework.

II. Economic and Program Developments

5. **Economic performance has been subdued in recent years, but a turnaround in the cotton sector has helped revive growth.** The cotton sector contributes an estimated 10 percent to total value added; it employs about 350,000 workers and touches an estimated 40 percent of Benin's population. With cotton production declining sharply because of delayed disbursement of 2004-05 season payments to cotton farmers and fertilizer distributors, and uncertainties regarding the privatization program, real GDP growth decelerated to 2.9 percent in 2005 (compared with 4 percent under the program). Weak investment demand owing to election-related uncertainties, continued currency appreciation, and a large terms of trade decline also depressed economic activity (Figure 1 and Text

table 1).[1] The impact on growth was softened by a vigorous pick up in commerce as trade relations between neighboring Nigeria and Benin improved following tensions in 2004. As cotton production recovers, following settlement in April 2006 of debts to farmers and fertilizer distributors, and the trade and transportation sectors benefit from Port of Cotonou reforms and ongoing improvements in trade relations with Nigeria, growth is likely to rebound to 4.5 percent in 2006. Inflation is projected to ease to 2½ percent by end-2006, following a spike in prices in 2005 owing to strong food demand from crisis-afflicted Niger and high oil prices.

Text Table 1. Benin: Selected Macroeconomic Indicators, 1995-2006
(In percent of GDP; unless otherwise indicated)

	1995-01 Average	2002	2003	2004	2005		2006	
					Prog.	Est.	Prog.	Proj.
Real GDP (annual change)	5.2	4.5	3.9	3.1	3.9	2.9	4.4	4.5
Inflation (annual change, end-year)	3.9	1.2	0.8	2.6	2.5	3.7	2.5	2.4
External current account balance[1]	-7.2	-8.6	-8.6	-7.9	-8.7	-7.2	-8.7	-7.0
Narrow primary budget balance[1]	3.0	1.0	0.2	0.0	-0.9	-1.4	-0.4	-0.9
Overall fiscal balance[1, 2]	-5.1	-4.3	-3.7	-4.5	-5.3	-3.6	-4.9	-5.2
Memorandum items:								
Terms of trade (annual change)	3.0	-19.3	3.4	21.2	-18.0	-15.9	-3.1	4.1
Real effective exchange rate (annual change)	2.5	3.7	8.4	2.4	...	2.2	...	...

Sources: Benin authorities; and IMF staff estimates.

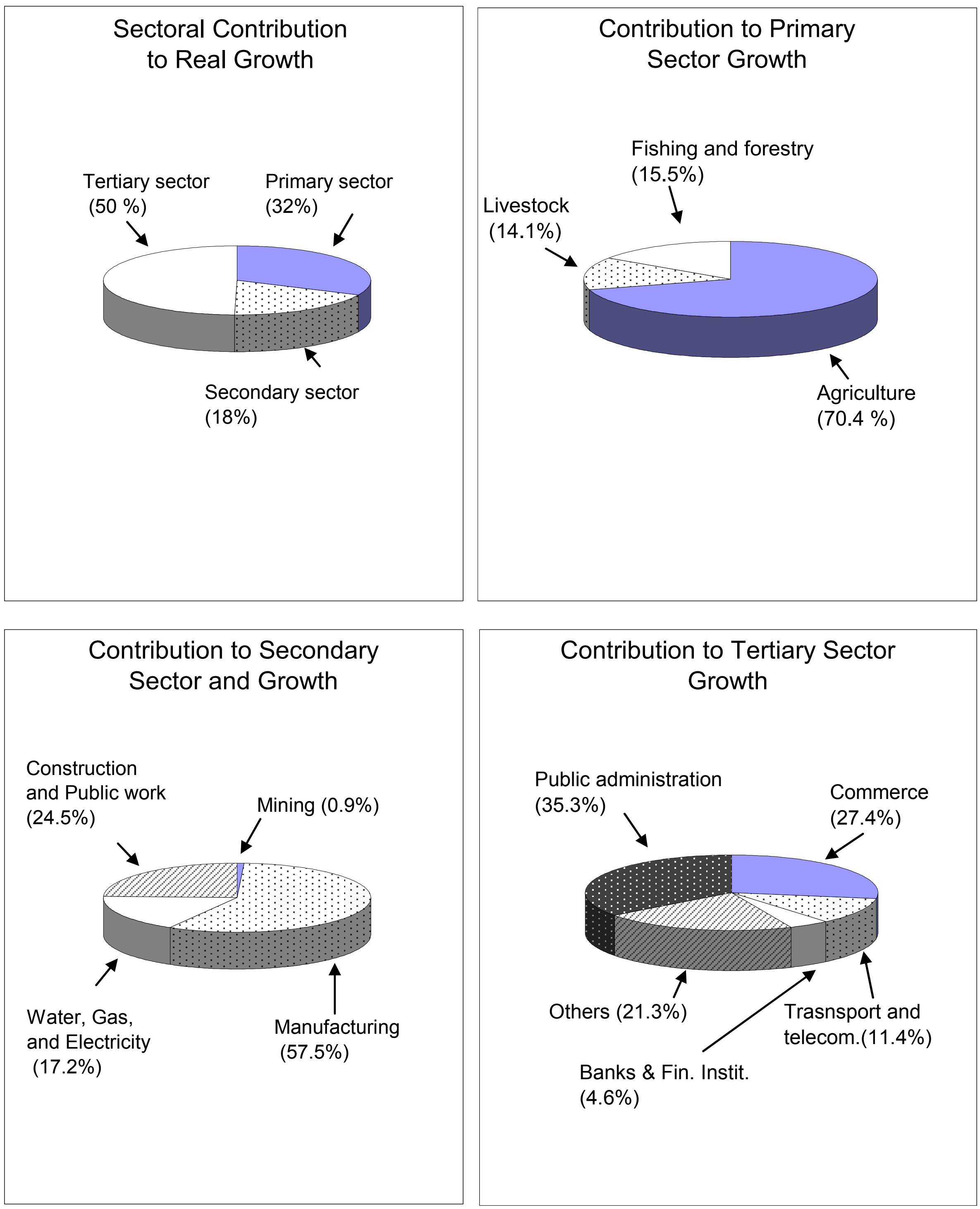
[1] Excluding grants.

[2] Payment order basis.

[3] Minus = depreciation

[1] The terms of trade have been highly volatile in recent years mainly because of swings in world cotton and oil prices. Their impact on the economy has been smoothed by the operation of various cotton producer subsidies and by lower-priced informal sector oil imports from Nigeria.

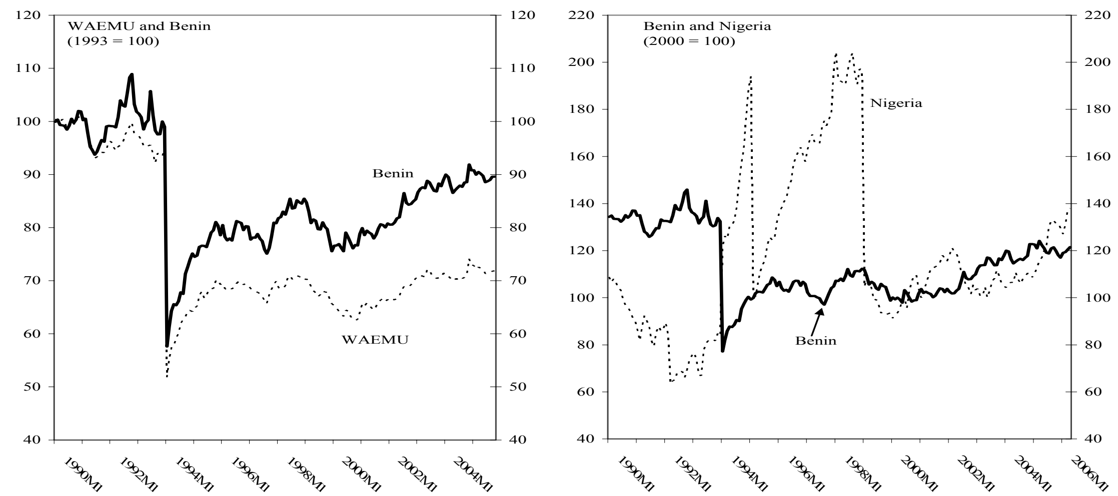
Figure 1. Benin: Sector Distribution of Real GDP Growth, 2000-05



Source: Benin authorities; and Funf staff estimates.

6. **External competitiveness has steadily eroded since the 1994 devaluation of the CFA franc**. The real effective exchange rate appreciated by another 2 percent in 2005, owing to unfavorable price developments.[2] By year-end 2005, Benin had lost over 60 percent of the competitiveness it had gained from the 1994 devaluation—with the real effective appreciation higher than in most other WAEMU countries (Figure 2). Moreover, as world oil prices surged and the f.o.b. price for ginned cotton declined 35 percent, the terms of trade deteriorated by about 16 percent in 2005. Nonetheless, the current account deficit, excluding grants, continued to moderate, reflecting lower formal sector oil imports stemming from management weaknesses at SONACOP (Benin's oil-importing monopoly) and weaker capital goods imports. Benin's share of the BCEAO's foreign exchange reserves is equivalent to over 10 months of imports, in part owing to comfortable donor support.

Figure 2. Benin: Real Effective Exchange Rate, 1990M1 - 2006M4
(Monthly average)



Source: IMF, *Information Notice System* .

[1] Official rate. Although consistent data on parallel market rate is not available, it drives mostly the official rate trends.

[2] The annual average appreciation was 4.9 percent in 2001–04.

Box 2. Benin: Coping With Structural Bottlenecks and Higher Prices in the Domestic Petroleum Distribution Sector

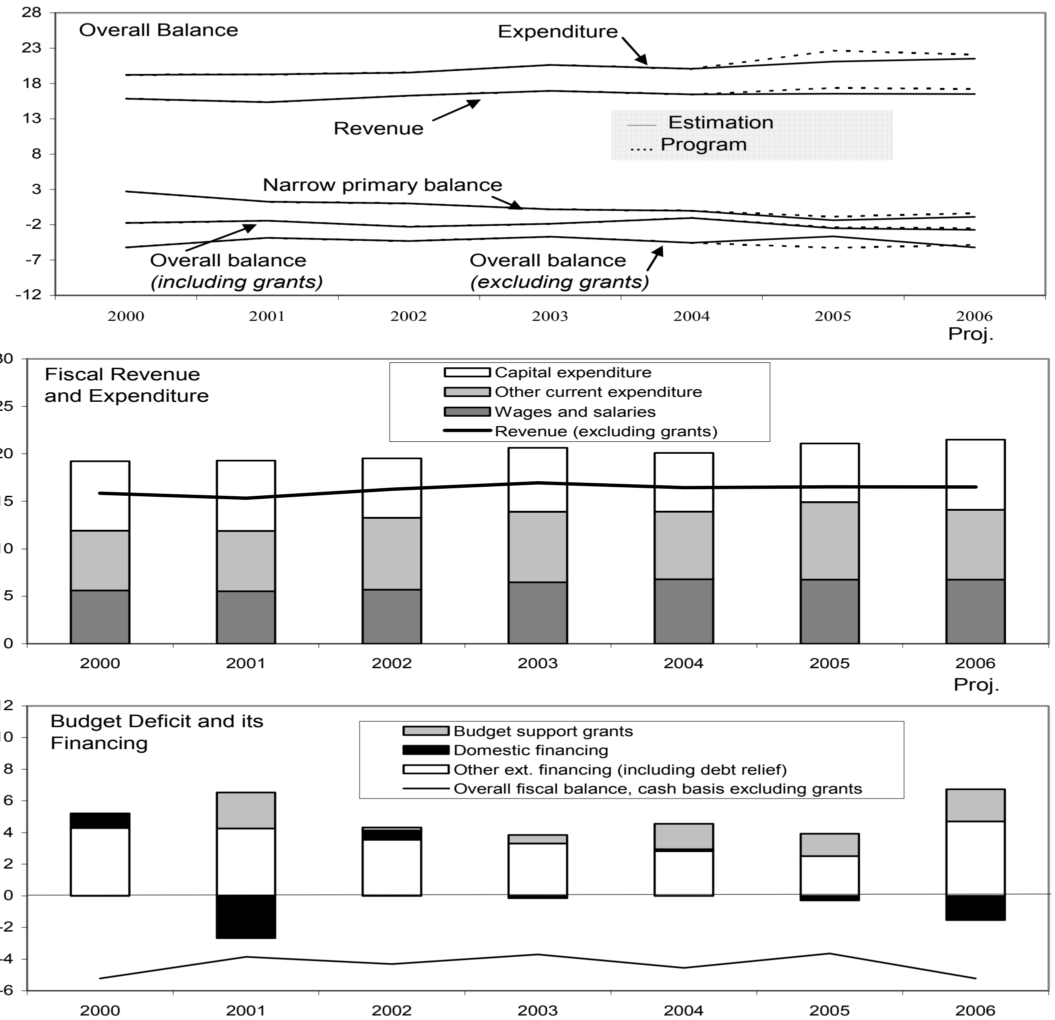
Beset by severe governance problems since its privatization in 1999, SONACOP—in which the state maintains a 35 percent share—had been unable to secure a steady supply of petroleum products in Benin, causing a resurgence in informal sector oil imports. By the end of March 2006, such informal imports covered an estimated 75 percent of domestic demand.

In March 2006, the outgoing administration requisitioned for three months all of SONACOP's assets, including storage facilities and gasoline stations, and named a new management team. The government established in April 2006 renewed the previous administration's requisition and took steps to improve the company's management, restoring the availability of petroleum products on the formal market at no cost to the budget. The authorities intend nevertheless to return SONACOP management to the private sector. In the meantime, in May 2006 the authorities, faced with escalating world oil prices, froze domestic retail prices by (i) suspending the automatic price-setting mechanism for oil products, and (ii) lowering the rate of the specific tax on petroleum products. As result, revenue from the VAT and special tax on petroleum products declined to CFAF 0.3 billion in May-July 2006, compared with CFAF 3.9 billion in the same period of 2005.

For the medium term, the authorities aim to raise the formal sector's market share while mitigating the social impact of world oil price increases**.** This strategy would improve petroleum tax revenue collection and reduce the safety risks associated with informal sector oil distribution activities. Envisaged policy actions include (i) early return of SONACOP to private sector ownership; (ii) granting investment-promoting fiscal incentives to domestic oil distributors; (iii) reestablishing the suspended flexible-pricing mechanism, (iv) enhancing customs controls of petroleum imports from neighboring Nigeria; and (v) instituting fiscal measures to protect vulnerable social groups from large oil price increases. The authorities intend to seek development partners' assistance in elaborating these measures in a medium-term reform strategy for the oil sector, including an expeditious implementation timetable.

7. **Benin's fiscal situation weakened in 2005 and in early 2006**. In 2005, the narrowly defined primary budget deficit widened to 1.4 percent of GDP, ½ percent of GDP above the program target. Revenue stagnated at 16½ percent of GDP, as weaknesses in revenue administration, especially at the General Directorate of Taxes, were left unaddressed. The government's cash flow came under severe pressure when the outgoing administration settled unprogrammed domestic arrears to suppliers (from 2004) equivalent to 1 percent of GDP. In early 2006, the underlying cash-flow situation deteriorated owing to the payment of bills held from FY 2005, wage arrears, and various restructuring expenditures. New domestic arrears equivalent to 1.5 percent of GDP were accumulated.

Figure 3. Benin: Selected Fiscal Indicators, 2000-06
(percent of GDP)



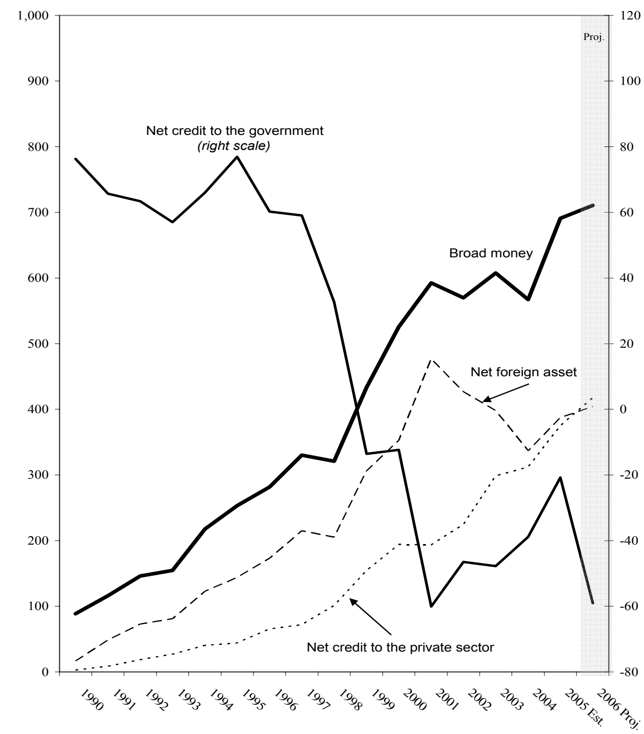
Sources: Benin authorities; and Fund staff estimates.

8. **Expenditure and revenue measures introduced in the second quarter of 2006 have improved the budgetary situation and strengthened Benin's short-term fiscal prospects.** Fiscal measures included (i) the institution of a treasury committee to monitor more closely revenue collection and spending execution under the supervision of the finance minister, (ii) strict adherence to expenditure execution procedures, and (iii) renewed commitment not to undertake extrabudgetary expenditures. With technical assistance from the World Bank, the new administration has also initiated an audit of the new domestic payments arrears that came to light in 2006. The audit report and a plan to settle certified arrears are to be completed by end-2006. In the second quarter of 2006, with revenue about 5 percent above target and expenditure substantially below target, the narrowly defined primary budget balance recorded a surplus (1.0 percent of GDP), compared with a targeted deficit of 0.2 percent of GDP. Net bank credit to the government declined by an estimated

CFAF 30 billion, compared with the CFAF 5 billion anticipated under the program. For 2006 as a whole, the narrowly defined primary budget deficit is projected to decline to the initial program target of 0.4 percent of GDP (0.9 percent, including MDRI-funded outlays).

9. **Money and credit conditions are relatively easy.** Broad money rose by over 22 percent in 2005, considerably more than nominal GDP (Figure 4 and Table 4). In response to rising inflation, a 20-percent expansion of credit to the private sector, and perceived capital flight risks ahead of the March 2006 presidential election, the BCEAO increased the reserve requirement ratio by 400 basis points, to 15 percent, in mid-2005, the highest level in the West African Economic and Monetary Union (WAEMU). Broad money and private sector credit growth has eased and is projected to slow to a pace closer to trend in 2006.

Figure 4. Benin: Monetary Development, 2000 - 06
(In billions of CFA francs)



Source: Benin authorities; IMF staff estimates.

10. **Performance under the program has been mixed.** Two of the seven quantitative and structural performance criteria, as well as two quantitative indicative targets and six structural benchmarks, were not observed. The missed performance criteria were related to the outgoing administration's guarantee of a nonconcessional loan to the state-owned telecommunications company (Benin Telecoms) and the accumulation of domestic payments arrears.[3] More generally, progress in implementing the structural reform agenda has been slow. Privatization of the cotton, telephone, and electricity parastatals is still pending, and a comprehensive program to expand activities at the Port of Cotonou, including private sector involvement in management, has yet to be completed**.** Nevertheless, the installation of key components of the software for the port's centralized clearing and invoicing management center was completed in November 2005, albeit with a two-week delay. This permitted the start in March 2006 of initial operations at the facility's one-stop shop for customs and other administrative transactions (a delayed December 2005 performance criterion). Efforts to expand the scope of these operations are needed and are under way.

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[3] The loan from a Chinese bank was in the amount of US$31 million, at an interest rate of LIBOR+1 and maturity of six years (including a one-year grace period). It has a grant element of 9 percent, compared with the minimum 35 percent specified under the program.

III. Policy Discussions

11. **The government's ambition is to make Benin's economy more resilient to external shocks, reinvigorate growth and facilitate progress toward the Millennium Development Goals (MDGs).** The authorities are developing a five-pillar growth strategy that underscores (i) preservation of macroeconomic stability; (ii) promotion of growth-supporting sectors to facilitate economic diversification; (iii) enhanced efficiency of public administration (including through more rigorous monitoring of governance practices); (iv) deepening and acceleration of structural reforms; and (v) public participation in policy-making. These priorities are consistent with the country's core commitments under the PRGF arrangement. In particular, the authorities concur that, in view of the fixed exchange rate regime, envisaged growth objectives require accelerated structural reforms and continued fiscal consolidation to preserve macroeconomic stability. Consistent with this understanding, discussions focused on the medium-term macroeconomic framework, especially fiscal policy options, as well as on structural reform priorities. The mission also reviewed recent and prospective performance under the PRGF-supported program.

A. Medium-Term Macroeconomic Framework: Realizing Higher Growth

12. **A comprehensive strategy that raises both capital accumulation and total factor productivity (TFP) growth is needed to boost economic growth to rates consistent with achieving the MDGs.** Econometric analysis of growth performance in 1965–2005[4] suggests that raising growth would require (i) fiscal policies that do not crowd out the private sector and which direct resources to higher public investment; (ii) completion of reforms to revitalize the important cotton sector and reform the port and utilities; and (iii) a better business environment. With the right mix of fiscal and structural policies, staff concurred that the longer-term growth rate could be raised to 6-7 percent, a level more consistent with achieving the MDGs.

13. **Over the next few years, achievable growth rates are expected to be more moderate and to continue to be highly sensitive to cotton sector performance**. Assuming a favorable external environment (i.e., continued global expansion, strong growth in Nigeria, and more stable cotton and oil prices), the agreed medium-term macroeconomic framework calls for annual real GDP growth of 4½-5½ percent in 2006–08, in line with performance before Benin's recent slowdown (Text Table 2). It assumes a continuing recovery of cotton production, which even after the rebound in 2006 remains well below potential capacity, [5] higher re-exports to Nigeria, and increased trade and transport activity as the port's one-stop

[4] See the chapter "Benin: Private Investment Dynamics and Growth Performance" in the accompanying selected issues paper. See also "Benin: Selected Issues and Statistical Appendix," Country Report 04/370.

[5] According to World Bank estimates, cotton production capacity amounts to 600-650,000 tons.

shop yields efficiency gains. Supported in part by fiscal space opened up for public investment by higher domestic revenue and debt relief, the investment/GDP ratio would rise to about 22½ percent in 2008, from about 20 percent in 2005. The assumptions are consistent with an inflation rate contained within the WAEMU limit of 3 percent, which would prevent further real exchange rate appreciation, and a narrowing of the external current account deficit to 6.5 percent of GDP by 2008.

Text Table 2. Benin: Selected Macroeconomic Indicators, 2005-08
(In percent of GDP; unless otherwise indicated)

	2005	2006	2007	2008
	Est.	Projection		
Real GDP (annual change)	2.9	4.5	5.1	5.5
Inflation (annual change, end-year)	3.7	2.4	2.5	2.5
External current account balance[1]	-7.2	-7.0	-6.7	-6.4
Narrow primary balance	-1.4	-0.9	-0.5	0.0
Current budget balance	1.6	2.4	2.7	3.5
Overall fiscal balance[1, 2]	-3.6	-5.2	-5.4	-5.1
Memorandum items:				
Production of cotton (in '000 of tons)[3]	190.8	350.0	463.6	498.5
Nigeria real GDP growth	6.9	6.1	5.2	5.4
Investment-to-GDP ratio	19.6	21.0	21.8	22.4
Terms of trade (annual change)	-15.9	4.1	5.6	4.2

Sources: Benin authorities; and Fund staff estimates.

[1] Excluding grants.
[2] Payment order basis.
[3] Data for growing season 2005-06, 2006-07, 2007-08, and 2008-09.

14. **The medium-term growth outlook faces downside risks**. The factors that could dampen growth include a further slump in cotton production (owing to bad weather, inefficient management of the ginning companies, slower-than expected reform outcomes, or a further decline in world prices); a resurgence of oil prices; renewed trade tensions with main trading partners; weak absorptive and institutional capacity; and slower-than-expected disbursement of programmed aid flows. If world cotton prices do indeed drop, the authorities would reduce the producer price and/or effect a fiscal adjustment to accommodate a government subsidy. They are also committed to passing the bulk of future oil price increases on to consumers while establishing safety net measures to protect vulnerable groups. Failure to gain public support either for the privatization program or for structural reforms to improve the business climate (e.g., judiciary and land tenure reforms) pose longer-term risks. On the positive side, the rapid response of the trade and transport sectors to port reforms and better trade relations with Nigeria illustrates the potential for reforms to translate into economic growth.

B. Medium-Term Fiscal Strategy: Carving Space for Higher Pro-Poor Spending

15. **Benin's fiscal program seeks further fiscal consolidation while implementing the poverty reduction strategy in the post-MDRI era.** The authorities underscored the urgent need to improve the poor's access to basic services through higher and more efficient spending in priority sectors. Total government spending is set to increase by about 2 percentage points of GDP in 2006-2008, supported by revenue gains equivalent to 1½ percent of GDP, debt service savings freed through MDRI debt relief, and additional aid inflows (Text table 3). The envisaged medium-term fiscal program takes account of the deficit of the public pension fund and assumes the elimination of the narrowly defined primary deficit by 2008, consistent with the WAEMU's fiscal convergence criteria.[6]

Text Table 3. Benin: Fiscal Space for Pro-growth Spending, 2006-08
(In percent of GDP)

	2005	2006	2007	2008
	Est.	Projection		
Total revenue and external financing	20.5	21.0	22.6	23.0
Total revenue	16.5	16.5	17.2	18.0
External financing, net[1]	3.9	4.5	5.3	5.0
Total expenditures	21.1	21.5	22.6	23.1
Wages	5.6	5.5	5.5	5.5
Capital expenditures	6.2	7.4	8.1	8.6
Other expenditures	9.3	8.6	9.0	9.0

Sources: Benin authorities; and Fund staff estimates.

[1] Including debt service savings from MDRI debt relief.

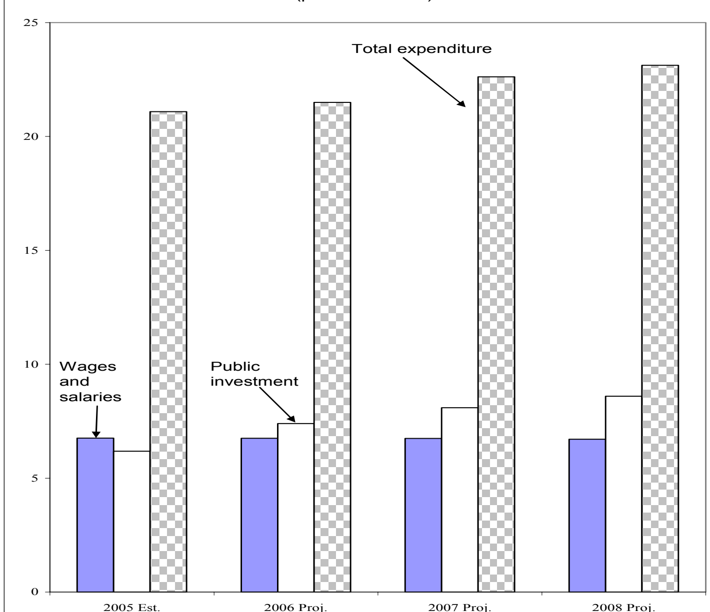
16. **Achievement of the targeted revenue increase hinges on measures that combat fiscal fraud, reduce tax evasion, and broaden the tax base.** Given Benin's relatively high taxation of the formal sector and its commitments under the WAEMU, there is limited scope for new tax policy measures. Under the authorities' program, the bulk of revenue increases would stem from strengthened tax and customs administration, including (i) further improvements in the management of the medium- and large-taxpayer units (especially by revising the turnover threshold so as to refocus the large taxpayer unit (LTU)'s activities on the largest taxpayers and computerizing more tax assessment and collection operations); (ii)

[6] These are: (i) non negative narrowly defined fiscal primary balance, (ii) non accumulation of domestic payment arrears; (iii) wage and salaries relative to tax revenue not larger than 35 percent, (iv) ratio of domestically financed investment to tax revenue not smaller than 20 percent, and (v) tax revenue to GDP ratio not less than 17 percent.

better customs control of imported goods through efficient operation of the one-stop shop at the Port of Cotonou; (iii) better exchanges of taxpayer data between the General Tax and Customs Directorates; (iv) modernization of the property tax; and (v) introduction of a Unified Taxpayer Identification Number. Other revenue measures could include moderate increases in excise tax rates based on recommendations from the Fund's Fiscal Affairs Department.[7] The authorities indicated readiness to address revenue shortfalls with appropriate corrective policy measures, including spending cuts, to ensure preservation of program budgetary targets.

17. **Containment of the wage bill and an orderly settlement of outstanding wage arrears to civil servants would provide space for priority spending.**[8] By limiting recruitment to retrenched and retiring staff numbers, the authorities would both keep medium-term civil service employment broadly stable and hold the wage bill at about 5½ percent of GDP, bringing it within the WAEMU ceiling of 35 percent of tax revenue (from 39 percent at year-end 2005). In response to staff advice to avoid faster-than-programmed settlement of sizable wage arrears to civil servants (7.1 percent of 2006 GDP), the authorities said they would keep 2007–08 annual wages and wage arrears payments at 6.2 percent of GDP, the projected outturn for 2006.

Figure 5. Benin: Development Budget, 2005-08
(percent of GDP)



Source: Benin authorities; and Fund staff estimates.

18. **The mission discussed the scope for front-loading pro-growth and pro-poor outlays and accommodating additional aid inflows.** MDRI debt relief from the IMF, the World Bank, and the African Development Bank—US$1,112 million (25 percent of 2005 GDP)—has reduced Benin's total external public debt to about 13 percent of GDP (Text table 4). Cognizant of the potential new borrowing space, the authorities are considering an ambitious public works program to revamp Benin's ailing economic and social infrastructure. The mission stressed the need to preserve debt sustainability and warned against wasteful

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[7] An FAD technical assistance mission visited Cotonou October 10-23, 2006.

[8] Facing a severe financial crisis in the late 1980s, the government froze civil service wages in 1987 and suspended the financial benefits of automatic, time-in-grade-based-promotions. The granting of general annual wage increases was resumed in 1991, but the gap between actual and grade-based salaries was not closed until 2004, giving rise to estimated wage arrears to civil servants of 7.1 percent of GDP at year-end 2006.

borrowing. Although the risks to medium-term debt sustainability are estimated to be moderate, the staff strongly urged the authorities to assess future loans on a case-by-case basis, taking account of concessionality, cost-benefit analysis, absorption capacity considerations, and Benin's commitments under the PRGF arrangement.[9] The mission also encouraged the authorities to work closely with development partners to plan and cost the envisaged infrastructure rehabilitation program. In the meantime, the authorities agreed to limit use of resources freed through MDRI debt relief to debt-service savings (approximately ½ percent of GDP per year). These are to be allocated to priority sector spending (primarily education, health, and infrastructure projects). These debt relief resources would be topped up by a grant of US$307 million (7 percent of GDP) from the US Millennium Challenge Account (MCA) to be disbursed over a five-year period beginning in October 2006.[10]

Text Table 4. Benin: External Debt Indicators, 2006-26
(In percent, post-MDRI unless otherwise indicated)

	Indicative thresholds	Baseline Scenario		
		2006	2007-11 1/	2012-26 1/
NPV of debt-to-GDP	40	11	12	15
Debt service to revenue	30	4	4	4
NPV of debt-to-revenue	250	64	66	77
Debt service-to-exports	20	5	5	4
NPV of debt-to-exports	150	86	80	81
Memorandum items:				
Debt-to-GDP (post-HIPC)		36	33	28
Debt-to-GDP (post-MDRI)		13	15	20

Source: Benin authorities; and Fund staff estimates.
[1] Simple average.

19. **The authorities expressed strong commitment to the strict observance of expenditure execution procedures.** In April 2006, the minister of finance formally prohibited the use of ad hoc Treasury Payments Orders (*Ordres de Paiement Trésor*), instruments that have boosted past extrabudgetary outlays. In 2007, as part of a medium-term strategy to enhance public expenditure management, the authorities will also begin

[9] Annex IV provides an updated DSA. Although Benin's external debt remains largely sustainable under the baseline scenario, slow growth, volatile export prices and output, and new nonconcessional borrowing could undermine external debt sustainability, placing the country at a moderate risk of debt distress.

[10] The program's contribution to GDP growth is estimated to average 0.3 percentage point a year during 2007-17. Annual MCA grant disbursements (between 0.3 and 1.4 percent of GDP per year during 2006-11) are not expected to pose challenges to macroeconomic stability.

implementing the recommendations of a recent FAD TA mission. Proposed measures include strengthening government expenditure tracking, securing the automatic generation of the summary table of government financial operations, and consolidating government accounts.

20. **The authorities are pressing ahead with preparations for civil service reform, with help from the World Bank and other donors.** They will implement an integrated information management system for the civil service over the next three years, subject to financing availability. Key reform measures for 2007 include consolidating deconcentrated personnel management in the education ministry and assessing other large ministries' readiness to take over their human resources management, finalizing job descriptions and qualifications and skill requirements for high-level positions, and adopting a civil service Code of Ethics and Conduct. These steps are paving the way for new performance assessment and merit-based remuneration systems, expected to be introduced by 2008. The authorities are also seeking to restore the civil service pension fund's medium-term financial viability, although no visible progress has been made thus far. The staff stressed the need to expedite the preparation and implementation of envisaged pension reforms.

C. Enhancing External Competitiveness Through Structural Reforms

21. **Privatization of the utilities, port, and cotton sectors—an essential part of the authorities' growth strategy—will take time.** With World Bank staff taking the lead, the mission and the authorities reached agreement on a revised structural reform agenda that would (i) complete government withdrawal from commercial activities in the cotton sector by mid-2007; (ii) bring to point of sale the state-owned electricity company by the end of August 2007; and (iii) start operations of the consolidated electronic billing system at the centralized clearing and invoicing management center by the end of December 2006 (see MEFP, paras. 24-27). The authorities also plan to bring the telecommunications company to the point of sale before end-January 2009. This is slower than World Bank staff advised. However, the authorities were of the view that time was needed to put in place a new management team, prepare a diagnostic of the telecom parastatal, and restructure the company first. They also noted that the measures planned for the cotton and electricity sectors would stretch their implementation capacity. Staff strongly encouraged the authorities to expedite the timetable for the telecom privatization, originally planned for end-2005, in order not to lose the momentum for reform.

22. **The government has also initiated second-generation economic reforms designed to eliminate critical structural impediments.**[11] The program aims to (i) improve access to markets; (ii) improve access to land (and thus increase investment in and the value of parcels); (iii) facilitate access to credit for micro-, small-, and medium-scale enterprises; and (iv) improve the business environment through judiciary reform. To enhance trade, besides

[11] Benin ranks 137 out of 175 economies on the World Bank's 2006 Ease of Doing Business Indicators.

continued port improvements, the staff urged the authorities to help dismantle the remaining intraregional trade barriers in the WAEMU.

23. **Although Benin's financial system is weak, most banks appear to meet key prudential norms** (text table 5)**.** The banking system has been steadily growing, with nominal bank deposits increasing by about 9 percent a year and credit to the private sector expanding from 4 percent to 19 percent of GDP during 1995–2005. At the end of July 2006, 12 banks and 2 leasing companies were licensed to operate; nonperforming loans were about 10 percent of total assets. Recent positive developments include the completion of reforms to address governance and other portfolio weaknesses in two banks previously overseen by the regional Banking Commission. However, in one of these banks, the capital ratio remains negative. The heavy concentration of loans in a limited number of sectors (and companies) is a potential source of vulnerability that must be closely monitored.

Text Table 5. Benin: Banking and Financing Prudential Indicators (as of end-June 2006)

Indicator	Coefficient	Number of compliant banks and financial institutions1/
1. Own resources requirement	>= 1000 CFAF million	10/12
2. Risk-adjusted own resources	>= 8%	9/12
3. Liquidity coefficients	>= 75%	8/12
4. Portfolio structure	>= 60%	0/12
5. Coverage of medium and long term loans	>= 75%	7/12
6. Loan to bank managers *	<= 20%	10/12
7. Risk concentration		
Threshold on global lending	<= 8*FPE	9/12
Threshold on single borrower	<= 75%*FPE	7/12

Source: BCEAO, National Agency of Benin

* as of end-Dec 2005

1/ As of end-June 2006, twelve banks and two financial institutions were licensed to conduct business in Benin. As the prudential ratios are calculated over a 12-month period, two banks are not included in the table.

D. Poverty Reduction Strategy Paper (PRSP) Issues

24. **The authorities are revising the PRSP.** Since the strategy's approval in 2003, the government has issued two annual progress reports (APR), one in December 2004 and one in August 2005; a third APR is expected to be finalized before end-2006. For the ongoing revision, the authorities have completed a modular survey of household living conditions (EMICOV) to improve knowledge of the poverty profile, conducted broad participatory consultations, and developed a consensus on the strategic priorities for the update PRSP (PRSP II), including a renewed emphasis on private sector-led economic growth. PRSP II is to be completed in December 2006.

E. Program Monitoring Issues and Capacity to Repay the Fund

25. **In the attached Letter of Intent, the authorities request completion of the first review under the PRGF-supported program.** They explained that the missed performance criterion on domestic arrears partly arose from pre-election spending pressures and inadequate spending controls that have now been addressed; they have initiated an audit of the arrears and would devise a plan for their resolution by year-end. The end-December 2005 start up of the centralized clearing and invoicing management center of the Port of Cotonou had been effected with a delay. But to signal their broader commitment to structural reform, in view of several missed structural benchmarks, the government would as a prior action for completing the review approve disengagement strategies from commercial activities in the cotton, telecommunications, and electricity sectors. Finally, the broken obligation to neither contract nor guarantee nonconcessional loans reflected a perceived urgent need by the previous government to secure finance for restructuring the telecommunications company, against the advice of Benin's debt management committee. The new administration has underscored the unit's crucial technical and advisory role, and agreed henceforth to neither contract nor guarantee nonconcessional loans.

26. **The mission welcomed the actions to address missed performance criteria and structural benchmarks**. It pointed out, however, that staff had advised the previous government against the guarantee of the nonconcessional loan to the telecommunications company; therefore, the new government's strong commitment to avoid such guarantees or loans in the remainder of the program would be important. Prior actions (see paragraph 3 of the LOI and paragraph 29 of the MEFP) largely aimed at demonstrating the authorities' commitment in the areas of missed program conditionality have been implemented.

27. **Proposed program conditionality for 2006 and 2007 includes measures to resume stalled privatization of the state-owned cotton and electricity companies (MEFP, Table 2)**. While outside the core expertise of the Fund, reform in these sectors (as noted in the Ex-Post Assessment of Performance under Fund-Supported Programs—Country Report 04/371) is seen as macro-critical. Other structural conditionality encompasses efforts to improve accountability in budget management and deepen port reforms. The World Bank is playing a key role in supporting the authorities' sectoral reforms.

28. **The program is fully financed for 2006 and 2007.** Financing needs are being met by donor assistance mostly from the World Bank, the African Development Bank, and the European Union. In consultation with staff, the authorities have realigned program monitoring with the budget cycle (calendar year), and established quarterly performance criteria and indicative targets to monitor program implementation (MEFP, Tables 1 and 2). The program continues to include adjusters on domestic financing for deviations from external programmed budget assistance.

29. **Benin is expected to preserve its excellent record in meeting its Fund obligations.** During the program period, the annual average repayment to the IMF would be SDR 0.021 million, only 0.006 percent of export of goods and services and 0.005 percent of government revenue by 2008.

F. Statistical and Other Issues and Disclosure

30. **Despite some statistical weaknesses in the national accounts, monetary aggregates, and social indicators, Benin's economic database is adequate for program monitoring purposes.** Benin participates in the General Data Dissemination Standard, and posts its metadata on the Fund's Dissemination Standards Bulletin Board. Fiscal data only covers the central government, and the reporting of such data needs strengthening; the authorities are currently receiving technical assistance in this area from both AFRITAC-West and FAD.

31. **The mission sought civil society's and the private sector's views on the Fund's policy dialogue with the government**. Union leaders strongly opposed the privatization program, expressing concern over anticipated personnel retrenchments. Staff stressed the reform's potential benefits, especially its positive impact on competitiveness, economic growth, and poverty alleviation. Representatives of the private sector largely agreed with Benin's IMF-supported reform policies; they called for a strengthening of their dialogue with the government on economic policy issues.

IV. Staff Appraisal

32. **Following a decade of strong and low inflationary growth, Benin's economic performance has considerably weakened in the last few years because of slow progress in addressing core economic vulnerabilities.** In 2005, per capita income growth fell to zero. Absent a considerable revival of growth, progress toward the millennium development goals (MDGs) will be limited.

33. **To revitalize the economy, the new government is developing a comprehensive growth strategy that is broadly consistent with Benin's core commitments under the PRGF-supported program.** The strategy's focus on macroeconomic stability, economic diversification, good governance, accelerated structural reforms, and more public involvement in policy-making processes is well-placed. Full implementation would help raise real GDP growth to 6-7 percent, the level needed to facilitate progress toward the MDGs.

34. **However, reform efforts, even if implemented speedily, will take time to gestate, limiting growth potential over the next few years**. The authorities can, nonetheless, minimize significant downside risks to the medium-term macroeconomic framework by ensuring an effective transfer of cotton-ginning factories to the private sector by mid-2007,

creating fiscal space for more public investment, and continuing to address obstacles to doing business.

35. **Staff welcomes the new government's determination to expedite implementation of hitherto stalled structural reforms**. Delays in implementing reforms are regrettable. However, the authorities are to be commended for decisive steps to resume, with technical support from World Bank staff, the long-delayed privatization of the cotton and electricity companies, and give new impetus to efforts to enhance the competitiveness of the Port of Cotonou. With the opening of the port's centralized clearing and invoicing management center and the progressive development of its operations, port clearing operations are being facilitated, including through consolidating information supplied on numerous port service bills at a single window. Work will be needed in 2007 to continue developing functionality, including for direct bank settlement. The reform is reducing the incidence of customs corruption and should also help enhance the port's competitiveness. Along with better trade relations with neighbors, the port's one-stop shop is already having a positive impact on activity in the trade and transport sectors. While the staff recognizes the constraints imposed by limited implementation capacity, the two-year delay in the telecom privatization is regrettable. Strong steps will need to be taken to expedite the reform process with a view to ensuring an early state disengagement from the sector.

36. **Second-generation reforms aimed at reducing impediments to private sector investment are an important next step.** Such measures include improving Benin's judicial and land tenure systems and facilitating credit access to more small- and medium-sized enterprises. Together with the ongoing privatization program, these initiatives will support private sector development and permit diversification of the production and export base, thus enhancing the economy's resilience to external shocks. A resolute and timely implementation of the reforms is crucial especially considering the erosion of competitiveness since the 1994 devaluation, as reflected in a steady appreciation of the real effective exchange rate. In line with this strategy, staff urges the authorities to expedite reform of the domestic petroleum products distribution sector, including an early reestablishment of the flexible price fixing mechanism.

37. **The government rightly underscores the need to preserve macroeconomic stability over the medium term**. Consistent with this, the authorities need to focus on reversing recent lackluster revenue performance, and maintaining spending at levels compatible with continued fiscal viability. To protect poverty reducing expenditures, personnel outlays need to be closely monitored and contained at levels consistent with the relevant provisions of the WAEMU's Growth and Stability Pact.

38. **Scaling up of pro-growth outlays in the post-MDRI era must take account of existing capacity constraints while preserving the viability of Benin's external position.** The multilateral debt relief initiative has brought Benin's debt burden to relatively low levels, and opened room for increases in pro-growth and pro-poor spending. Against a backdrop of a

much improved debt outlook, the authorities have initiated preparations for an ambitious infrastructure rehabilitation program. Financing for the program should be obtained on terms that do not put debt sustainability at risk over time. All planned projects should undergo extensive cost-benefit analysis and be financed by highly concessional loans.

39. **Staff recommends the completion of the first review under the PRGF arrangement.** Benin's macroeconomic performance remains broadly on track following efforts to address fiscal slippage in the early part of this year. Implementation of the structural program has been disappointing resulting in several benchmarks being missed. But the new administration has resumed long-delayed reforms, including the privatization program for key sectors. Given the recent approval of the government's disengagement strategies for the cotton and electricity sectors, ownership appears strong, and the staff expects reform progress to improve. The new government has also begun to address unplanned domestic arrears and has said it will abstain from borrowing or guaranteeing loans on nonconcessional terms. The guaranteeing of a nonconcessional loan to Benin Telecoms by the previous government was ill-advised and the authorities will need to more closely heed their debt management committee's recommendations in the future. That aside, on balance, staff supports the authorities' request for waivers with regard to the missed performance criteria.

40. **The main risk to the program pertains to possible policy reversals should the authorities fail to rally domestic support for the structural reform measures.** Other risk factors include renewed tensions in trade with regional partners, a weakening of world cotton prices, and difficulties in raising revenue to program targets. To contain such risks, the authorities must deepen and expedite their reform agenda, including maintenance of spending at levels compatible with medium-term fiscal viability. Staff welcomes ongoing efforts in this direction and urges the government to stay the course.

41. **It is proposed that the next Article IV consultation with Benin take place within 24 months subject to the provisions of the decision on consultation cycles in program countries**.

Table 1. Benin: Main Economic and Financial Indicators, 2004-08

	2004	2005		2006		2007	2008
		Country Rpt. 05/283	Est.	Country Rpt. 05/283	Proj. 1/	Projection 1/	
	(Annual changes in percent, unless otherwise indicated)						
National income							
GDP at current prices	3.4	5.8	8.5	6.5	7.3	7.6	8.1
GDP at constant prices	3.1	3.9	2.9	4.4	4.5	5.1	5.5
GDP deflator	0.3	1.8	5.4	2.0	2.6	2.4	2.4
Consumer price index (average)	0.9	2.5	5.4	2.5	3.0	2.5	2.5
Consumer price index (end of period)	2.6	2.5	3.7	2.5	2.4	2.5	2.5
Production of cotton (in '000 of tons) 2/	427.7	416.5	190.8	437.3	350.0	463.6	538.8
Central government finance							
Revenue	0.2	11.8	9.1	5.6	7.0	12.6	12.8
Expenditure and net lending	0.7	19.2	13.9	3.8	9.3	13.2	10.5
Money and credit							
Net domestic assets 3/	3.4	11.1	12.9	...	0.4	8.8	1.7
Domestic credit 3/	4.8	11.1	13.4	...	0.4	8.1	4.5
Net claims on central government 3/	1.5	3.0	3.2	...	-5.5	-0.8	-0.7
Credit to the nongovernment sector	4.5	12.1	20.2	...	6.2	8.9	5.2
Broad money	-6.7	5.8	21.8	...	2.9	12.3	4.3
Velocity (GDP relative to average M2)	3.6	4.7	3.7	...	3.6	3.6	3.6
External sector (in terms of CFA francs)							
Exports, f.o.b.	7.7	7.3	-6.0	4.1	-1.5	34.3	10.1
Imports, f.o.b.	3.9	5.8	-5.5	6.0	4.2	15.7	7.8
Export volume	-11.9	28.1	22.7	6.0	-11.1	36.3	14.2
Import volume	3.0	3.6	3.3	4.6	4.0	4.5	5.0
Terms of trade (minus = deterioration)	21.2	-18.0	-15.9	-3.1	4.1	5.6	4.2
Nominal effective exchange rate (minus = depreciation)	4.4	...	-0.5	...	...	...	...
Real effective exchange rate (minus = depreciation)	2.4	...	2.2	...	...	...	...
	(In percent of GDP, unless otherwise indicated)						
Basic ratios							
Gross investment	19.0	20.3	19.6	20.6	21.0	21.8	22.4
Government investment	6.1	7.4	6.2	7.5	7.4	8.1	8.6
Private sector investment	12.8	12.9	13.4	13.1	13.6	13.7	13.8
Gross domestic saving	6.7	7.6	9.6	8.1	10.2	11.3	12.3
Government saving	3.8	4.4	3.3	5.2	5.1	5.5	6.1
Nongovernment saving	3.0	3.2	6.2	2.8	5.2	5.9	6.2
Gross national saving	11.7	12.1	12.8	12.0	13.9	15.0	15.9
Central government finance							
Revenue	16.4	17.4	16.5	17.2	16.5	17.2	18.0
Expenditure and net lending	20.1	22.6	21.1	22.1	21.5	22.6	23.1
Primary balance 4/	-3.3	-5.0	-4.3	-4.5	-4.8	-5.1	-4.9
Primary balance (narrow definition) 5/	0.0	-0.9	-1.4	-0.4	-0.9	-0.5	0.0
Overall fiscal deficit (payment order basis, excluding grants)	-3.7	-5.3	-4.6	-4.9	-5.0	-5.4	-5.1
Overall fiscal deficit (cash basis, excluding grants)	-4.5	-6.1	-3.6	-5.5	-5.2	-5.8	-5.5
Debt service (after debt relief) in percent of revenue 1/ & 6/	1.6	1.3	7.0	1.9	4.0	3.9	3.7
External sector							
Trade balance	-11.0	-11.3	-9.6	-11.4	-9.7	-9.3	-9.1
Current account balance (excluding grants)	-7.9	-8.7	-7.2	-8.7	-7.0	-6.7	-6.5
Current account balance (including grants)	-7.2	-8.2	-6.8	-8.7	-7.0	-6.7	-6.5
Overall balance of payments	-3.2	-1.7	2.8	-2.5	-1.3	-1.2	-0.8
Debt-service to exports ratio 1/	6.9	6.1	6.5	6.6	5.4	4.8	4.8
Net present value of debt-to-exports ratio 7/	132.1	139.4	75.1	142.3	82.3	75.1	77.5
Debt-to-GDP ratio (after HIPC and before MDRI)	32.4	34.1	36.9	34.3	36.2	34.7	33.8
Debt-to-GDP (post MDRI)	32.4	34.1	36.9	34.3	12.7	13.4	14.2
Gross reserves in months of imports	8.7	5.1	11.4	4.5	11.4	10.5	10.2
Nominal GDP (in billions of CFA francs)	2,138.2	2,261.5	2,319.7	2,408.7	2,488.0	2,678.1	2,893.8
CFA francs per U.S. dollar (period average)	527.6	499.2	526.6	499.5	524.7	513.1	510.5
Population (midyear, in millions)	7.2	7.4	7.4	7.6	7.6	7.9	8.1

Sources: Beninese authorities; and IMF staff estimates and projections.

1/ The 2006 projections incorporate the MDRI resources for the IMF, IDA and AfDF in stock operations.
2/ Cotton production for T-1/T season. Production of cotton seed in crop year T-1/T affects agricultural production in year T-1, industry, services, and exports of ginned cotton in year T.
3/ In percent of broad money at the beginning of the period.
4/ Total revenue minus all expenditure, excluding interest due.
5/ Total revenue minus all expenditure, excluding foreign-financed capital expenditure and interest due.
6/ Interest payment only.
7/ After HIPC relief and before MDRI.

Table 2 . Benin: Consolidated Central Government Operations, 2004-08

	2004	2005	2006		2007		2008	
		Est.	Prog. Country Rpt. 05/283	Proj. 1/	Program Country Rpt. 05/283	Proj.	Program Country Rpt. 05/283	Proj.
	(In billions of CFA francs)							
Total revenue	351.4	383.4	414.6	410.4	453.6	462.0	497.0	520.9
Tax revenue	311.4	334.0	369.9	366.7	405.7	414.0	445.4	468.5
Tax on international trade	155.9	174.8	185.8	190.9	203.2	212.7	222.8	242.7
Direct and indirect taxes	155.5	159.2	184.1	175.8	202.5	201.3	222.6	225.7
Nontax revenue	40.0	49.4	44.7	43.8	47.9	47.9	51.6	52.5
Total expenditure and net lending	429.5	489.3	531.8	534.9	572.8	605.7	621.6	669.1
Current expenditures	297.8	345.9	350.0	350.8	374.3	389.0	402.7	420.5
Current primary expenditures	290.8	339.0	341.8	345.0	365.0	381.5	393.3	413.2
Wages	118.3	130.3	136.4	138.1	144.6	148.4	154.8	159.6
Pensions and scholarships	26.7	26.5	30.9	29.8	33.2	32.1	35.9	34.7
Transfers and current expenditures	145.8	182.2	174.4	177.1	187.2	200.9	202.7	218.9
Current transfers	65.5	81.8	71.0	76.6	76.2	78.9	82.4	85.2
Other current expenditure	80.3	100.4	103.4	100.5	111.0	122.1	120.3	133.7
Interest	7.0	6.9	8.2	5.8	9.3	7.5	9.4	7.3
Internal debt	1.2	1.3	0.2	0.2	0.2	1.7	0.2	0.2
External debt	5.8	5.6	8.0	5.7	9.1	5.8	9.3	7.1
Capital expenditures and net lending	131.7	143.4	181.8	184.0	198.5	216.7	218.9	248.7
Investment	131.0	144.2	181.8	184.0	198.5	216.7	218.9	248.7
Financed by domestic resources	61.2	76.3	82.4	87.4	91.9	94.1	101.9	108.1
Financed by external resources	69.8	67.9	99.3	96.7	106.6	122.7	117.0	140.5
Net lending (minus = reimbursement)	0.7	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (payment order basis, excl. grants)	-78.1	-105.8	-117.1	-124.5	-119.2	-143.8	-124.7	-148.2
Change in arrears	-8.5	-42.2	-15.0	-46.0	-13.0	-13.0	-13.0	-13.0
External debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic debt	-8.5	-42.2	-15.0	-46.0	-13.0	-13.0	-13.0	-13.0
Payments during complementary period/float	-10.7	63.4	0.0	40.9	0.5	0.5	1.0	1.0
Overall balance (cash basis, excl. grants)	-97.3	-84.7	-132.1	-129.6	-131.7	-156.3	-136.7	-160.2
Financing	97.2	84.7	82.1	79.0	81.1	98.9	89.3	116.5
Domestic financing	2.4	-6.4	-7.7	-38.0	-14.3	-11.7	-16.6	-11.7
Bank financing	8.9	18.2	-16.7	-38.3	-9.3	-5.7	-10.6	-5.7
Net use of Fund resources	-2.8	-3.4	-2.7	-30.6	-2.3	1.3	-3.6	1.3
Disbursements	1.1	0.7	1.3	0.7	1.3	1.3	0.7	1.3
Repayments	-3.9	-4.1	-4.0	-31.3	-3.6	0.0	-4.3	0.0
Other	11.7	21.5	-14.0	-7.7	-7.0	-7.0	-7.0	-7.0
Nonbank financing	-6.5	-24.6	9.0	0.3	-5.0	-6.0	-6.0	-6.0
Privatization	1.6	0.5	15.0	0.0	0.0	0.0	0.0	0.0
Restructuring	-5.3	-26.5	-6.0	-2.0	-5.0	-6.0	-6.0	-6.0
Other	-2.8	1.5	0.0	2.3	0.0	0.0	0.0	0.0
External financing	94.8	91.1	89.8	-466.9	95.3	110.6	105.9	128.2
Project financing	69.8	67.9	99.3	96.7	106.6	122.7	117.0	140.5
Grants	40.9	39.7	56.7	56.1	60.8	72.4	66.7	82.2
Loans	28.9	28.1	42.7	40.6	45.8	50.2	50.3	58.3
Amortization due	-9.3	-9.7	-9.6	-563.6	-11.3	-12.1	-11.1	-12.3
Program aid	34.3	33.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	14.8	8.2	0.0	0.0	0.0	0.0	0.0	0.0
Loans	19.5	24.8	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief obtained	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
MDRI grants				583.9		0.0		0.0
IMF				31.3				
IDA & AfDF				552.6				
Financing gap	0.0	0.0	50.1	50.6	50.6	57.4	47.4	43.7
Memorandum items:	(In percent of GDP, unless otherwise indicated)							
Total grants and revenue	19.0	18.6	19.6	18.8	19.9	20.0	20.2	20.8
Grants	2.6	2.1	2.4	2.3	2.4	2.7	2.4	2.8
Revenue	16.4	16.5	17.2	16.5	17.5	17.2	17.8	18.0
Total expenditure	20.1	21.1	22.1	21.5	22.2	22.6	22.2	23.1
Of which: wage bill	5.5	5.6	5.7	5.5	5.6	5.5	5.5	5.5
Capital expenditure	6.1	6.2	7.5	7.4	7.7	8.1	7.8	8.6
Overall balance (payment order basis, excl. grants)	-3.7	-4.6	-4.9	-5.0	-4.6	-5.4	-4.5	-5.1
Overall balance (payment order basis, incl. grants)	-1.0	-2.5	-2.5	-2.7	-2.3	-2.7	-2.1	-2.3
Primary balance	-3.3	-4.3	-4.5	-4.8	-4.3	-5.1	-4.1	-4.9
Primary balance (narrow definition) 2/	0.0	-1.4	-0.4	-0.9	-0.1	-0.5	0.1	0.0
Current balance	2.5	1.6	2.7	2.4	3.1	2.7	3.4	3.5
Debt relief (in billions of CFA francs)	0.0	0.0	21.9	20.2	22.4	19.7	24.0	19.2
GDP (in billions of CFA francs)	2,138.2	2,319.7	2,408.7	2,488.0	2,585.7	2,678.1	2,794.6	2,893.8

Sources: Beninese authorities; and IMF staff estimates and projections.

1/ The 2006 projections incorporate the MDRI resources for the IMF, IDA and AfDF in stock operations.

2/ Total revenue minus total expenditure, excluding investment financed from abroad, interest payments and net lending.

Table 3. Benin: Balance of Payments, 2004-08

	2004	2005		2006		2007		2008	
		Program Country Rpt. 05/283	Est.	Program Country Rpt. 05/283	Proj. 1/ (	Program Country Rpt. 05/283	Proj. 1/	Program Country Rpt. 05/283	Proj. 1/
				(In billions of CFA francs)					
Trade balance 2/	-235.4	-255.0	-223.1	-274.1	-242.2	-281.9	-249.2	-293.2	-263.3
Exports, f.o.b.	181.0	185.7	170.2	193.3	167.6	212.9	225.1	238.0	247.8
Cotton and textiles	114.6	118.1	93.0	115.0	78.3	125.2	107.2	139.8	121.6
Other	66.4	67.6	77.2	78.3	89.4	87.7	117.9	98.1	126.2
Imports, f.o.b.	-416.4	-440.8	-393.3	-467.4	-409.8	-494.8	-474.3	-531.1	-511.1
Of which: petroleum products	-80.6	-95.3	-69.0	-93.7	-106.3	-92.2	-130.7	-94.2	-135.6
Services (net)	-26.3	-30.9	-21.8	-28.9	-24.2	-27.0	-30.7	-26.1	-29.1
Credit	125.4	118.8	132.6	131.4	137.2	143.4	146.4	156.5	158.1
Debit	-151.7	-149.7	-154.4	-160.3	-161.4	-170.4	-177.1	-182.6	-187.2
Income (net)	-20.5	-22.8	-23.3	-25.7	-25.2	-27.3	-27.1	-28.2	-27.4
Of which: interest due on government debt	-5.8	-5.0	-5.6	-8.0	-5.7	-9.1	-5.8	-9.3	-7.1
Current transfers (net)	128.0	125.3	109.6	120.2	116.8	129.0	126.2	138.5	130.4
Unrequited private transfers	60.0	58.7	61.4	62.9	63.2	67.4	67.7	72.3	68.5
Public current transfers	68.0	66.6	48.2	57.2	53.5	61.6	58.5	66.3	61.9
Of which: program grants	14.8	13.4	8.2	0.0	0.0	0.0	0.0	0.0	0.0
Current account balance	-154.2	-183.4	-158.6	-208.5	-174.7	-207.2	-180.7	-208.9	-189.5
Current account balance (excl. program grants)	-169.0	-195.8	-166.8	-208.5	-174.7	-207.2	-180.7	-208.9	-189.5
Capital account balance	40.9	53.2	39.7	56.7	640.0	60.8	72.4	66.7	82.2
Official project grants 3/	40.9	53.2	39.7	56.7	56.1	60.8	72.4	66.7	82.2
Debt cancellation 4/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other capital transfers (MDRI grants)					583.9		0.0		0.0
IMF (Stock operation)					31.3		0.0 #		0.0
World Bank (IDA) & AfDB (stock op.)					552.6		0.0		0.0
Financial account (net)	43.9	105.1	184.5	91.9	-498.8	90.8	75.9	99.8	83.9
Medium- and long-term public capital	42.8	69.6	47.0	37.1	-519.0	38.5	42.1	43.3	50.1
Disbursements	52.1	79.5	56.8	46.6	44.5	49.8	54.2	54.4	62.4
Project loans	32.6	43.9	32.0	46.6	44.5	49.8	54.2	54.4	62.4
Program loans	19.5	35.6	24.8	0.0	0.0	0.0	0.0	0.0	0.0
Amortization due	-9.3	-9.9	-9.7	-9.6	-563.6	-11.3	-12.1	-11.1	-12.3
Principal not yet due 3/	--	--	--	--	--	--	--	--	--
Medium- and long-term private capital	26.4	6.8	46.7	34.7	20.2	22.2	33.7	25.3	33.7
Deposit money banks	0.0	0.0	-20.4	-1.0	0.0	-1.0	0.0	-2.0	0.0
Short-term capital	20.0	28.7	49.8	21.1	0.0	31.1	0.0	33.2	0.0
Errors and omissions	-45.3	0.0	61.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-69.4	-25.0	65.7	-60.0	-33.6	-55.6	-32.4	-42.4	-23.4
Financing	69.3	25.0	-70.9	10.0	-17.0	5.0	-25.0	-5.0	-20.3
Change in net foreign assets (minus = increase)	69.3	25.0	-70.9	10.0	-17.0	5.0	-25.0	-5.0	-20.3
Of which: net use of Fund resources	-2.6	-1.9	-1.9	-5.2	-30.6	-4.8	-1.3	-5.0	-1.3
Debt relief obtained	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	50.0	50.6	50.6	57.4	47.4	43.7
Memorandum items:				(In percent of GDP, unless otherwise indicated)					
Net reexports	2.8	2.7	2.6	2.7	2.7	2.8	2.7	2.8	2.7
Reexports	5.6	5.5	5.6	5.6	5.6	5.7	5.6	5.6	5.6
Imports for reexports	-2.8	-2.8	-3.0	-2.9	-2.9	-2.9	-2.9	-2.9	-2.9
Current account balance	-7.2	-8.2	-6.8	-8.7	-7.0	-8.0	-6.7	-7.5	-6.5
Current account balance (excl. program grants)	-7.9	-8.7	-7.2	-8.7	-7.0	-8.0	-6.7	-7.5	-6.5
Trade balance	-11.0	-11.3	-9.6	-11.4	-9.7	-10.9	-9.3	-10.5	-9.1
Exports	8.5	8.2	7.3	8.0	6.7	8.2	8.4	8.5	8.6
Imports	-19.5	-19.5	-17.0	-19.4	-16.5	-19.1	-17.7	-19.0	-17.7
Services and income (net)	-2.2	-2.4	-1.9	-2.3	-2.0	-2.1	-2.2	-1.9	-2.0
Current transfers (net)	6.0	5.5	4.7	5.0	4.7	5.0	4.7	5.0	4.5
Capital account balance	1.9	2.4	1.7	2.4	25.7	2.4	2.7	2.4	2.8
Financial account balance	2.1	4.1	8.0	3.8	-20.0	3.5	2.8	3.6	2.9
Overall balance	-3.2	-1.7	2.8	-2.5	-1.3	-2.1	-1.2	-1.5	-0.8
Financing gap	0.0	0.6	0.0	2.1	2.0	2.0	2.1	1.7	1.5
GDP (in billions of CFA francs)	2,138.2	2,261.5	2,319.7	2,408.7	2,488.0	2,585.7	2,678.1	2,794.6	2,893.8

Sources: Beninese authorities; and IMF staff estimates and projections.

1/ The 2006 projections incorporate the MDRI resources for the IMF, IDA and AfDF in stock operations.
2/ Excluding reexports and imports for reexports whose net balance is allocated between services and public transfers.
3/ Official capital grants from the United States (MCA) of about US $ 60 millions per annum for the period 2006-2011.
4/ The entry in 2003 is for the stock of debt operation at the HIPC completion point.

Table 4. Benin: Monetary Survey, 2004-06

	2004		2005	2006	
	Country Rpt. 05/283	Act.	Est.	June	Dec. Proj. 1/
	(In billions of CFA francs)				
Net foreign assets	244.2	336.7	387.3	431.4	404.3
Central Bank of West African States (BCEAO)	165.1	257.6	328.5	396.8	345.5
Banks	79.1	79.1	58.7	34.6	58.7
Net domestic assets	228.1	230.3	303.6	285.1	306.4
			18.1		
Domestic credit	273.1	280.0	356.0	316.3	358.9
Net claims on central government	-38.8	-38.9	-20.8	-50.5	-59.0
Credit to the nongovernment sector	312.1	312.1	375.1	369.7	417.9
Other items (net)	-45.0	-49.7	-52.5	-31.2	-52.5
Broad money (M2)	472.3	567.0	690.8	716.5	710.7
Currency	35.0	129.9	195.2	215.7	209.4
Bank deposits	429.2	429.0	487.0	491.0	492.7
Deposits with postal checking accounts	8.1	8.1	8.6	9.8	8.6
	(Change in percent of beginning-of-period broad money unless otherwise indicated)				
Net foreign assets	-9.2	-10.1	8.9	6.4	2.5
Net domestic assets	4.2	3.4	12.9	-2.7	0.4
Domestic credit	4.4	4.8	13.4	-5.8	0.4
Net claims on government	1.8	1.5	3.2	-4.3	-5.5
Credit to nongovernment sector	2.7	2.2	11.1	-0.8	6.2
Broad money	-5.0	-6.7	21.8	6.6	2.9
Velocity of broad money	4.4	3.6	3.7	3.9	3.6
Credit to the nongovernment sector (annual change in percent)	4.5	4.5	20.2	22.2	11.4
Broad money as share of GDP	22.1	26.5	29.8	28.8	28.6
Nominal GDP (in billions of CFA francs)	2,138.2	2,138.2	2,319.7	2,488.0	2,488.0
Nominal GDP growth (annual change in percent)	3.4	3.4	8.5		7.3

Sources: BCEAO; and IMF staff estimates and projections.

1/ Projections incorporate the effect of the cancellation of Fund credit under the MDRI

Table 5. Benin: Proposed Schedule of Disbursements Under the PRGF Arrangement, 2005-08 1/

Amount	Available Date	Conditions Necessary For Disbursement 2/
SDR 0.88 million	August 12, 2005	Executive Board approval of the three-year Arrangement.
SDR 0.88 million	December 10, 2005	Observance of performance criteria for September 30, 2005, completion of the first review under the arrangement.
SDR 0.88million	May 15, 2007	Observance of performance criteria for December 31, 2006, completion of the second review under the arrangement.
SDR 0.88 million	November 15, 2007	Observance of performance criteria for June 30, 2007, completion of the third review under the arrangement.
SDR 0.88 million	May 15, 2008	Observance of performance criteria for December 31, 2007, completion of the fourth review under the arrangement.
SDR 0.88 million	November 15, 2008	Observance of performance criteria for June 30, 2008, completion of the fifth review under the arrangement

Source: International Monetary Fund.

1/ Assuming access equivalent to 10 percent of quota, or SDR 6.19 million.
The date of the last disbursement will be determined at a later time.
2/ Other than the generally applicable conditions under the Poverty Reduction and Growth Facility (PRGF) arrangement, including the performance clause on the exchange and trade system.

Table 6. Benin: Millennium Development Goals

	1990	1995	2001	2002	2003	2004	2015 Target	Likelihood of reaching target
Goal 1. Eradicate extreme poverty and hunger								
Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.								Likely
- Population below US$ 1 a day (percent)	57.0	..	..	43.0	...	...	28.0	
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger								Likely
- Prevalence of child malnutrition (percent of children under 5)	35.0	29.2	23.0	..	..	...	18.0	
- Population below minimum level of dietary energy consumption (percent)	19.0	..	13.0	..	..		10.0	
Goal 2. Achieve universal primary education								
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling								Likely for boys
- Net primary enrollment ratio (percent of relevant age group)	48.8	59.7	70.3	..	..	83.0	100.0	
- Percentage of cohort reaching grade 5	55.0	60.9	...	68.3	69.4	71.0		
- Youth literacy rate (percent age 15-24)	40.4	47.0	54.3	55.5	..	...		
Goal 3. Promote gender equality and empower women								
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015								Unlikely
- Ratio of girls to boys in primary and secondary education (percent)	69.0	..	..	67.0	68.1	72.0	100.0	
- Ratio of young literate females to males (percent ages 15-24)	43.6	47.3	52.0	52.9	..	56.1		
- Proportion of seats held by women in the national parliament (percent)	3.0	7.0	6.0	6.0	6.0	...		
Goal 4. Reduce child mortality								
Target 5: Reduce by two-thirds between 1990 and 2015 the under-five mortality rate								Unlikely
- Under-five mortality rate (per 1,000)	185.0	170.0	158.0	..	154.0	152.0	61.7	
- Infant mortality rate (per 1,000 live births)	111.0	104.0	94.0	92.0	91.0	89.6		
- Immunization against measles (percent of children under 12-months)	79.0	65.0	65.0	78.0	83.0	86.0		
Goal 5. Improve maternal health								
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.								Unlikely
- Maternal mortality ratio (modeled estimate, per 100,000 live births)	547.0	..	..	474.0	..	...	137.0	
Goal 6. Combat HIV/AIDS, malaria and other diseases								
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS								Likely
- HIV/AIDS prevalence	0.3	3.2	4.1	1.9	..	2.1	<6.0	
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases								Likely
- Prevalence of death associated with malaria (per 10,000)	21.0	11.0		6.8	..	...	12.0	
Goal 7. Ensure environmental sustainability								
Target 9: Halve by 2015 proportion of people without access to safe drinking water								Likely
- Access to improved water source (percent of population)	54.0	..	59.0	61.0	..	...	80.0	

Sources: Benin's authorities and World Bank estimates.

Appendix I. Benin: Letter of Intent

Republic of Benin
Ministry of Development, Economy,
And Finance

Cotonou, October 29, 2006

The Minister

To:

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Sir:

The implementation of Benin's reform program under the Poverty Reduction and Growth Facility (PRGF) has been broadly satisfactory during 2005-2006. Discussions with Fund staff in the context of the first program review found that all but two of the performance criteria for the period were met.

The missed performance criteria pertain to the program requirements that the authorities not accumulate domestic payments arrears and neither contract nor guarantee nonconcessional debt. At end-June 30, 2006, domestic payments arrears accumulated in FY 2005 stood at about CFAF 33 billion (1.3 percent of 2006 GDP). With technical assistance from the World Bank, the government is carrying out a comprehensive evaluation of these arrears. The audit report, which is expected to be completed by December 2006, will include an arrears clearance plan. During the same period, the government guaranteed CFAF17.4 billion (US$ 31.3 million) in nonconcessional borrowing by Benin Télécoms, the state-owned telephone company. Also, the government did not meet the program's quantitative benchmarks for domestic revenue mobilization and the wage bill for the first review test date of September 30, 2005.

The government has taken the necessary steps to address existing weaknesses in the areas of missed performance criteria and to ensure that relevant targets and commitments are fully observed in the future. In particular, the government has enhanced Treasury cash-flow monitoring by establishing a cash-flow committee headed by the Minister of Finance. The corrective measures taken to ramp up budget tracking should prevent accumulation of new domestic payments arrears. Furthermore, the government reaffirms herewith its commitment to no longer contract or guarantee nonconcessional loans in the future. In light of the remedial actions undertaken, the government requests waivers of nonobservance of the missed performance criteria; it also requests that the first PRGF review be completed and related PRGF resources disbursed.

Benin achieved economic growth of 2.9 percent in 2005, which is projected to rebound to 4.5 percent in 2006, driven by strong performance in the agricultural sector with a substantial recovery of cotton production, and by an up tick of activity in the trade and transport sectors. The recovery of the two sectors reflects smoother trade flows with Nigeria and a substantial improvement in the performance of the port of Cotonou. The government is determined to further strengthen growth and reduce poverty and will continue to pursue generally prudent macroeconomic policies, while expediting implementation of its structural reform agenda. It wishes to benefit from Fund technical and financial assistance under the program supported by the PRGF arrangement, which was approved by the IMF Executive Board on August 5, 2005.

The government authorizes the IMF to publish the staff report and other documents pertaining to the discussions under the first program review.

Truly yours,

/s/

Pascal I. Koupaki

Appendix I Attachment I

Benin. Memorandum of Economic and Financial Policies for 2006-07

I. Introduction

1. **Since the adoption of its medium-term economic program supported by the International Monetary Fund under the Poverty Reduction and Growth Facility (PRGF), the government has taken measures to consolidate progress made under previous programs and to lay the foundations for a new, second-generation, reform agenda.** The reform efforts aim to consolidate fiscal sustainability and improve the institutional environment, strengthen the country's socioeconomic infrastructure, and promote exports and economic diversification. They should enhance economic competitiveness, give new impetus to growth, and accelerate progress toward the Millennium Development Goals.

2. **The PRGF-supported program provides a framework for preserving macroeconomic stability and creating conditions for greater involvement of the private sector in the economy**. In this context, the government is pushing resolutely ahead with its fiscal consolidation program, and promoting modernization of public utilities by privatizing the state-owned enterprises operating in this sector. In agriculture and transport, reforms are focused for the most part on government disengagement from the cotton sector, and on modernization of the autonomous Port of Cotonou.

3. **This memorandum reviews progress made since the adoption of the program supported by the PRGF arrangement** and presents the policies and measures that the government proposes to implement in the last quarter of 2006 and in 2007 to achieve its objectives under the program.

II. Economic Developments and Performance under the Program

Recent economic developments and outlook for end-2006

4. **Continuing a downturn experienced since 2002, real GDP growth decelerated to 2.9 percent in 2005**. The economic slowdown reflects the decline in the level of activity in the primary sector, particularly in cotton production, despite some improvement in trade relations with Nigeria and the resumption of activity at the Port of Cotonou, which stimulated trade and transport services. Owing to the twofold impact of the food crisis in neighboring Niger on the prices of foodstuffs and of the rising prices of petroleum products on energy and transport, inflation rose to an annual average of 5.4 percent, largely exceeding the West African Economic and Monetary Union (WAEMU) convergence criterion. The external

current account deficit (excluding official transfers) narrowed slightly to 7.2 percent of GDP, compared with 7.9 percent in 2004. Although exports shrank because of the sharp drop in cotton prices, the decline in imports was even greater, particularly those of capital goods and petroleum products by financially-strained SONACOP, the dominant domestic oil distributor.

5. **Economic growth should be more robust in 2006 rising to 4.5 percent of GDP.** It will be driven by the recovery of the cotton sector and benefit from the impact of both the reforms in the port sector and smoother trade relations with Nigeria. Inflation should ease to 3 percent, consistent with the relevant WAEMU convergence criterion. The external current account deficit is expected to stabilize around 7 percent of GDP, notably on account of good cotton exports performance.

6. **In 2005, tax revenue was below target essentially owing to poor performance at the Directorate General of Taxes (DGID).** Domestic tax revenues fell to the equivalent of 6.9 percent of GDP, as compared with 7.3 percent of GDP in 2004. Contributing factors include: (i) a slowdown in economic activity; (ii) technical difficulties in the management of tax credits, particularly for the VAT and BIC; (iii) delayed deployment of human and physical resources under the 2005 performance contract for the revenue collection agency; and (iv) exemption of a large proportion of workers in the private and public sectors from personal income tax in application of relevant provisions of the 2005 budget law. Customs revenues increased slightly to 7.5 percent of GDP (7.3 percent in 2004), in particular following a sharp reduction in exemptions. Total revenue reached 16.5 percent of GDP, compared with an initial program target of 17.4 percent of GDP.

7. **Because of suffered revenue shortfalls and lower-than-expected external financial assistance, spending was cut to ensure achievement of the main fiscal objectives for 2005.** As a result, poverty reduction spending accounted for only 24 percent of total primary expenditure, as against a target of 28 percent; and the overall fiscal deficit was contained at 4.6 percent of GDP, compared with a target of 5.3 percent of GDP and an outturn of 3.7 percent of GDP in 2004. The efforts were somewhat frustrated by considerable extrabudgetary spending effected through the use of ad hoc Treasury Payment Orders and by the settling of all outstanding invoices carried over from FY 2004. This contributed to the accumulation of CFAF 63 billion in unpaid 2005 invoices at end-year. By June 30, 2006, the unpaid bills carried over from 2005 had been reduced to CFAF 33 billion, reflecting a decisive government effort to clear these potential arrears in the first half of the year. The outstanding balance is being audited with World Bank assistance in an effort to gauge their validity and develop a related settlement plan by end-December 2006.

8. **The budgetary situation sharply deteriorated during the first four months of 2006.** While revenue was slightly below the initial estimate, large expenditures were effected in connection with the presidential elections and substantial financial support was provided to some problem sectors, in particular cotton. Assistance to the latter sector comprised carried-

over subsidies from 2004/05 (0.3 percent of GDP), unsettled fertilizer charges (0.2 percent of GDP), and various debts to cotton farmers (0.1 percent of GDP). Other payments were made to clear the outstanding Treasury invoices from FY 2005. As result, the government's cash-flow position deteriorated sharply, prompting the authorities to borrow heavily from the banking system.

9. **Determined action is being taken to meet the main fiscal targets for FY 2006.** Since April, measures have been introduced to restore fiscal discipline and ensure achievement of the program objectives for the year. With a view to improving revenue performance, the authorities have notably intensified the audit of major taxes (including VAT and mobile telephone company royalties), and strengthened efforts to streamline tax credit management. Major personnel changes have also been made in the Directorate General of Customs and Indirect Taxes (DGDDI), with a view to enhancing the effectiveness of the department. This should be better equipped to perform its dual mission of facilitating foreign trade and collecting government revenue. With respect to expenditure, resort to ad hoc Treasury payment orders which have been used for extrabudgetary spending in the past, has been prohibited, and would only be effected under exceptional circumstances. At the same time, the government has set up a treasury committee to track more closely revenue and expenditure and to match government resources with commitments. As a result, revenue should stabilize at around 16.5 percent of GDP and expenditure be contained at 21.5 percent of GDP, making possible the reduction of the primary fiscal deficit (in the narrow sense) to the programmed equivalent of 0.4 percent of GDP (0.9 percent including spending with resources freed through MDRI debt relief). Estimated at 2 percent of GDP, the residual financing gap identified for FY 2006 will be covered mainly by assistance from the World Bank, African Development Bank, and the European Union.

10. **Monetary policy, which is conducted by the Central Bank of West African States (BCEAO), continued to focus on strengthening the basis for the CFA franc peg to the Euro**. Revision by the BCEAO of the methodology for estimating currency in circulation resulted in an upward adjustment of Benin's contribution to the official foreign exchange reserves of the BCEAO. In addition, as credit to the government was scaled back, it was possible to substantially increase credit to the private sector in 2005. However, this trend weakened in 2006, reflecting in part the high required reserve ratio that was raised to 15 percent in mid-2005.[1] Money supply continues to grow at a faster rate than nominal GDP, despite the downtick expected in 2006, reflecting a gradual strengthening of the demand for money.

[1] The BCEAO made the adjustment in 2005 in a situation due to pressures on domestic prices and risks of capital flight in the run up to the last presidential election. A downward revision of the required reserve ratio is currently being considered.

Program implementation

11. **Benin's macrobudgetary situation remained broadly on track, while progress in structural reforms was limited.** Despite recorded revenue shortfalls and strong pressures on the wage bill, spending is generally managed in a manner that helps keep fiscal balances within programmed limits**.** In contrast to broadly satisfactory developments in the macroeconomic area, the government has yet to complete its programmed disengagement from the cotton, telecommunications, and electricity sectors. Only in the port sector have the authorities achieved measured tangible progress. In some cases, delays in the implementation of structural reforms have been caused by lags in mobilizing required technical assistance; in others, the initial reform timetable appears to have been too ambitious (Tables 1 and 2).

III. Economic and Financial Policies for 2007

A. Macroeconomic Framework

12. **The government is determined to give new impetus to economic reforms.** After a decade of relatively strong growth, Benin has experienced a slowdown in economic activity since 2002. Several factors explain this development, in particular the deterioration in the terms of trade, mainly due to declining cotton prices on the world market and spiraling petroleum product prices, the loss of competitiveness related to the appreciation of the currency, and major delays in the implementation of structural reforms. The authorities are determined to decisively tackle these difficulties by tightening the fiscal stance as necessary to maintain macroeconomic stability; they are also committed to reinvigorating Benin's stalled structural reform agenda.

13. **Real GDP growth should continue the upward trend started in 2006, reaching 5.1 percent in 2007.** The anticipated rebound of economic activity is mainly attributable to the recovery of the cotton sector, the further easing of tensions in trade relations with Nigeria, as well as the impact of structural reforms undertaken, in particular at the Port of Cotonou. Over the three year period to 2008, the real GDP growth rate is expected to average 4.5 - 5.5 percent, with inflation remaining within the WAEMU convergence ceiling of 3 percent. Reflecting mostly the expected recovery of cotton exports, the external position is expected to improve somewhat in 2007; and the external current account deficit would slightly narrow to 6.7 percent of GDP, down from 7 percent in 2006.

14. **Growth would be even stronger beyond 2008, underpinned by the competitiveness gains from, and newfound dynamism of, the reformed energy, telecommunications, and cotton ginning sectors**. Over that time horizon, economic performance would also benefit from rehabilitated economic and social infrastructure, as well as the improvement in the business climate in the wake of the reform of the judicial and land tenure systems, and greater access to credit for SMEs. These reforms will be financed*, inter*

alia, with resources from the Millennium Challenge Account. The financial support expected from that source is US$307 million over five years.[2]

15. **Given its systemic economic role, the government has undertaken a far-reaching program to overhaul the petroleum products distribution sector**. In this context, management of SONACOP, the dominant oil importing company, is being closely monitored. In a move to halt the deterioration of the company's financial situation and to mitigate its negative impact on the economy, the government had initially seized control of the (privatized) company, and taken strong measures to secure its supply sources. The measures have helped restore the availability of petroleum products on the formal market, but the government remains committed to the principle of private management of SONACOP. In consultation with its development partners, the authorities intend to develop an appropriate state disengagement strategy aimed at revitalizing the petroleum product distribution sector.

B. Fiscal Policy

16. **The program for 2007 aims to bolster Benin's fiscal consolidation efforts so as to preserve fiscal sustainability while increasing spending to support growth and poverty reduction.** Revenue collection should reach the level of initial program target of 17.2 percent of GDP, compared with 16.5 percent of GDP in 2006. The fiscal program targets a primary fiscal deficit equivalent to 0.5 percent of GDP, with the overall deficit (cash basis, excluding grants) contained at 5.8 percent of GDP.

17. **In 2007, revenue mobilization efforts will focus on strengthening the efficiency of tax and customs administration,** with technical support from AFRITAC West and the IMF's Fiscal Affairs Department (FAD).[3] The increase in direct and indirect tax revenue will reflect the full effect of the DGID's performance contract, better tracking of taxpayers by the Large Taxpayer Unit (DGE),[4] and the Medium-Sized Enterprise Tax Center (CIME). These units will be better equipped, particularly with computers, and staffed to ensure higher revenue collection, including of tax arrears, and the necessary streamlining of the system of tax credits. On the customs side (DGDDI), the main focus is on simplifying customs clearance procedures with the effective operation of the port's one-stop shop, better import valuations, stepped-up efforts to control smuggling, especially by water, and tracking of exemptions.

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[2] The agreements for access to these resources were signed in Washington, D.C. (USA) in February 2006.

[3] An FAD technical assistance mission visited Cotonou during October 10-23, 2006.

[4] The minimum turnover threshold for enterprises coming under the DGE was recently increased to rationalize the directorate's workload and refocus its activities on the very largest taxpayers.

18. **On the expenditure side, nonpriority expenditures will be rigorously monitored to ensure realization of the program's fiscal targets.** In this context, the government has identified the spending categories that would be subject to cuts to compensate for eventual revenue shortfalls. The wage bill is to fully reflect the government's current obligations to its permanent workers, and the employment and remuneration policy will be guided by the commitment to fully comply with the relevant WAEMU convergence criterion. The government is continuing preparations for its civil service modernization program. Under the latter civil service employment would be determined with a view to ensuring an effective operation of government services. The civil service reform program also aims to provide permanent government employees with competitive salaries and benefits, while keeping the wage bill below one third of fiscal revenues. Clearance of the outstanding stock of wage arrears will be effected in annual installments that are compatible with agreed fiscal targets under the program. In particular, care will be taken to ensure that annual personnel expenditure, including wage arrears, does not exceed the equivalent of 6.2 percent of GDP, the level achieved in 2006.

19. **Other current primary expenditure will be limited to CFAF 200.9 billion (7.5 percent of GDP), or an increase of 13 percent**. The increased spending appropriations provide financing for a more effective implementation of the poverty reduction strategy that seeks to further improve access to education and health services and to safe drinking water for the vulnerable populations. The investment budget will also focus on the priority sectors and be limited to approximately CFAF 94.1 billion, or an increase of 7.7 percent over last year's level. Efforts are made to improve the tracking of public expenditure, notably by strengthening the operating budget of permanent secretariat of the National Commission for Poverty Reduction and Development (CNDLP) that monitors the implementation of the PRS, and by enhancing the efficiency of the expenditure-tracking and project execution units in the civil service. Expenditure without prior commitment orders, particularly expenditure that are effected with ad hoc Treasury payment orders, will only be executed in exceptional cases of extreme urgency.

20. **Benin has obtained debt relief under the Multilateral Debt Reduction Initiative (MDRI)**. It has been agreed that additional spending with resources freed through MDRI debt relief will primarily be allocated to projects in education and health, to facilitate achievement of the Millennium Development Goals (MDGs). In 2007, expenditure financed with MDRI resources should total CFAF 15 billion (0.6 percent of GDP).

21. **In light of the above, the narrowly defined primary and overall fiscal deficits (commitment basis, excluding grants) are projected to stand at 0.5 percent of GDP and 5.1 percent of GDP, respectively**; the former remaining broadly in line with initial program targets**.** Taking into account a targeted net reduction in domestic payments arrears of CFAF 13 billion, the government's overall net borrowing requirements are expected to be fully covered. The main sources of budgetary support identified are: (i) World Bank: CFAF

15 billion; (ii) European Union: CFAF 21 billion; (iii) African Development Bank: CFAF 11 billion; and (iv) other development partners: CFAF 10 billion.

C. Money and Credit

22. **Monetary policy will be conducted by the BCEAO at the regional level.** Government borrowing from the banking system will be prudent, and monetary policy aimed at ensuring moderate inflation and expansion of credit to the economy, reduced risk of capital flight, and preservation of Benin's comfortable contribution to the international reserves of the regional central bank. Broad money is projected to increase by 12.3 percent in 2007, more than the expansion of nominal GDP, as compared with 2.9 percent in 2006. Treasury securities issued on the subregional financial market in July 2006 will be refinanced at maturity on January 8, 2007, in the amount of CFAF 25.4 billion.

D. Balance of Payments and External debt

23. **In 2007, the external current account deficit, excluding grants, is projected to narrow slightly to around 6.7 percent of GDP, from 7 percent of GDP in 2006.** This reflects mainly strong cotton exports for the 2006/07 season, following a sizable contraction in 2006, and despite a moderate increase in the major import categories. The government reaffirms its commitment to a prudent borrowing policy in the post-HIPC/MDRI era, to protect Benin's external debt sustainability. It is outlining an external debt policy that would enable Benin to make good use of new loans contracted, without putting the external position at risk, to secure financing for additional spending in support of growth and improved public access to social services. In this vein, the government, with the support from the African Development Bank, has initiated an exhaustive evaluation of the financing requirements for its MDG. On that basis, it will start talks with its development partners on the sources and nature of the funding needed, particularly as regards envisaged new loans. The government intends to neither contract nor guarantee any additional nonconcessional loans.

E. Structural Policies

24. **In the structural area, the government's main objectives are:** (i) to put in place modern regulatory frameworks for the energy and telecommunications sectors in 2007 and to initiate the transfer of management of these two key sectors to private operators of international repute ; (ii) to disengage from commercial activities in the cotton sector; and (iii) to further enhance the competitiveness of the autonomous Port of Cotonou by, in particular, offering the full range of activities at the management center for the one-stop shop and preparing for the involvement of the private sector in the management of port facilities.

25. **In consultation with the World Bank, the government has conducted an assessment of the electricity sector and developed measures and practical modalities for implementing envisaged reforms.** In August 2006, the government submitted to the World Bank a document on its vision for the reform. After adopting the proposed strategy for

divestiture of SBEE (lease concession) in late October 2006, the government plans to launch the call for bids and for expressions of interest before end-August 2007, with a view to concluding a management contract with the selected strategic partner by end-January 2008.

26. **In the telecommunications sector, a regulatory framework has been defined to govern the operation of the mobile and land-line telephone systems**. The new members of the regulatory board will soon be appointed. A consortium comprising an investment bank, and audit firm, and a law firm is being recruited. The consortium will assist the government in handling the Benin Télécoms privatization transaction and, in particular, will audit the company's financial statements and perform a strategic analysis of the enterprise (including financial restructuring) to develop a transaction strategy and issue the call for bids. With technical support from World Bank staff, the government has defined and formally approved a timetable for the implementation of the transaction. Under the latter, the call for bids is expected to be launched by end-January 2009, following a 24-month restructuring of the company. In view of the constraints of a highly competitive sector, work on the rehabilitation and recovery of Benin Télécoms should be carried out in parallel with the analysis and the preparations for the call for bids.

27. **The government reaffirms its commitment to withdraw from commercial activities in the cotton sector as of the end of the 2006/07 season.** It has approved a divestiture strategy for SONAPRA, including plans for the creation of a new, mainly privately-owned, cotton ginning company with minor shareholding by the state, company workers, and other entities active in the cotton industry. The new company is to start operations by end-June 2007.

F. Poverty Reduction Strategy Paper (PRSP)

28. **The government is updating its poverty reduction strategy (PRS)** to improve the effectiveness of this crucial instrument for the development of poverty reduction strategies and policies. The updating of the PRS, the final version of which was adopted in 2003, required an in-depth re-assessment of Benin's poverty profile, which led to the conduct of a modular survey of household living conditions (EMICOV). The new PRS emphasizes the role of the private sector in the economy; its preparation benefited from the active participation of members of civil society in the context of broad participatory consultations at the national and regional levels. The new poverty reduction strategy paper (PRSP II) has just been approved by the government and should be submitted to Benin's development partners in December 2006.

IV. Program Monitoring

29. **Completion of the first review of the arrangement under the PRGF for Benin is subject to timely completion of the following prior actions**: (i) adoption by the Council of Ministers of the strategies for government disengagement from the cotton, electricity, and telecommunications sectors, accompanied by a timetable for implementation of related key

reform measures, as stated in paragraphs 24-27 above; (ii) selection of an auditing firm to assess the validity of outstanding domestic arrears and to develop an arrears clearance strategy; and (iii) reaffirmation of the government's commitment to neither guarantee nor contract nonconcessional loans[5]. These measures were taken in October 2006.

30. **Program monitoring will be based on quarterly structural and quantitative benchmarks and performance criteria** (Tables 1 and 2). The authorities will report the data necessary for program monitoring to the IMF, in accordance with the Technical Memorandum of Understanding. During the program period, the government will not introduce restrictions on payments and transfers on current international transactions, or tighten any such restrictions, without first consulting the Fund; introduce or modify multiple currency practices; conclude bilateral payments agreements not compatible with Article VIII of the IMF's Articles of Agreement; or introduce or intensify restrictions on imports for balance of payments purposes.

31. **The second review of the arrangement under the PRGF will take place in mid-February 2007.**

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[5]In November 2005, the outgoing government guaranteed a nonconcessional loan contracted by the telephone parastatal (Benin Telecoms) in an amount equivalent to US$ 31.3 million. The proceeds were used to modernize obsolete equipment and enhance investor interest in the privatization program.

Table 1. Benin: Quantitative Performance Criteria and Indicative Targets for the period September 2005-June 2007
(In billions of CFA francs)

	End-September 2005 indicative targets			End-December 2005 indicative targets			End-June 2006 Informal targets 5/		
	Program	Estimate	Status	Program	Estimate	Status	Program	Estimate	Status
A. Quantitative Performance Criteria and Indicative Targets 1/									
Net domestic financing of the government 2/ 3/	11.0	5.1	met	6.4	-6.4	met	-4.4	-32.7	met
Primary fiscal balance (excluding grants)	-12.5	14.1	met	-19.5	-31.9	not met	-5.0	27.4	met
Accumulation of domestic payments arrears 4/	0.0	0.0	met	0.0	0.0	met	0.0	33.0	not met
Memorandum items:									
Budgetary assistance	30.6	14.7		49.0	37.0		0.0	0.0	
B. Continuous quantitative performance criteria									
Accumulation of external payments arrears	0.0	0.0	met	0.0	0.0	met	0.0	0.0	met
External debt contracted or guaranteed by government with maturities of 0-1 year	0.0	0.0	met	0.0	0.0	met	0.0	0.0	met
Nonconcesional external contracted or guaranteed with maturities of one year or more	0.0	0.0	met	0.0	17.4	not met	0.0	0.0	met
C. Indicative Targets (Cumulative from December 31, 2005)									
Total revenue	276.3	270.0	not met	392.8	383.5	not met	177.3	185.4	met
Wage bill	96.5	98.8	not met	128.7	130.3	not met	68.2	65.6	met

1/ The targets and performance criteria are cumulative as from end-December of previous year.
2/ The ceiling on domestic financing will be adjusted pro tanto if the amount of disbursed budgetary assistance falls short of the program forecast up to a limit of CFA francs 10 and 18 billions at end-September and end-December 2006, respectively.
3/ If external budgetary assistance exceeds the amount projected in excess of more than CFAF 3 billion, the ceiling will be adjusted downward by the excess disbursement beyond CFAF 3 billion, unless it is used to absorb domestic arrears.
4/ This performance criterion is monitored on a continuous basis.
5/ Informal targets agreed with staff.
6/ To be set at time of second PRGF review.

Table 1 (concluded). Benin: Quantitative Performance Criteria and Indicative Targets for the period September 2005-June 2007
(In billions of CFA francs)

	End-September 2006 informal target 5/	End-December 2006 Performance Criteria	End-March 2007 Informal targets	End-June 2007 Performance Criteria 6/
	Program	Program	Program	Program
A. Quantitative Performance Criteria and Indicative Targets 1/				
Net domestic financing of the government 2/ 3/	4.7	-38.0	0.5	21.0
Primary fiscal balance (excluding grants)	-19.0	-22.2	11.9	-4.4
Accumulation of domestic payments arrears 4/	0.0	0.0	0.0	0.0
Memorandum items:				
Budgetary assistance	9.6	50.6	0.0	0.0
B. Continuous quantitative performance criteria				
Accumulation of external payments arrears	0.0	0.0	0.0	0.0
External debt contracted or guaranteed by government with maturities of 0-1 year	0.0	0.0	0.0	0.0
Nonconcesional external contracted or guaranteed with maturities of one year or more	0.0	0.0	0.0	0.0
C. Indicative Targets (Cumulative from December 31, 2005)				
Total revenue	286.9	410.4	98.8	197.5
Wage bill	104.0	138.1	32.9	74.3

1/ The targets and performance criteria are cumulative as from end-December of previous year.
2/ The ceiling on domestic financing will be adjusted pro tanto if the amount of disbursed budgetary assistance falls short of the program forecast up to a limit of CFA francs 10 and 18 billions at end-September and end-December 2006, respectively.
3/ If external budgetary assistance exceeds the amount projected in excess of more than CFAF 3 billion, the ceiling will be adjusted downward by the excess disbursement beyond CFAF 3 billion, unless it is used to absorb domestic arrears.
4/ This performance criterion is monitored on a continuous basis.
5/ Informal targets agreed with staff.
6/ To be set at time of second PRGF review.

Table 2. Benin: Prior Actions, Structural Performance Criteria and Benchmarks for 2005 - 07

Measures	Date	Status
Prior action for completing the first PRGF review.		
Approval of disengagement strategies for Benin Telecoms SA, the cotton parastatal (SONAPRA), and for the electrical power company (SBEE)		
Selection of an auditing firm to assess outstanding domestic arrears and develop arrears settlement plan		
Formal reaffirmation of government commitment to neither contract nor guarantee nonconcessional loans		
Structural performance criteria		
Start up the centralized clearing and invoicing management center of the port of Cotonou	End-December 2005	Completed in March 2006
Effective start of consolidated electronic billing at one-stop window at Cotonou Port 1/	End-December 2006	
Establishment of a privately controlled ginning company (SONAPRA)	End-June 2007	
Structural benchmarks		
Installation of the software for the centralized clearing and invoicing management center of the port of Cotonou	End-September 2005	Completed on October, 15 2005
Transmittal to Fund staff of the proposed program to develop and expand the activities of the port of Cotonou	End-June 2007	
Transmittal to Fund staff of the report of government's debt vis-à-vis civil servants resulting from the past wage freeze and the accompanying plan to settle those obligations	End-December 2006	
Transmittal to the Audit Chamber of the relevant accounts of the 2004 budget; transmittal to the National Assembly of the settlement laws for the 2003 and 2004 budgets.	End-December 2006	
Formalization and execution of the methodology for collecting, processing, and presenting government finance statistics, including the government financial operations table, and increased staffing of the permanent secretariat of the National Commission for Development and Fight Against Poverty (CNDLP) for effective implementation of the methodology.	End-December 2005	Completed

1/ Implementation of the BFU (*Bordereau de Facturation Unique*) component of the IT system to provide for a basic assessment document to be used by importers to make payment at commercial banks.

Appendix I—Attachment II

Technical Memorandum of Understanding

October 29, 2006

1. This technical memorandum of understanding defines the quantitative and structural performance criteria and benchmarks for the program supported by the Poverty Reduction and Growth Facility (PRGF). It also sets out the frequency and deadlines for data reporting to the staff of the International Monetary Fund (IMF) for program-monitoring purposes.

I. DEFINITIONS

2. Unless otherwise indicated, the government is defined as the central government of the Republic of Benin and does not include local authorities, the central bank, or any other public entity with autonomous legal personality that is not included in the table of government financial operations (TOFE).

3. The definitions of "debt" and "concessional borrowing" for the purposes of this memorandum of understanding are as follows:

(a) As set out in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Borrowing (Executive Board Decision No. 6230-(79/140), amended by Executive Board Decision No. 12274-(00/85) (8/24/00), debt is understood to mean a current, that is, not contingent, liability created under a contractual agreement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services at some future points in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debt can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to the obligor by the lender on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payment until some time after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided that the lessee has the right to use for one or more specified period(s) of time, that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of this guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the arrangement, excluding those payments that cover the operation, repair, or maintenance of the property. Under this definition of debt set out above, arrears, penalties, and judicially awarded damages arising from failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

(b) **A loan is considered concessional** if, on the date the contract is signed, the ratio of the present value of the loan, based on the reference interest rates, to the nominal value of the loan is less than 65 percent (i.e., a grant element exceeding 35 percent). The reference interest rates used in this assessment are the commercial interest reference rates (CIRRs) established by the Organization for Economic Cooperation and Development (OECD). For debts with a maturity exceeding 15 years, the ten-year reference interest rate published by the OECD is used to calculate the grant element. For shorter maturities, the six-month market reference rate is used.

II. Quantitative Performance Criteria

A. Ceiling on Net Domestic Financing of the Government

Definition

4. Net domestic financing of the government is defined as the sum of (i) net bank credit to the government, as defined below, (ii) net nonbank financing of the government, including the proceeds from the sale of government assets net of the cost of structural reforms to which these proceeds are earmarked, and (iii) government treasury bills issued in CFAF on the regional financial market of the WAEMU.

5. Net bank credit to the government is defined as the balance between the liabilities and claims of the government vis-à-vis the central bank and commercial banks. The scope of net credit to the government is that used by the Central Bank of West African States (BCEAO) and is consistent with the established Fund practice in this area. It implies a broader definition of government than that specified in paragraph 2. Claims of the government include the CFA franc cash balance, postal checking accounts, subordinated debt (*obligations cautionnées*), and all deposits with the BCEAO and commercial banks of public entities, with the exception of industrial or commercial public entities (EPIC) and public enterprises, which are excluded from the calculation. Government debt to the banking system includes all debt to these same financial institutions.

6. The net bank credit to the government and the net amount of government treasury bills and bonds issued in CFAF in the regional financial market of the WAEMU are calculated by the BCEAO, and nonbank financing is calculated by the Beninese Treasury, whose figures are those deemed valid in the context of the program.

7. The ceiling on the net domestic financing of the government will be adjusted if disbursement of external budgetary assistance (excluding IMF financing and HIPC assistance) net of debt service obligations (excluding IMF repayment obligations) and payments of arrears, exceed or fall short of program forecasts. In the event of disbursement in excess of more than CFAF 3 billion, the ceiling will be adjusted downward pro tanto by the excess disbursement beyond CFAF 3 billion, unless they are used to absorb domestic arrears. In contrast, if at the end of each quarter disbursements are less than the programmed amounts, the ceiling will be raised pro tanto by the amount of the shortfalls up to the limit (on a noncumulative basis) of CFAF 10 billion at end-September 2006, CFAF 18 billion at end-December 2006. The amount of external budgetary assistance provided is calculated from end-December 2004 onward. Budgetary assistance is defined as grants, loans, and debt relief (excluding project loans and grants, IMF resources, and debt relief under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative)).

Performance criteria and indicators

8. The ceiling on net domestic financing of the government is established as follows: CFAF 4.7 billion at end-September 2006, and CFAF-38 billion at end December 2006. The ceiling is an indicative target as at end-September 2006 and a performance criterion as at end-December 2006.

Reporting requirement

9. Detailed data on domestic financing to the government, including a detailed list of the bank account balances of other public entities, will be transmitted on a monthly basis within the four weeks following the end of the month. The definitive data will be provided within an additional four weeks after the provisional data have been reported.

B. Narrow Primary Fiscal Balance

Definition

10. The narrow primary fiscal balance is defined as the difference between total budgetary revenues (tax and nontax) and the budgetary expenses, less interests on the debt and capital expenditure financed by foreign grants and net loans.

Performance criterion

11. The ceiling on the narrow primary fiscal balance is established as follows: a deficit not higher than CFAF 19 billion at end-September 2006, and a deficit not higher than CFAF 22.2 billion at end December 2006. The ceiling is an indicative target as at end-September 2006 and a performance criterion as at end-December 2006.

Reporting requirement

12. Provisional data on the narrow primary fiscal balance, including the data generated by the computerized budget management system (SIGFIP), will be transmitted on a monthly basis within the four weeks following the end of the month. The definitive data will be provided within an additional four weeks after the provisional data have been reported.

C. Accumulation of New Domestic Payments Arrears on Government Obligations

Definition

13. Domestic payments arrears on government obligations are defined as outstanding debt owed by the government to residents due following the expiration of a 60-day grace period, unless specified otherwise, but not paid, and any financial obligation of the government verified as such by the government (including any government debt). The Caisse Autonome d'Amortissement (CAA-the government debt management agency) and the Treasury keep and update the inventory of domestic debt arrears on government obligations and maintain records of their payments.

Performance criterion

14. The government undertakes not to accumulate any new domestic payments arrears on government debt. For obligations other than government debt, the government undertakes not to accumulate arrears beyond six months. The nonaccumulation of domestic payments arrears will be monitored on a continuous basis throughout the program period.

Reporting requirement

15. Data on outstanding balance, accumulation, and repayment of domestic payments arrears on government obligations will be provided monthly within eight weeks following the end of each month.

D. Nonaccumulation of External Public Payments Arrears

Definition

16. External public payments arrears are defined as the sum of payments owed to non residents due and not paid on debt of the government and on external debt guaranteed by the government. The definition of "debt" provided in paragraph 3 applies here.

Performance criterion

17. Under the program, the government will not accumulate external payments arrears, with the exception of arrears arising from debt under renegotiation or being rescheduled. The

performance criterion on the nonaccumulation of external public payments arrears will be monitored on a continuous basis throughout the program period.

E. Ceiling on Nonconcessional External Debt with a Maturity of One-Year or More Newly Contracted or Guaranteed by the Government

Definition

18. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Borrowing (Executive Board Decision No. 6230-(79/140), amended by Executive Board Decision No. 12274-(00/85) (8/24/00), but also to commitments contracted or guaranteed (including lease-purchase agreements) for which no value has yet been received. The external debt excludes treasury bills and bonds issued in CFAF on the regional financial market of the West African Economic and Monetary Union.

19. The concept of "government" for the purposes of this performance criterion includes government as defined in paragraph 2, public institutions of an administrative nature (EPA), public institutions of a scientific and/or technical nature, public institutions of a professional nature, and local governments.

Performance criterion

20. Nonconcessional external borrowing and guaranteeing will be zero throughout the 2006/07 program.

Reporting requirement

21. Information on any borrowing (including terms of loans and creditors) contracted or guaranteed by the government shall be transmitted each month within four weeks following the end of the month.

F. Ceiling on Short-Term External Debt Newly Contracted or Guaranteed by the Government

Definition

22. The definitions in paragraphs 18 and 19 also apply to this performance criterion.

23. Short-term external debt is debt with a contractual term of less than one year. Import-related loans and debt-relief operations are excluded from this performance criterion.

Performance criterion

24. In the context of the program, the government will not contract or guarantee short-term nonconcessional external debt.

25. As of December 31, 2004, the government of Benin has no short-term external debt.

III. Quantitative indicators

A. Floor on Government's Revenues

Definition

26. Government revenues are defined as those that appear in the government's financial operations table (TOFE).

Indicative targets

27. Indicative targets for total government revenues are set at CFAF 286.9 billion at end-September 2006, and CFAF 410.4 at end-December 2006 (cumulative since end-December 2005).

Reporting requirement

28. The government shall report its revenues to IMF staff each month in the context of the TOFE and before the end of the following month.

B. Ceiling on the Wage Bill

Definition

29. The wage bill includes all public expenditure on wages, bonuses, and other benefit or allowances granted civil servants employed by the government, the military and other security forces, and includes expenditure with respect to special contracts and other permanent or temporary employment with the government. The wage bill, therefore, excludes the salaries related to projects financed by foreign donors as well as the transfers related to the salaries of the teachers at the level of local municipalities.

Indicative targets

30. The quantitative benchmarks are defined as cumulative amounts after end-December 2004. The civil servant wage bill quarterly ceilings are CFAF 104 billion at end-September 2006, and CFAF 138.1 billion at end-December 2006.

Reporting requirement

31. The government shall report the wage bill to IMF staff each month in the context of the TOFE.

IV. Prior Actions for Circulation of the Request for the completion of the First review

32. The following actions have been taken before the circulation of the staff report on the first PRGF review to the Executive Board of the Fund:

- Approval of disengagement strategies for Benin Telecoms SA, the cotton parastatal (SONAPRA), and for the electric power company (SBEE);

- Selection of an audit firm to assess outstanding domestic arrears and develop arrears settlement plan;

- Formal reaffirmation of government commitment to neither contract nor guarantee nonconcessional loans.

V. Structural Performance Criterion

33. The following actions are set performance criteria

- Start up the centralized clearing and invoicing management center of the Port of Cotonou

- Effective start of the consolidated electronic billing at the centralized clearing and invoicing management center of the Port of Cotonou

- Establishment of a privately controlled ginning company to purchase and operate the ginning plants of SONAPRA

VI. Structural Benchmarks

34. The government will complete the following actions:

- Transmittal to the Fund of the proposed program to develop and expand the activity of the Port of Cotonou;

- Transmittal to Fund staff of the report of government's debt vis-à-vis civil servants resulting from the past wage freeze and the accompanying plan to settle those obligations;

- Transmittal to the Audit Chamber of the relevant accounts of the 2005 budget; transmittal to the National Assembly of the settlement laws for the 2003 and 2004 budgets;

VII. Other Data Requirements for Program Monitoring

C. Public Finance

35. The government will provide to the Fund the following:

- detailed monthly revenue and expenditure estimates, including social expenditures, payments on arrears, and HIPC Initiative-related expenditure;
- monthly data on domestic financing (bank and nonbank) of the budget (including government bonds held by the nonbank public), which will be transmitted on a monthly basis within four weeks of the end of each month;
- data on the implementation of the development budget, with detailed information on the sources of financing, which will be transmitted on a quarterly basis within 4 weeks of the end of each quarter.

D. Monetary Sector

36. The government will provide to the Fund the following data on a monthly basis within eight weeks of the end of the month:

- the consolidated balance sheets of deposit money banks, and the individual bank balance sheet, as needed;
- the monetary survey;
- lending and deposit rates;
- the standard bank supervision indicators for banks, as well as those for nonbank financial institutions and for individual institutions, as needed.

E. External Sector

37. The government will provide to the Fund the following data within 12 weeks of the end of each quarter:

- Export and import price and volume data;
- Other balance of payments data, including data on services, private transfers, official transfers, and capital account transactions.

F. Real Sector

38. The government will provide to the Fund:

- Monthly disaggregated consumer price indices will be transmitted on a monthly basis within two weeks of the end of each month;
- Any revisions to the national accounts data will be transmitted within eight weeks of the date of revision.

G. Structural Reforms and Other Data Requirements

39. The government will provide to the Fund:

- Documentation of all decisions, laws, decrees, orders, and circulars undertaken by the government pertaining to the economy of Benin will be submitted within ten days of publication;
- All studies and research papers related to the economy of Benin will be submitted within two weeks of publication.

Appendix II—Relations with the Fund
As of September 30, 2006

I. Membership Status: Joined: July 10, 1963; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	61.90	100.00
Fund holdings of currency	59.72	96.48
Reserve Position	2.19	3.53
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	9.41	100.00
Holdings	0.03	0.31

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
PRGF Arrangements	0.88	1.42

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	Aug 05, 2005	Aug 04, 2008	6.19	0.88
PRGF	Jul 17, 2000	Mar 31, 2004	27.00	27.00
PRGF	Aug 28, 1996	Jul 16, 2000	27.18	16.31

VI. Projected Payments to Fund; (with Board-approved HIPC Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal					
Charges/Interest	0.09	0.37	0.37	0.37	0.37
Total	0.09	0.37	0.37	0.37	0.37

VII. Implementation of HIPC Initiative:

	Enhanced Framework
I. Commitment of HIPC assistance	
Decision point date	Jul 2000
Assistance committed	
By all creditors (US$ Million)[1]	265.00
Of which: IMF assistance (US$ million)	24.30
(SDR equivalent in millions)	18.40
Completion point date	Mar 2003

II. Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	18.40
Interim assistance	11.04
Completion point balance	7.36
Additional disbursement of interest income[2]	1.66
Total disbursements	20.06

[1]Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts can not be added.
[2]Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

VIII. Implementation of MDRI Assistance:

I.	Total Debt Relief (SDR Million)[1]	36.06
	Of Which: MDRI	34.11
	HIPC	1.95
II.	Debt Relief by Facility (SDR Million)	

	Eligible Debt		
Delivery Date	**GRA**	**PRGF**	**Total**
January 2006	N/A	36.06	36.06

[1]The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for the assistance. The debt relief covers the full stock of debt owed to the Fund as of end-2004 which remains outstanding at the time the member qualifies for such debt relief. The MDRI is financed by bilateral contributions and the Fund's own resources, as well as the resources already disbursed to the member under the HIPC Initiative (see Section VII above).

Decision point - point at which the IMF and the World Bank determine whether a country qualifies for assistance under the HIPC Initiative and decide on the amount of assistance to be committed.

Interim assistance - amount disbursed to a country during the period between decision and completion points, up to 20 percent annually and 60 percent in total of the assistance committed at the decision point (or 25 percent and 75 percent, respectively, in exceptional circumstances).

Completion point - point at which a country receives the remaining balance of its assistance committed at the decision point, together with an additional disbursement of interest income as defined in footnote 2 above. The timing of the completion point is linked to the implementation of pre-agreed key structural reforms (i.e., floating completion point).

IX. Safeguards Assessments:

The Central Bank of West African States (BCEAO) is the common central bank of the countries of the West African Economic and Monetary Union. A safeguards assessment completed on November 4, 2005 found that progress has been made in strengthening the BCEAO's safeguards framework since 2002 when the last safeguards assessment took place.

The BCEAO now publishes a full set of audited financial statements and improvements have been made to move financial reporting closer to International Financial Reporting Standards (IFRS). Furthermore, an internal audit charter has been put in place and mechanisms have been established to improve risk management and risk prevention, including a follow up on internal and external audit recommendations.

The new assessment also identified a number of areas where further steps would help solidify the progress made. The main recommendations relate to improvements in the external audit process (including the adoption of a formal rotation policy), further enhancement of the transparency of the financial statements by fully adopting IFRS, and strengthening of the effectiveness of the internal audit function.

X. Exchange Arrangement:

Benin is a member of the West African Economic and Monetary Union (WAEMU). The exchange system common to all member countries of the WAMU is free of restrictions on payments and transfers for current international transactions subject to Fund jurisdiction. The union's common currency, the CFA franc, had been pegged to the French franc at the rate of CFAF 1 = F 0.02. Effective January 12, 1994, the CFA franc was devalued, and the new parity set at CFAF 1 = F 0.01. Effective January 1, 1999, the CFA franc was pegged to the euro at a rate of EUR 1 = CFAF 655.957. As of end December 2005, the rate of the CFA franc in terms of the SDR was SDR 1= CFAF 794.72.

XI. Article IV Consultations:

The last Article IV consultation discussions were held in Cotonou during June 7-18, 2004. The staff report (Country Report 04/368), together with selected issues and a statistical appendix (Country Report 04/370), was discussed by the Executive Board, and the 2004 Article IV consultation was concluded on October 6, 2004.

XII. ROSC Assessment:

An FAD mission conducted the fiscal module of a Report on Observance of Standards and Codes (ROSC) in May 2001. The mission recommended the adoption of a three-year action plan containing measures to improve expenditure management. The mission also identified a list of actions to be taken quickly to ensure that the authorities were able to monitor budget execution. The ROSC fiscal transparency module for Benin was circulated to the Board on June 6, 2002 (Country Report 02/217).

XIII. Technical Assistance:

Department	Type of Assistance	Time of Delivery	Purpose
FAD	Resident expert	September 1989-September 1994	Advising Minister of Finance on tax reform
FAD	Resident expert	November 1990-November 1992	Advising Minister of Finance on budgetary procedures
STA	Technical assistance	February 4-17, 1998	Formulating a strategy to improve statistical organization and management of the Central Bank of West African States.
FAD	Technical assistance	September 7-22, 1998	Advising Minister of Finance on tax administration.
STA	Technical assistance	April 17-28, 2000	Devising new questionnaires for balance of payments statistics and reactivating the banking settlements reporting system.
FAD	Technical assistance	April 25-May 5, 2000	Advising Minister of Finance on tax administration
STA	Technical assistance	May 7-11, 2000	Improving the collection, compilation, and dissemination of data on monetary and financial statistics
FAD	Technical assistance	May 16-29, 2001	Preparing a fiscal transparency module of a ROSC and assessment of capacity to monitor HIPC Initiative resources.
FAD	Technical assistance	September 11-25, 2002	Helping the authorities strengthen domestic revenue and customs administrations.

FAD	Technical assistance	August 23 – September 3, 2003	Evaluating public expenditure management reforms and monitoring capacity of poverty- reducing expenditures.
FAD	Technical assistance	October 22 – November 5, 2003	Evaluating the implementation of the action plan to strengthen domestic revenue and customs administrations
STA	Technical assistance	November 11- November 24, 2004	Assessing the quality of balance of payment statistics.

XIV. Resident Representative:

Mr. Yao has been the Resident Representative since September 26, 2005.

Appendix III—Relations with the World Bank Group

Partnership in Benin's development strategy

1. Benin's poverty reduction strategy paper (PRSP), finalized in December 2002, was discussed at the Bank and Fund Boards in March 2003. The PRSP provides a framework for aligning donor assistance programs, including those of the Bank and the Fund, with the country's poverty reduction efforts. Benin is now planning to prepare its second PRSP.

2. The IMF has taken the lead in helping Benin maintain macroeconomic stability. In that context, the three-year Poverty Reduction and Growth Facility (PRGF) arrangement, which was approved in July 2005, addresses issues related to fiscal consolidation and structural reforms that are key to maintaining macroeconomic stability and fostering growth. The PRGF's structural conditionality focused on the following areas: public expenditure management, tax policy and administration, civil service reform, and the privatization program.

3. Public expenditure management reform has been an important focus of the Bank's assistance program. In close collaboration with the Fund and other donors, the Bank has provided technical and financial assistance to the government's reform efforts in this area. The Bank has also been in the lead in helping Benin strengthen the provision of basic social services, most importantly in the education and health sectors, pursuing a divestiture program in the utility and infrastructure sectors, and enhancing the competitiveness of the cotton sector.

IMF-World Bank collaboration in specific areas

4. Common objectives and joint support for Benin's PRSP and the Initiative for Heavily Indebted Poor Countries (HIPC Initiative) processes have increased collaboration between the Fund and Bank in recent years. The Bank and Fund teams are closely coordinating their policy advice to the authorities. There is also close coordination in the determination of structural conditionality

5. In general, the Bank is leading the policy dialogue on key structural aspects of the reform program, with a strong focus on public expenditure management. The Fund is in the lead in the policy dialogue on macroeconomic issues, particularly fiscal elements of the reform.

Areas in which the Bank leads

6. **Divestiture program and private sector development**. The Bank has supported Benin's program for the divestiture of public enterprises **through different projects.** The remaining enterprises to be privatized include the cotton parastatal, SONAPRA, and most public utilities: the telecommunications company (OPT), the water and electricity

distribution company (SBEE), and the Autonomous Port of Cotonou (PAC). Assistance for the privatization of the OPT and **for improving the Cotonou port operations** is provided through the Private Sector Development Project. The Bank supports the privatization of the electricity branch of the SBEE through the Energy Services Delivery Project which was approved by the Bank's Board on July 6, 2004. Successful completion of this privatization is a condition for moving to the second phase of this project. The privatization of SONAPRA's ginning mills is supported by the Cotton Sector Project. **The now closed** Transportation Sector Project assisted the government in designing a strategy to involve the private sector in the management of the PAC. The Fund is involved in policy dialogue on these operations, given the importance of the divestiture program to macroeconomic stability and growth.

7. **Service delivery reforms.** Improving access to basic social services is one of the four main strategic pillars of Benin's PRSP, and the health and basic education sectors are among the priority sectors that have received increased budget allocations in the medium term expenditure framework (MTEF). The Bank supported reform programs in these sectors through investment projects that were closed in the past three years. In line with the CAS discussed at the Bank's Board on July 3, 2003, the Bank is continuing to work closely with the government on enhancing access to, and quality of, education and health care services through policy dialogue and financial and technical assistance in the context of the Poverty Reduction Support Credits (PRSCs). A number of key policy measures in these two sectors have been implemented as conditions for reaching in March 2003 the enhanced HIPC Initiative completion point, and the first and second PRSCs which were presented to the Bank's Board in March 2004 and June 2005, respectively. The Bank is also playing a lead role in support of a multisector response to the HIV/AIDS pandemic, based on the government's comprehensive strategic framework covering 2000-05, adopted in December 2000. A follow-up project is under preparation for FY07 Board presentation.

8. **Poverty monitoring.** The PRSP presents an action plan to establish a reliable database for measuring income poverty in 2003 using a revised methodology. The Bank is providing technical support for the implementation of this action plan and for other efforts aimed at understanding the determinants of poverty in Benin. These include the poverty and social impact analysis (PSIA) of cotton sector reform, which was prepared by IDA in collaboration with the government, and the Poverty Assessment (PA), which was released in June 2004.

9. The Poverty Assessment was disseminated in conjunction with the PRSP in December 2004 with the assistance of the Bank. The Bank is also advising the authorities, in the context of the implementation of the PRSP, on strengthening institutional arrangements for monitoring and evaluating poverty in the country.

10. **Cotton sector reforms**. Cotton is Benin's only major cash crop, and the sector has accounted in recent years for around 80 percent of its export earnings. The cotton sector is a key focus of the Bank's assistance program. A comprehensive reform of this sector, aimed at

liberalizing and strengthening the capacity of producers has been undertaken since the early 1990s, with the support of the Bank and bilateral donors. Important progress has been achieved so far, such as by eliminating the monopsony of the state enterprise (SONAPRA) in cotton marketing, liberalizing input supply, and opening the sector to private ginners. In 2002, the Bank Board approved a Cotton Sector Reform Project, which is supporting the consolidation of the reforms. The Bank is also helping the government to define the regulatory framework for the sector which was adopted at end 2004.

Areas in which the Bank and Fund share the lead

11. **Public expenditure management reform.** Through its Public Expenditure Reform Adjustment Credit (PERAC) and related Supplemental Credit (now both closed), the Bank played a lead role in assisting the authorities in putting in place a framework for a thorough public expenditure management reform, which was launched in 2001. The PERAC aimed at enhancing the effectiveness and poverty focus of public expenditure. As shown in the 2004 PER, the reform has achieved good progress so far, such as the finalization of an MTEF on the basis of the PRSP, the completion of a performance-based budget cycle, an effective delegation of spending authority to line ministries, and an introduction of a computerized budget implementation system, as well as in the area of reporting on and auditing government accounts. The Fund supported these reform efforts through a number of financial and structural benchmarks in the PRGF management.

12. **Fiscal policy and fiduciary framework.** Fiscal consolidation was a key objective of the Fund-supported PRGF arrangement. The Bank is focusing on inter- and intrasector allocations, in particular in the priority sectors covered by the PERAC and the future PRSCs (education, health, water and sanitation, transportation, agriculture, forestry and environment). These priority sectors have represented about 55 percent of total expenditure, excluding debt service, in recent years. In addition, the Bank is helping to strengthen Benin’s fiduciary framework through analytical and advisory activities (AAA), such as forthcoming update of the Country Procurement Assessment Report (CPAR), the Country Financial Accountability Assessment (CFAA), and the governance and anti-corruption survey. The PRSC-2 supports a comprehensive action plan for public procurement reform that addresses main weaknesses identified in the 1999 CPAR.

13. **Poverty reduction strategy.** Together with other external development partners, the Bank and Fund have jointly provided assistance to the government in the preparation of Benin’s PRSP. The PRSP was discussed at Bank and Fund Boards in March 2003, together with a joint staff assessment prepared by Bank and Fund staffs. Both institutions will continue to jointly advise the authorities on the refinement, implementation, monitoring, and evaluation of the strategy. Bank and Fund staffs also helped the government finalize its second annual progress report of the poverty reduction strategy, formally transmitted in April 2005 and circulated to the Bank and Fund Boards in June 2005. The Bank supported the government to prepare a detailed action plan for the dissemination of the PRSP. The

consultation program is designed to reach key line ministries within the government, the National Assembly as well as the civil society and the private sector. (announce the upcoming PRSP).

14. **Debt sustainability.** The Bank and the Fund jointly supported the government's efforts to reach the HIPC Initiative completion point in March 2003. In the context of the new PRGF program, Bank and Fund staffs updated the debt sustainability analysis for Benin, in close collaboration with the authorities. To maintain debt sustainability after enhanced HIPC Initiative relief, the authorities will need to pursue a prudent external financing policy. The Bank and Fund intend to continue the dialogue with the government on this issue, including through providing advice on the required strengthening of domestic capacities for debt management.

15. **Civil service reform and devolution policy**. The Bank provided in the past major technical assistance for the design of the reform of the civil service promotion and compensation system. Through its Enhanced Structural Adjustment Facility (ESAF) and subsequent PRGF, the Fund has included structural measures designed to implement this reform. However, a key measure—the adoption of legislation regarding the new compensation system for civil servants—has been stalled for several years. Another important area of public sector reform is the devolution policy, which gained momentum following the municipal elections held in December 2002. The Fund is monitoring closely the fiscal implications of this policy. The Bank has recently conducted two pieces of analytical work on public administration reform and decentralization as a basis for policy dialogue.

16. **Financial sector policy.** The Fund has supported the government's efforts to strengthen Benin's financial sector. These efforts have focused on ensuring that banks meet the Regional Banking Commission's prudential ratios. The reform of the financial sector also includes the divestiture of the state-owned Continental Bank and the rehabilitation of microfinance institutions. As part of the Private Sector Development Project, the Bank has been providing support to two major microfinance institutions. A financial sector review was completed and the report was released in July 2004.

Areas in which the Fund leads

17. **Macroeconomic stability.** The medium-term objective of Benin's macroeconomic program is to achieve strong economic growth and reduce poverty, while maintaining financial stability. The Fund has been supporting this program through its dialogue on macroeconomic policy, technical assistance, and the PRGF framework.

18. **Tax and custom administration reforms.** To enhance Benin's fiscal revenues, the Fund has provided technical assistance to help the authorities prepare and update action plans aimed at improving the performance of the tax and customs administrations as well as broadening the tax base.

World Bank strategy

19. **The overriding objective of the current Bank's** Country Assistance Strategy (CAS) discussed at its Board on July 3, 2003 is to help Benin reverse the recent trends of limited or no poverty reduction amid relatively robust growth. Progress in reducing poverty and attaining the Millennium Development Goals (MDGs) requires further deepening of cotton sector reforms, strengthening efforts toward diversifying the economy, making tangible progress in the social sectors, building effective and responsive public institutions, promoting gender equality, and strengthening collaboration with the private sector and civil society. The CAS describes a program of financial assistance and nonlending services as the Bank's contribution to addressing these challenges. It supports the implementation and further refinement of the PRSP, and it is aligned to the four PRSP pillars.[1] **A new CAS is scheduled to be prepared in 2008 once the Government has finalized its PRSC.**

20. The CAS enforces the gradual shift of the Bank's lending program toward programmatic lending, as initiated under the interim CAS (I-CAS) approved in January 2001 and in response to the PRSP's explicit invitation to donors to do more in that area. Building on the PERAC, the Bank expects this shift to enhance the development impact of its assistance to Benin by fostering national leadership of development programs. It has also facilitated donor coordination around Benin's PRSP. This will require, however, a continued strong commitment to advance public sector management reforms aimed at increasing efficiency in the use of public resources. To address these transitional challenges, the Bank will continue its support of Benin's public expenditure reform through financial and technical support. Annual single-tranche PRSCs are envisaged to remain a key vehicle for Bank support to the country. A first PRSC was presented to the Bank's Board in March 2004, and the second PRSC, presented to the Bank's Board in June 2005, will continue to support the PRSP pillars, with components on macroeconomic stability, service delivery, and governance.

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[1]The four pillars to effective poverty reduction are the following: (i) the strengthening of the medium-term macroeconomic framework; (ii) human development and environmental management, including improving the access of the poor to quality basic services (basic education, primary health care, water and sanitation, food security and nutrition, adequate habitat, and rural roads); (iii) improvement of governance and institutional reforms, such as decentralization, public administration reform, and strengthening of the legal and judicial system; and (iv) improvement of employment or income-generating opportunities for the poor, and the strengthening of their capacity to participate in decision making and production.

Benin: Status of World Bank Portfolio
(In millions of U.S. dollars, as of June 28, 2006)

	Effectiveness Date	Original Principal (IDA)	Undisbursed (IDA)
Private Sector	8/31/00	30.4	5.6
Cotton Sector Reform	9/12/02	18.0	8.8
HIV/AIDS Multisector	7/17/02	23.0	1.4
Energy Service Delivery	4/25/05	45.0	43.0
National CDD	5/2/05	50.0	44.6
2nd Decentralized Cities	3/8/06	35.0	33.1
Malaria	Not yet effective	31.0	32.3
Total		232.4	168.8

21. The PRSP preparation process has fostered collaboration between the Bank and other development partners, including civil society organizations. Donors have signaled their willingness to align their assistance programs to the PRSP and some of them (the European Union, the African Development Bank, Switzerland, Denmark, and the Netherlands) have engaged in budget support operations, in close coordination with the Bank's PRSC preparation process.

22. As of **June 28, 2006**, the Bank lending portfolio consisted of seven operations, with a net commitment of US$232.4 million and an undisbursed balance of US$**168.8** million (see table above). The CAS has a determined lending volume for the period FY04 - FY06 amounting to US$200 million. As discussed previously, a large part of IDA financing (US$85 million) has been channeled through PRSCs. As indicated in the CAS, a key objective of the Bank's nonlending program is to help the government strengthen its sector-wide expenditure programs as a basis for consolidating programmatic support and building the capacity required for preparing, implementing, and monitoring these programs.

Prepared by World Bank Staff. Questions may be asked to **Mr. Nils O. Tcheyan**, Acting Country Director for Benin, ext. 38445; or Ms. Nancy Benjamin, Country Economist for Benin, ext. 30189.

Appendix IV—Debt Sustainability Analysis[1]

Although Benin's external debt ratios under the baseline scenario are projected to remain below the relevant indicative debt burden thresholds, the possibility of slower-than-projected growth, volatile export prices and output, and new nonconcessional borrowing could lead to a breach of the policy-based indicative thresholds, placing the country at a moderate risk of debt distress. Thus, as new borrowing space opens up in the post-MDRI era, staff recommends that the future borrowing program be assessed with due caution, with special consideration given to the concessionality of new loans, cost-benefit analyses of investment projects, and the assessment of the absorptive capacity of the economy.

A. Introduction

Benin's risk of debt distress is moderate based on the path of external debt burden indicators under alternative scenarios and stress tests. The external debt burden indicators do not breach the relevant policy-dependent indicative thresholds[2] under the baseline scenario, but are substantially above the thresholds under standard alternative scenarios and some boundary tests. These findings are in line with Benin's previous DSA, which flagged the possibility of debt levels exceeding indicative thresholds under stress tests and alternative scenarios[3].

Benin's debt has declined gradually since 2001. The outstanding stock of debt decreased from about 59 percent of GDP at end-2001 to 42 percent in 2003, the year the country reached the completion point under the enhanced HIPC Initiative.[4] By 2006, the nominal

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[1] This DSA was carried out jointly by the Fund and World Bank staffs.

[2] The low income country debt sustainability framework (LIC DSF) provides indicative levels (thresholds) of debt burdens beyond which a country's risk of debt distress reaches levels that are considered unacceptable. The LIC DSF recognizes that better policies and institutions allow countries to manage higher levels of debt, and thus the threshold levels are policy-dependent. Benin's policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), place it as a "medium performer". The relevant indicative thresholds for this category are indicated in Text table 1 below.

[3] The last DSA for Benin was conducted in August 2005. See IMF Country Report No. 05/288, Section IV.

[4] Benin reached the enhanced HIPC Initiative completion point in March 2003 (see "Benin – Enhanced initiative for Heavily Indebted Poor Countries – Completion Point Document;" Country Report 03/189).

debt-to-GDP ratio is projected to decline further to 12.7 percent, reflecting total debt cancellation under the Multilateral Debt Relief Initiative (MDRI).[5]

The present debt sustainability analysis (DSA) is based on the full implementation of MDRI. In 2006–11, the projected share of loan disbursements from multilateral creditors is assumed to stay at its post-MDRI level as at end-2006 in part reflecting the impact of IDA and AfDF "moderate" lending policies to MDRI countries in the post-MDRI period. Beyond 2011, multilateral debt as a share of total debt is assumed to increase steadily.[6]

Although Benin's external debt burden indicators do not breach the indicative thresholds under the baseline scenario, vulnerabilities associated with slower growth, adverse exogenous shocks, or decreased availability of concessional financing point to a moderate risk of debt distress. This situation underscores the need to preserve macroeconomic stability and deepen structural reforms with a view to maintaining the economy on a path of sustained growth.

Going forward, a prudent borrowing strategy would help the country maintain its risk of debt distress within acceptable limits. Such a strategy, built on appropriate concessionality of new loans, cost-benefit analyses of investment projects, and assessment of the absorptive capacity constraints of the economy, would help prevent a rapid re-accumulation of new debt.

The rest of the analysis is organized as follows: Section B spells out the baseline scenario; Section C discusses alternative scenarios and stress tests; and Section D further highlights the positive impact of the MDRI on Benin's debt dynamics and provides staff recommendations.

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[5] The MDRI cut-off dates for the IMF and the African Development Fund debt (AfDF) is end-2004 and that for International Development Association (IDA) credits is end-2003. Without MDRI, that ratio would have been 36.2 percent by end-2006.

[6] MDRI (but not HIPC) debt relief entails a (less than proportional) reduction in the allocation of resources from IDA and the AfDB to the recipient countries. At end 2005, multilateral debt after HIPC represented 95 percent of Benin's total debt; that share declined to 84 percent after the MDRI. The IDA debt ratio was 48 percent pre-MDRI and about 18 percent post-MDRI.

B. Baseline Scenario: 2006–26[7]

The macroeconomic projections for 2006–26, built around Benin's existing short-run structural capacity constraints, assume the implementation of growth-enhancing structural policies in the medium and long term (See Box 1)[8]. Assuming the government's sustained implementation of reforms to diversify the economy and increase its resilience to adverse shocks, average real GDP growth is projected at 5.3 percent and 5.5 percent in 2006-11, and 2012-26, respectively, from a historical average of 4.2 percent during 2000-05. The period 2000-05 is the historical basis for the projections.

Growth is projected to be initially driven primarily by the cotton and service sectors. Seed cotton output is projected to reach full capacity of 600,000 tons for cotton-ginning plants by 2026, as the GDP share of other sector rises. Consumer price inflation is expected to be in line with the relevant West African Economic and Monetary Union convergence criterion, remaining at about 2.5 percent through 2026, below the historical average of 3.4 percent.

The baseline scenario underscores the importance of enhancing fiscal discipline. On average, the overall fiscal deficit, excluding grants, is projected to be below 5 percent of GDP in 2006–26, with revenue rising to a projected 20 percent of GDP and total expenditure expected to reach the equivalent of 25 percent of GDP, on average, in the period. Total expenditure is projected to increase gradually in the initial period, from 21 percent in 2005 to 26 percent in 2011, reflecting an expected higher investment budget, particularly for infrastructure projects, to sustain future growth. The financing gap is assumed to average 3 percent per annum, increasing gradually, from less than 2 percent of GDP in 2006 to about 4 percent of GDP in 2011. Beyond 2011, the financing gap is expected to decline steadily, falling below 1 percent in 2026.

The baseline scenario also stresses the importance of fostering a business environment that attracts foreign direct investment. GDP and export growth beyond the cotton sector will depend on continued capital accumulation that requires substantial increases in FDI from a historical average of 1.5 percent of GDP to 3.9 percent of GDP. Financing new investments with loans, particularly nonconcessional borrowing, can lead to a quick deterioration of Benin's debt ratios.

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[7] The DSA exercise focuses on external debt as the stock of domestic debt is projected to remain below 2.5 percent of GDP on average in 2006-26.

[8] The updated DSA includes minor changes in macroeconomic assumptions and in new borrowing conditions from the 2005 DSA (IMF Country Report No. 05/288). In particular, the previous DSA assumed interest rate, grace period, and maturity of 1.9 percent, 7.7 years, and 28 years, respectively (See Box 1). In addition, based on historical structure, we assumed that 53 percent of the financing gap will be covered by external creditors.

Box 1. Benin: Baseline Scenario - Macroeconomic Assumptions for 2006–26

- **Real GDP** is projected to rise by 5.3 percent annually in 2006 –11 and by 5.5 percent annually in 2012–26, from an historical average growth of 4.2 percent in 2000-05, reflecting the implementation of growth-supporting policies and private sector involvement.

- In 2006-11, real GDP growth is is expected to be based on growth in the cotton and service sectors. Beyond 2011, economic diversification is projected to gradually take hold, as a result of which non-cotton activity would account for an increasing share of growth performance. In particular, the service sector, which currently accounts for about 40 percent of GDP, is expected to expand rapidly as structural reforms take hold.

- After a projected average increase of 13 percent during 2006–11, the growth of cotton production is projected to decelerate steadily to an annual average of 0.6 percent in 2012–2026. Cotton production is expected to reach full capacity (i.e. 600, 000 tons) by 2026; however, improvements in cotton production efficiency would enhance productivity in the latter years.

- **Inflation** as measured by the consumer price index is projected to average 2.5 percent annually in 2006–26.

- **Fiscal.** The fiscal deficit, excluding grants, is projected to be below 5 percent of GDP. The projected public financing gap is within 2–4 percent of GDP. The grant share is assumed to be maintained at the historical level of about 47 percent.

- **External sector.** Over the medium term, the terms of trade are assumed to improve on average by 4.2 percent annually, and the current account deficit is projected to remain below 5 percent of GDP on average.

    - The volume of exports of goods and nonfactor services is expected to grow by about 9 percent a year, in line with projected cotton and noncotton production.

    - The volume of imports is projected to rise 10.3 percent annually in 2006–2026, reflecting the projected average change in yearly gross domestic expenditure. Therefore, its average (nominal) shares to GDP and domestic expenditure are expected to increase gradually from respectively 26 percent and 23 percent in 2000-05 to 30 percent and 25 by 2026.

    - A large fraction of import growth is expected to be in capital goods; a meaningful share of such imports is projected to be financed by FDI, which is forecast to average 3.9 percent of GDP in the projection period compared with the 2000-05 historical high of 3.2 percent in 2000 and low of 0.9 percent in 2003.

Public debt and outcomes. New public external borrowing averages about 2 percent of GDP a year. New loans have a projected average maturity of 26 years, a grace period of 8 years, and an average interest rate of 2 percent. Average discount rate of 5 percent is built into the net present value calculations, yielding an average grant element on new loans of about 32 percent.

Benin's external debt burden indicators do not breach the relevant policy-dependent indicative thresholds at any time under the baseline scenario (see Text Table 1)**.** The NPV of debt to GDP ratio is expected to stabilize at approximately 15 percent of GDP, compared to a threshold of 40 percent. The NPV of debt to exports ratio is projected to reach 99 percent in 2016, a level that poses low risks of debt distress provided Benin's policy performance remains solid. Finally, the debt service ratio is expected to remain well below the 20 percent threshold throughout the projection period under the baseline.

Text Table 1. Benin: External Debt Indicators, 2006 - 2026
(in percent, post-MDRI unless otherwise indicated)

	Indicative thresholds	Baseline Scenario		
		2006	2007-11 1/	2012-2026 1/
NPV of debt-to-GDP	40	11	12	15
Debt service to revenue	30	4	4	4
NPV of debt-to-revenue	250	64	66	77
Debt service-to-exports	20	5	5	4
NPV of debt-to-exports	150	86	80	81
Memorandum items:				
Debt-to-GDP (post-HIPC)		36	33	28
Debt-to-GDP (post-MDRI)		13	15	20

Source: Benin authorities; and Fund staff estimates.

[1] Simple average.

C. Alternative Scenarios and Stress Tests

Alternative scenarios and bound tests reveal moderate risk of debt distress. For instance, the net present value of the debt-to-exports ratio could breach the policy-dependent indicative threshold after 2011 under the historical scenario and, to a lesser degree, under the scenario of increased nonconcessional borrowing. The NPV of debt to GDP ratio would also breach the indicative threshold in the historical scenario.

Alternative scenarios show that Benin's debt profile is vulnerable to nonconcessional borrowing as well as growth rates and current account deficits at historical levels. The alternative scenarios assume the following risks (i) a historical performance in economic growth, FDI and the current account, reflecting lags in implementing reforms;[9] (ii) new borrowing on nonconcessional terms; and (iii) a weaker cotton production owing to poor rainfall. The NPV of debt-to-exports ratio and debt service ratio breach the indicative thresholds in the case of the first two shocks, and all relevant debt ratios deteriorate under the historical and lower cotton output scenarios, reflecting cotton's significant share in total exports (Text Table 2).

Text Table 2. Benin: Sensitivity Analysis - Selected Key Indicators of PPG External Debt, 2006-26
(In percent)

	2006	2007	2008	2009-2011	2012-26
NPV of debt-to-GDP ratio					
Baseline	10.6	10.9	11.4	12.2	14.7
Historical scenario	10.6	13.2	15.7	23.2	42.0
Lower cotton production 1/	10.6	13.1	13.7	14.7	17.7
New borrowing on less favorable terms 2/	10.6	11.5	12.9	15.5	24.8
NPV of debt-to-exports ratio					
Baseline	86.3	78.6	80.1	81.0	81.4
Historical scenario	86.3	95.0	110.7	154.0	228.1
Lower cotton production 1/	86.3	132.8	130.7	128.5	122.6
New borrowing on less favorable terms 2/	86.3	82.9	91.0	102.9	133.8
Debt service ratio					
Baseline	5.5	4.9	4.8	4.4	4.4
Historical scenario	5.5	4.9	5.3	6.0	14.0
Lower cotton production 1/	5.5	8.3	7.9	7.0	6.7
New borrowing on less favorable terms 2/	5.5	4.9	8.2	14.1	18.5

Source: Benin authorities; and Fund staff estimates.

[1] 15 percent below the baseline production.
[2] Assumed commercial loan: (i) Interest rate: average 2007-12 LIBOR+1=6.4 %, (ii) Maturity: 6 years, (iii) grace period : 1 year, (iv) discount factor: 10 %

The substantial deterioration of debt ratios under the historical scenario stresses the importance of FDI-financed investments to promote export growth beyond 2011. Replacing FDI inflows with loans as a means of financing investment in imported capital goods would substantially increase the risk of debt distress, particularly if loans are contracted on non-concessional terms. An acceleration of export growth is also necessary to relieve the pressure from underlying current account financing needs.

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[9] The historical scenario assumes continuation of the historical 2000–05 growth performance of 4.2 percent, on average, in 2006–26, as opposed to the 5.5 percent average real GDP growth assumed in the baseline scenario. Moreover, the historical scenario assumes a higher current account deficit (6.9 percent vs. 4.4 percent of GDP, on average) and lower FDI inflows (1.5 percent vs. 3.9 percent of GDP, on average).

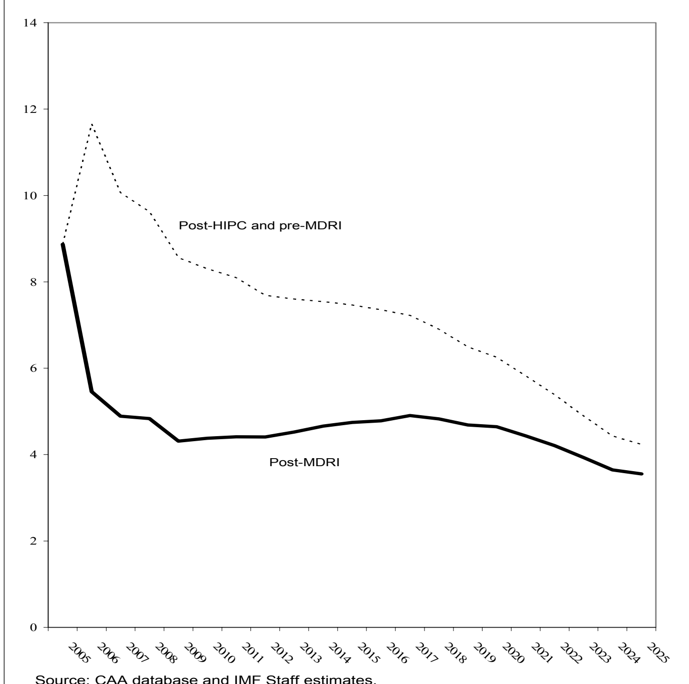
Benin's debt indicators are also vulnerable to exogenous shocks, particularly shocks to export growth. As summarized in Table 2, the NPV of debt-to-exports ratio would rise quickly and exceed the policy-dependent threshold under a temporary shock to export growth. Moreover, a combination of shocks to GDP growth and non-debt creating financing flows (such as FDI) would also lead to an elevation of the risk of debt distress.

D. Multilateral Debt Relief Initiative

MDRI-related debt relief has significantly reduced debt-service ratios. The 2006 debt service–to-export ratio fell from 12 percent after HIPC relief and before MDRI assistance, to 5 percent after MDRI delivery. Excluding both HIPC and MDRI relief, that ratio would have been about 18 percent. Continued reduction to Benin's risk of debt distress post-MDRI will depend on two major policy determinants: (i) new borrowing behavior; and (ii) authorities' effectiveness both in using resources freed up by HIPC and MDRI to meet development challenges as well as in attracting additional aid and investments through a strong policy and institutional environment.

The projected post-MDRI debt service ratio is more than halved in the medium term. Beyond 2011 the ratio is projected to increase steadily as the country contracts new debt, but the ratio remains below the indicative threshold (Figure 1).

Figure 1. Benin: Projected Debt Service-to-exports after HIPC and MDRI, 2005-26
(Percent)



Source: CAA database and IMF Staff estimates.

Upon receiving debt relief under the MDRI, Benin had seen its borrowing capacity open up and realized average debt service savings of about US$64 million,[10] or 1.3 percent of GDP, a year. In allocating MDRI-and HIPC-related debt-service savings, the government aims to scale up pro-growth and pro-poor expenditure to accelerate progress toward the Millennium **Development Goals**.[11]

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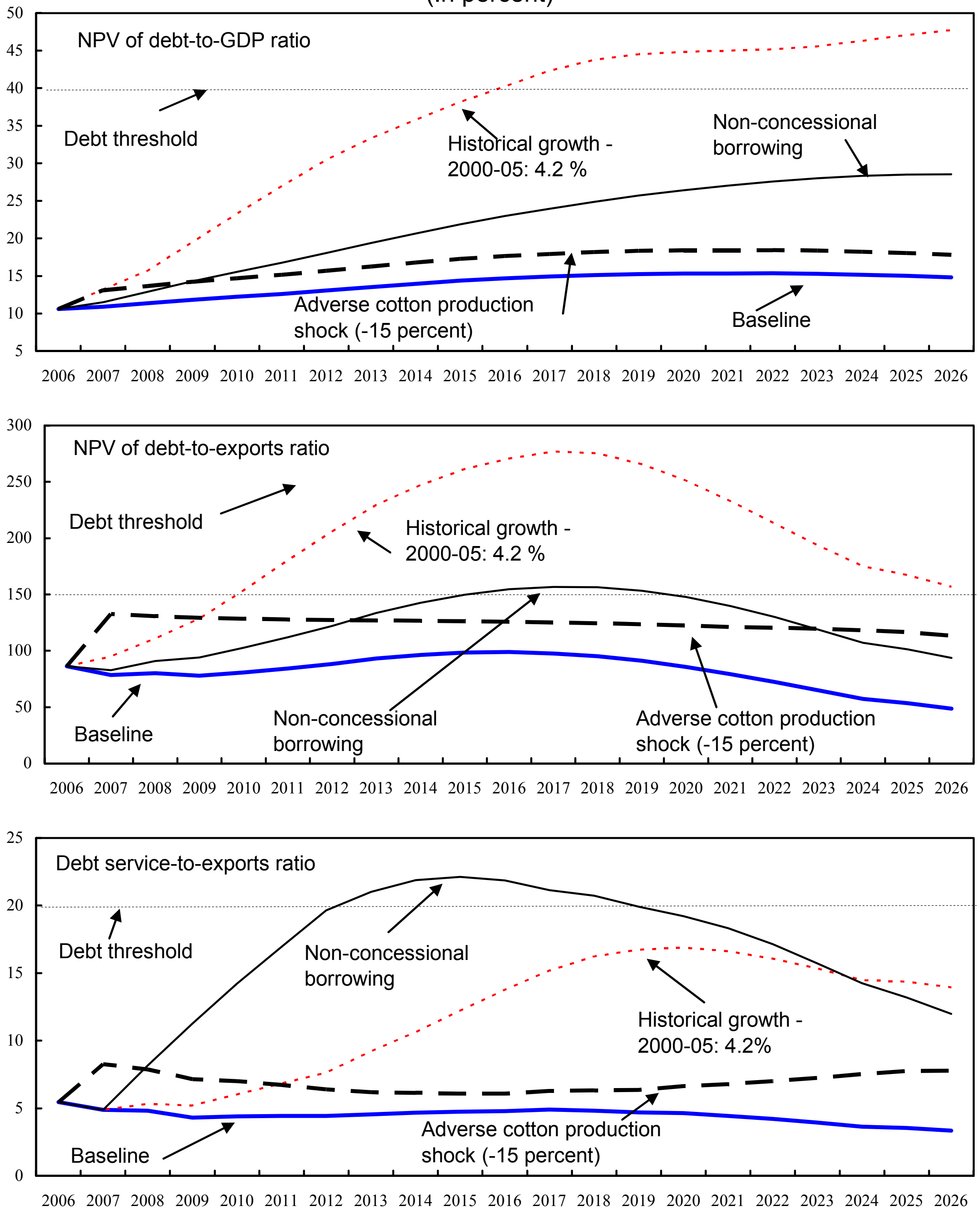
[10] Including new borrowing and controlling for both estimated amounts and the distribution of compensatory financing from IDA and AfDF relative to debt-service payments.

[11] Chapter II of the Selected Issues paper elaborates on this issue.

In the period ahead, staff recommends that the authorities maintain prudent borrowing strategy that includes: i) maximizing the use of concessional financing and grants; and ii) integrating rigorous cost-benefit analysis of new projects, particularly those that are financed with new debt, including considerations of the absorptive capacity of the economy. The authorities ought to ensure that resources freed up by HIPC and MDRI, as well as new grants from development partners, are not used to support new nonconcessional borrowing but rather pro-poor and pro-growth spending. Moreover, given the moderate risk identified in this DSA, debt-financed projects must be thoroughly scrutinized to ensure that their expected returns justify not only the financing costs but also the additional risks to Benin's debt profile. Effective implementation of such a borrowing strategy would benefit from close collaboration with and technical assistance from Benin's development partners, especially the World Bank.

Figure 2. Benin: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006-2026
(In percent)



Source: Staff projections and simulations.

Non-concessional borrowing: (i) Interest rate: average 2007-12 LIBOR+1=6.4 %, (ii) Maturity: 6 years, (iii) grace period : 1 year, (iv) discount factor: 10 %

Table 1. Benin: External Debt Sustainability Framework, Baseline Scenario, 2004-2026 1/ 2/
(In percent of GDP, unless otherwise indicated)

	Act.	Est. 2/	Historical Average 3/	Standard Deviation 3/	Projections									
	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
External debt (nominal) 1/	**34.9**	**36.9**			**12.7**	**13.4**	**14.2**	**14.9**	**15.5**	**16.1**	**14.5**	**19.0**	**21.3**	
o/w public and publicly guaranteed (PPG)	34.9	36.9			12.7	13.4	14.2	14.9	15.5	16.1	14.5	19.0	21.3	
Change in external debt	-2.8	2.0			1.1	0.6	0.8	0.7	0.6	0.6	0.7	0.5	0.3	
Identified net debt-creating flows	1.4	1.5			2.9	1.7	1.6	-0.4	-0.8	-0.9	0.7	-0.5	-0.8	
Non-interest current account deficit	**6.9**	**6.0**	**6.5**	**1.1**	**6.8**	**6.5**	**6.2**	**4.4**	**3.8**	**3.5**	**5.2**	**3.7**	**3.5**	4.1
Deficit in balance of goods and services	12.2	10.0			10.7	10.5	10.0	8.5	7.7	7.3	9.1	7.0	8.5	
Exports	14.3	13.1			12.3	13.9	14.2	15.2	15.1	15.0	14.3	14.9	30.5	
Imports	26.6	23.1			23.0	24.3	24.1	23.6	22.9	22.2	23.4	21.9	39.0	
Net current transfers (negative = inflow)	-6.0	-4.7	-5.5	0.7	-4.7	-4.7	-4.5	-4.7	-4.6	-4.5	-4.6	-4.0	-3.2	-3.8
Other current account flows (negative = net inflow)	0.6	0.7			0.8	0.8	0.7	0.6	0.7	0.7	0.7	0.7	-1.8	
Net FDI (negative = inflow)	-1.2	-2.0	-1.5	0.8	-3.6	-4.4	-4.1	-4.4	-4.1	-3.9	-4.1	-3.7	-3.6	-3.8
Endogenous debt dynamics 4/	-4.2	-2.5			-0.3	-0.4	-0.4	-0.5	-0.5	-0.5	-0.4	-0.6	-0.7	
Contribution from nominal interest rate	0.3	0.3			0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.4	0.4	
Contribution from real GDP growth	-1.0	-0.9			-0.5	-0.6	-0.7	-0.7	-0.8	-0.8	-0.7	-0.9	-1.1	
Contribution from price and exchange rate changes	-3.5	-1.8			…	…	…	…	…	…		…	…	
Residual (3-4) 5/	-4.3	0.5			-1.8	-1.1	-0.8	1.1	1.4	1.4	0.0	1.0	1.1	0.7
o/w exceptional financing	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
NPV of external debt 6/	18.9	9.4			10.6	10.9	11.4	11.8	12.2	12.6	11.6	14.7	14.8	
In percent of exports	132.1	72.0			86.3	78.6	80.1	78.0	80.8	84.2	81.3	98.9	48.7	
NPV of PPG external debt	**18.9**	**9.4**			**10.6**	**10.9**	**11.4**	**11.8**	**12.2**	**12.6**	11.6	**14.7**	**14.8**	
In percent of exports	132.1	72.0			86.3	78.6	80.1	78.0	80.8	84.2	81.3	98.9	48.7	
Debt service-to-exports ratio (in percent)	6.5	8.9			5.5	4.9	4.8	4.3	4.4	4.4	4.7	4.8	3.3	
PPG debt service-to-exports ratio (in percent)	6.5	8.9			5.5	4.9	4.8	4.3	4.4	4.4	4.7	4.8	3.3	
Total gross financing need (billions of U.S. dollars)	0.3	0.2			0.2	0.1	0.2	0.0	0.0	0.0	0.1	0.1	0.2	
Non-interest current account deficit that stabilizes debt ratio	9.7	4.0			5.7	5.9	5.4	3.7	3.2	2.9	4.5	3.3	3.2	
Key macroeconomic assumptions														
Real GDP growth (in percent)	3.1	2.9	4.2	1.2	4.5	5.1	5.5	5.5	5.5	5.5	5.3	5.5	5.5	5.5
GDP deflator in US dollar terms (change in percent) 7/	10.3	5.6	4.6	9.6	3.0	4.7	2.9	2.8	2.9	3.2	3.3	2.4	2.4	2.4
Effective interest rate (percent) 8/	1.0	1.1	1.1	0.3	2.1	1.9	2.0	2.0	2.1	2.1	2.0	2.1	2.1	2.1
Growth of exports of G&S (US dollar terms, in percent)	19.2	-1.0	5.1	12.8	1.0	24.6	11.0	16.0	8.5	7.6	11.4	10.0	15.8	13.3
Growth of imports of G&S (US dollar terms, in percent)	13.9	-5.5	5.6	11.5	7.0	16.6	7.7	6.2	5.1	5.8	8.1	8.8	16.7	12.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	36.0	36.8	36.5	35.9	35.4	34.9	35.9	33.1	26.8	31.0
Memorandum item:														
Nominal GDP (billions of US dollars)	4.1	4.4			4.7	5.2	5.7	6.1	6.7	7.3		10.7	22.9	

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ 2005: Post-MDRI stock. 2006: first year of projection based on post-MDRI (full implementation) debt stock end-2005.
3/ Historical averages and standard deviations are derived over 2000-05.
4/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
5/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
6/ Assumes that NPV of private sector debt is equivalent to its face value.
7/ Average CFA F/US dollar exchange: 628.5, 510.8, and 502.2 in 2000-05, 2006-11, and 2012-26 respectively.
Average GDP deflator in CFA F terms: 2.8 percent, 2.4 percent, and 2.4 percent in 2000-05, 2006-2011, and 2012-26 respectively.
8/ Current-year interest payments devided by previous period debt stock.

Table 2. Benin: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006-26
(In percent)

	Projections							
	2006	2007	2008	2009	2010	2011	**2016**	2026
NPV of debt-to-GDP ratio								
Baseline	11	11	11	12	12	13	**15**	15
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	11	13	16	19	23	27	**40**	48
A2. New public sector loans on less favorable terms in 2007-26 2/	11	11	13	14	16	17	**23**	29
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	11	12	13	15	16	17	**21**	24
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	11	13	17	18	18	18	**18**	16
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	11	12	13	14	14	15	**17**	18
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	11	13	16	16	16	17	**17**	16
B5. Combination of B1-B4 using one-half standard deviation shocks	11	12	16	17	17	17	**19**	17
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	11	19	20	20	21	21	**23**	21
NPV of debt-to-exports ratio								
Baseline	86	79	80	78	81	84	**99**	49
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	86	95	111	128	154	180	**271**	157
A2. New public sector loans on less favorable terms in 2007-26 2/	86	83	91	94	103	112	**155**	94
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	86	77	80	82	88	95	**122**	68
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	86	128	194	184	186	189	**196**	85
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	86	79	80	78	81	84	**99**	49
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	86	97	112	107	108	111	**117**	52
B5. Combination of B1-B4 using one-half standard deviation shocks	86	105	143	137	140	143	**155**	71
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	86	139	99	95	97	100	**110**	51
Debt service ratio								
Baseline	5	5	5	4	4	4	**5**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	5	5	5	5	6	7	**14**	14
A2. New public sector loans on less favorable terms in 2007-26 2/	5	5	8	11	14	17	**22**	12
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	5	5	5	5	5	5	**7**	5
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	5	7	8	9	9	9	**11**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	5	5	5	4	4	4	**5**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	5	5	5	5	5	5	**6**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	5	6	7	7	7	7	**8**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	5	5	5	5	5	5	**6**	4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	29	29	29	29	29	29	**29**	29

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Appendix V—Benin: Statistical Issues
(As of end-September 2006)

1. Benin's economic database is broadly adequate for both program monitoring and surveillance, and, the common indicators required for surveillance are generally provided to the Fund on a timely basis. However, there are weaknesses in the areas of national accounts, public finance, monetary statistics, and balance of payments. In January 2001, the authorities adopted the General Data Dissemination System (GDDS) as the framework for the development of the national statistical system; sectoral metadata, which were initially posted on the Fund's Dissemination Standards Bulletin Board in September 2001, are due to be updated. As a follow-up to GDDS participation, STA technical assistance (funded by the Japanese government) is being offered to the eight member countries of the West African Economic and Monetary Union (WAEMU) to assist with implementation of plans for the improvement of their statistical systems. A Fund regional statistical advisor initiated a program of assistance in government finance statistics, which is now managed by the West Africa Regional Technical Assistance Center (AFRITAC West). A real sector statistics improvement program, conducted in collaboration with the regional statistical office AFRISTAT and initiated in May 2002, is currently being implemented.

Real sector statistics

2. National statistics agencies were represented at two GDDS seminars: Yaoundé, October 1998; and, Bamako, April 2001. As a follow-up to the Bamako workshop, significant steps have been initiated to upgrade the national income accounting system based on the *System of National Accounts 1968 (1968 SNA).* Benin also participates in WAEMU's harmonization of statistical methodologies through the multilateral surveillance process, currently seeking regional improvements in the area of national accounts. In 2003, the National Statistics Institute (INSAE) undertook the necessary steps to change the base year for the accounting of the agricultural output and to include the consumption of fixed capital assets in the public administration accounts. Under the GDDS project for the AFRITAC West countries, a statistical register and an industrial production index are being developed, and a series of missions are scheduled to assist in the implementation of the *1993 SNA*.

3. Consumer prices for Benin are measured using the WAEMU harmonized consumer price index.

Government finance statistics

4. Monthly government finance statistics are compiled by the Ministry of Finance with a one- to three-month lag, based on information provided by the budget, customs, tax, and treasury directorates. The Ministry of Finance prepares a monthly reconciliation of spending commitments made by the budget directorate and payments made by the treasury. However, no final budget or treasury accounts are published at the end of the fiscal year. Recently,

Benin provided 2005 data for publication in the *Government Finance Statistics Yearbook (GFSY)*. No data are reported for publication in *International Financial Statistics (IFS)*

Monetary and financial statistics

5. Monetary and financial statistics are compiled and disseminated by the regional Central Bank of West African States (BCEAO). Difficulties experienced by the BCEAO in estimating currency in circulation for the individual member countries, partly because of delays in processing cash in its vaults, prompted AFR and STA to draft a joint letter to the Governor of the BCEAO requesting an analysis of the developments in currency-in-circulation and net foreign assets, and a description of measures being undertaken to improve the situation. In response, the BCEAO made substantial revisions in 2005 to the estimates of banknotes in circulation in member states resulting from cross-border banknote movement. These revisions were due to changes in the method to estimate currency in circulation in the WAEMU countries. The revised method, based on updated sorting coefficients (initially established in 1990), has been applied retroactively from December 2003. The BCEAO is using sorting coefficients to evaluate the amounts of currency issued by each country, which in turn, are used to estimate currency in circulation and to adjust the net foreign assets of each member country.

6. A monetary and financial statistics mission visited the BCEAO headquarters in Dakar in May 2001, and STA participated in a BCEAO-sponsored seminar on monetary statistics in April 2003. In these regional forums, STA reviewed with the BCEAO representatives outstanding methodological issues that concern the member countries of the WAEMU and discussed the BCEAO's plans to adopt the *Monetary and Financial Statistics Manual (MFSM).*

7. In August 2006, as part of the authorities' efforts to implement the *MFSM*'s methodology, the BCEAO reported to STA monetary data for June 2006 for all member countries using Standardized Report Forms (1SR-central bank, 2SR-other depository corporations, and 5SR-monetary aggregates). The data are being reviewed in STA.

Balance of payments

8. Since December 1998, the responsibility for compiling and disseminating balance of payments statistics has been formally assigned to the BCEAO by area-wide legislation adopted by the countries participating in the WAEMU. The national agency of the BCEAO in Cotonou is responsible for compiling and disseminating Benin's balance of payments statistics, and the BCEAO headquarters in Dakar for delineating the methodology and calculating the international reserves managed on behalf of the participating countries.

9. Data consistency has significantly improved over the past few years, with a full transition to the *Balance of Payments Manual, Fifth Edition (BPM5)*. The BCEAO national agency disseminates balance of payments statistics with a seven month lag, exceeding GDDS

guidelines. The BCEAO also compiles and disseminates the annual data of the international investment position data with an 18-month lag.

10. Regarding trade data, the ASYCUDA [1]customs computer system is now installed in all main border customs houses; ASYCUDA ++ is installed in the port and at the airport. The interconnection between the computer systems of the main departments of Customs has not been completed yet and the monitoring of import data needs to be stepped up.

11. Further improvement in the data for services and transfers (especially workers' remittances) will depend on the intensification of the contacts with reporting bodies. The authorities' commitment to strengthen the human and technical resources should be enhanced.

12. Concerning the financial account, the foreign assets of the private nonbanking sector are still not well covered, especially the assets of WAEMU residents, which are obtained through partial surveys of residents' foreign assets. The organization of an exhaustive annual survey of foreign direct investment transactions is still at a very preliminary stage. The BCEAO has recently updated the compilation of commercial bank data on payments involving nonresidents; however these data are not used to produce annual balance of payments estimates, but rather to assess existing information.

13. A technical assistance mission on balance of payments statistics visited Cotonou November 11-23, 2004. Key findings were that human resources devoted to balance of payments statistics by the national agency of the BCEAO are insufficient, but that the reporting system was well developed and consistent. Regarding trade in goods, and the recording of informal transactions, the statistical adjustments to Customs data appear methodologically sound; however, the hypotheses and reference bases on which they rest are largely untested. Other weaknesses in the current account concern the underestimation of transportation services and overestimation of current transfers. In the financial account, the coverage of direct investment is poor while unsorted banknotes impacts on the compilation of net external assets in the balance of payments and international investment position statistics.

[1] The ASYCUDA (or SYDONIA, in French) software, sponsored by the United Nations Conference on Trade and Development (UNCTAD) and by donor countries, has already been implemented in many countries. Freely available to customs administration, it is provided together with appropriate staff-training schemes.

Poverty data

14. Major methodological weaknesses remain regarding poverty data. In particular, the methodology used in the household surveys raises concerns about the treatment of the nonfood expenditure share in the calculation of the poverty line, the division of Benin into 12 agro-ecological zones, and the comparability of poverty statistics across urban and rural areas and across time. The authorities are implementing an action plan to address these methodological issues. The authorities have completed a modular survey of household living conditions to update the poverty profile in the context of the preparation of the second PRSP.

External debt

15. The Caisse Autonome d'Amortissements (CAA) is responsible for signing international loan agreements, maintaining the debt database, and servicing the government's external debt obligations. Since 1995, the CAA has been using the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) to record and manage the debt. For the majority of creditors, the CAA's database is fairly comprehensive and up-to-date, and contains accurate stock data, as well as projected debt-service flows, on a loan-by-loan basis. For a small number of creditors, however, regular statements are not received.

Benin: Table of Common Indicators Required for Surveillance
(As of October 10, 2006)

	Date of latest observation	Date received	Frequency ofData[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	Current	Current	D	D	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	7/06	10/06	M	M	M
Reserve/Base Money	7/06	10/06	M	M	M
Broad Money	7/06	10/06	M	M	M
Central Bank Balance Sheet	7/06	10/06	M	M	M
Consolidated Balance Sheet of the Banking System	7/06	10/06	M	M	M
Interest Rates[2]	9/06	10/06	M	M	M
Consumer Price Index	8/06	10/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]					
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	8/06	9/06	M	M	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]					
External Current Account Balance	12/04	6/06	A	A	A
Exports and Imports of Goods and Services	12/04	6/06	A	Q	A
GDP/GNP	2005	3/06	A	A	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND
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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with Benin

On November 27, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Benin.[1]

Background

Economic performance has been relatively subdued since 2003 after a decade of high growth. Slow economic growth has reflected limited progress in addressing core economic vulnerabilities and delays in implementing crucial growth-supporting structural reforms, against a backdrop of an appreciating real effective exchange rate and, more recently, a sizable deterioration in the terms of trade. Real GDP growth fell to 2.9 percent in 2005 largely because of weakness in the cotton sector, which contributes an estimated 10 percent to total value added, and because investment demand was affected by election-related uncertainties. Inflation spiked upwards owing to strong food demand from crisis-afflicted Niger and high oil prices.

Benin has lost over 60 percent of competitiveness gains from the 1994 devaluation of the CFA franc—more than in most other West African Economic and Monetary Union (WAEMU) countries. The real effective exchange rate appreciated by another 2 percent in 2005 due to unfavorable price developments. Moreover, as world oil prices surged and the f.o.b. price for ginned cotton declined 35 percent, the terms of trade deteriorated by about 16 percent in 2005. Nonetheless, the current account deficit, excluding grants, continued to moderate, reflecting

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

lower formal sector oil imports stemming from management weaknesses at SONACOP (Benin's oil-importing monopoly) and weaker capital goods imports.

Notwithstanding further delays in structural reforms, a turnaround in cotton production is helping to revive growth in 2006. Growth is also benefiting from Port of Cotonou reforms and ongoing improvements in trade relations with Nigeria. Real GDP growth is expected to rebound to 4.5 percent in 2006. Inflation is projected to ease to 2½ percent by end-2006 and the current account deficit (excluding official grants) is expected to decline further to 7 percent of GDP.

The narrowly defined primary budget deficit is projected to meet the program target of 0.4 percent of GDP (0.9 percent, including Multilateral Debt Relief Initiative-funded outlays) in 2006. Fiscal prospects have benefited from expenditure and revenue measures introduced in the second quarter of 2006. These measures include the institution of a treasury committee to monitor more closely revenue collection and spending execution under the supervision of the finance minister, and strict adherence to expenditure execution procedures. With technical assistance from the World Bank, the new administration has initiated an audit of the new domestic payments arrears that came to light in 2006; the audit report and a plan to settle certified arrears are to be completed by end-2006.

Broad money rose by over 22 percent in 2005, considerably more than nominal GDP. In response, the BCEAO increased the reserve requirement ratio in Benin by 400 basis points, to 15 percent, in mid-2005, the highest level in the WAEMU. Broad money and private sector credit growth has subsequently eased and is projected to slow to a pace closer to trend in 2006.

In 2006, Benin received debt relief of US$1.112 billion (25 percent of 2005 GDP) under the Multilateral Debt Relief Initiative; this has reduced the country's total external public debt to about 13 percent of GDP. The assistance will partly be allocated to priority sector spending in education, health, and infrastructure.

Over the medium term, the government's economic policies aim to accelerate growth while keeping inflation low. Assuming a favorable external environment and a continuing recovery of cotton production, the medium-term macroeconomic framework calls for annual real GDP growth of 4½-5½ percent in 2006–08, in line with performance before Benin's recent slowdown. Inflation is expected to be contained within the WAEMU limit of 3 percent, which would prevent further real exchange rate appreciation, while the external current account deficit narrows to 6.5 percent of GDP by 2008. The narrowly defined primary budget deficit (including MDRI-funded outlays) would be eliminated in 2008.

A key element of the authorities' structural reform agenda is to reinvigorate stalled privatization of the utilities, port, and cotton sectors. Under the cabinet-approved disengagement strategies, the government would: (i) complete its withdrawal from commercial activities in the cotton sector by mid-2007; (ii) bring to point of sale the state-owned electricity company by the end of August 2007; and (iii) start operations of the consolidated electronic billing system at the Port of

Cotonou's centralized clearing and invoicing management center by the end of December 2006. The authorities also intend to bring the telecommunications company to the point of sale before end-January 2009. A revised Poverty Reduction Strategy Paper (PRSP) that places a renewed emphasis on private sector-led economic growth is to be completed in December 2006.

Executive Board Assessment

Executive Directors welcomed the rebound in growth in 2006, which in part reflects a recovery in cotton output. Directors commended the adoption of a growth strategy by Benin's authorities that aims at strengthening the fiscal position and rekindling structural reforms. They stressed the importance of addressing core economic vulnerabilities to accelerate growth, reduce poverty, and help achieve Benin's Millennium Development Goals. Structural reforms will also be essential to counter the long-term decline in competitiveness and overcome absorptive and institutional capacity constraints. Directors also encouraged the authorities to seek concessional financing from development partners for their economic program.

Directors stressed that long-term fiscal sustainability is crucial to sustained economic growth and poverty reduction. They commended the authorities for measures taken to reverse recent fiscal slippages and emphasized the importance of adherence to the convergence criteria under the Growth and Stability Pact in the West African Economic and Monetary Union.

Looking ahead, Directors were encouraged by the government's commitment to improving revenue and expenditure administration, which they considered essential to achieving fiscal consolidation and providing space for increased pro-poor spending. They underscored the need to strengthen revenue performance through improved tax and customs administration and urged the authorities to implement the recommendations of recent Fund technical assistance on revenue management. Directors underscored the need for strict observance of expenditure execution procedures. They also noted the envisaged orderly settlement of overdue obligations to civil servants and stressed that this, together with appropriate containment of the wage bill, was essential to provide space for priority spending. Directors took note of the authorities' efforts to restore the medium-term financial viability of the civil service pension fund, but regretted the lack of visible progress so far. They commended the authorities for their implementation of the April 2006 ban on the use of ad-hoc Treasury Payments Orders, which had boosted extra-budgetary outlays in the past, and encouraged the authorities to enhance public expenditure management, especially as regards expenditure tracking.

Directors noted that Benin's financial system appears mostly sound and welcomed the completion of reforms to address governance and portfolio weaknesses in some banks. However, they recommended continued efforts to reduce nonperforming loans and vigilance to avoid the risks related to the substantial loan concentration in a limited number of sectors and companies.

Directors cautioned against a borrowing policy that would put external debt sustainability at risk in the post-MDRI era. Directors advised that, as new borrowing space opens up, particular attention be given to the concessionality of new loans, cost-benefit analyses of envisaged investment projects, and appropriate assessment of the absorptive capacity of the economy. In this context, Directors regretted that the outgoing administration had gone against the advice of its debt committee and guaranteed a non-concessional loan to the state-owned telephone company.

Directors welcomed the authorities' renewed commitment to enhancing external competitiveness through reforms in the parastatal sectors. They emphasized the crucial importance of bolstering the viability of Benin's cotton sector, and welcomed the announced government withdrawal from industrial and commercial activities in the sector by mid-2007. Directors stressed the need for an adequate regulatory framework in the energy sector to encourage private sector involvement. They expressed concern about the slow pace of reforms in the telecommunications sector, and welcomed the announced strategic assessment of the telecom parastatal in preparation for its privatization.

Directors strongly encouraged the authorities to pursue reforms aimed at addressing weaknesses in the judicial system, modernizing land tenure, and facilitating access to credit for small and medium sized enterprises.

Benin: Selected Economic Indicators, 2002-05

	2003	2004	2005	2006
	(Annual changes in percent)			
Income and prices				
Real GDP	3.9	3.1	2.9	4.5
Consumer prices (average)	1.5	0.9	5.4	3.0
Real effective exchange rate	8.4	2.4	2.2	...
.Terms of trade	3.4	21.2	-15.9	4.1
	(Annual change in percent of beginning-of-period broad money)			
Money and credit				
Net foreign assets	-4.7	-10.8	7.3	2.5
Broad money	6.6	-6.7	21.8	2.9
Credit to the nongovernmental sector	33.0	4.5	20.2	6.2
Net credit to central government	-0.2	1.5	3.2	-5.5
	(In percent of GDP, unless otherwise indicated)			
Investment and saving				
Gross domestic investment	19.6	19.0	19.6	21.0
Gross national saving	11.2	11.7	12.8	13.9
External sector				
Current account balance	-8.3	-7.2	-6.8	-7.0
Overall balance of payments	-0.4	-3.2	2.8	-1.3
NPV of debt to export of goods and nonfactor services	147.1	132.1	75.1	86.3
Central government finance				
Central government revenue	17.0	16.4	16.5	16.5
Total expenditure and net lending	20.6	20.1	21.1	21.5
Primary fiscal balance	-3.1	-3.3	-4.3	-4.8
Overall fiscal balance	-3.7	-3.7	-4.6	-5.0

Sources: Beninese authorities; and IMF staff calculation and estimates

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November 27, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review Under Benin's PRGF Arrangement and Approves US$1.3 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Benin's economic performance under an SDR 6.19 million (about US$9.3 million) Poverty Reduction and Growth Facility (PRGF)[1] arrangement (see Press Release No. 05/190), and approved the disbursement of an amount equivalent to SDR 880,000 million (about US$1.3 million).

Conclusion of the first review had been delayed due to a lack of progress on cotton and public utility sectors reform in the run-up to the recent presidential election. The Board waived Benin's non-observance of the performance criteria concerning the accumulation of new domestic payment arrears and the non- contracting or guaranteeing of nonconcessional external debt with maturities of one year or more.

Benin reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in March 2003, receiving total debt relief of about US$265 million. In January 2006, Benin received debt relief under the Multilateral Debt Relief Initiative from the IMF in the amount of SDR 36.1 million (about US$54 million).

Following the Executive Board's discussion of Benin, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, stated:

"The authorities have adopted a growth-enhancing strategy that is supported by the Poverty Reduction and Growth Facility (PRGF). The authorities' strategy seeks to achieve strong and sustained growth and addressing vulnerabilities to exogenous shocks, and will be crucial to reducing poverty and facilitating progress toward achieving Benin's Millennium Development Goals.

"Fiscal consolidation is a key pillar of the authorities' growth strategy. The authorities will enhance fiscal revenue through improved tax and customs administration, while strengthening

[1] The PRGF is the IMF's concessional facility for low-income countries. PRGF loans carry an annual interest rate of 0.5 percent, and are payable over 10 years with a 5½-year grace period on principal payments.

expenditure management and carefully limiting the public sector wage bill. The savings generated through these efforts, combined with the fiscal space from the debt relief will bolster pro-growth and pro-poor spending. Further strengthening public expenditure management to enhance transparency and improve governance in public finances will also be essential. To preserve fiscal and debt sustainability over time the authorities will need to seek external assistance on highly concessional terms for the ambitious infrastructure rehabilitation program.

"On the structural front, the authorities' will advance the privatization agenda to support private sector development and foster production and export diversification. In this respect, the authorities intend to withdraw from industrial and commercial activities in the cotton and electricity sectors, expedite plans for privatizing Benin Telecom, and intensify ongoing efforts to improve the competitiveness of the port of Cotonou. Other key areas of structural reform include the judicial and land tenure systems, not least to support efforts to facilitate access to credit for small- and medium-sized businesses," Mr. Lipsky said.

Statement by Laurean W. Rutayisire, Executive Director for Benin
November 27, 2006

On behalf of my Beninese authorities, I would like to thank the staff for the constructive policy discussions held in Cotonou and the well-written set of papers. My beninese authorities fully appreciate the continuous financial and technical assistance they have received from the Fund over the years.

Despite subdued economic performance in recent years, growth has been revived owing to a recovering cotton sector which contributed about 10 percent to total value added, employs a significant portion of Benin's labor force and touches 40 percent of its population. The economic slump experienced by Benin in the recent past owes mostly to exogenous shocks associated with large terms of trade declines which stem from falling world cotton prices and escalating petroleum product prices. In spite of these adverse developments, the authorities are determined to adopt policy measures aimed at rebounding the economy, notably strengthening of macroeconomic stability through tightening the fiscal stance and reingovirating the structural reform agenda in the energy, telecommunications and cotton ginning sectors. The strength of the financial sector, which has grown and is made up of banks that meet key prudential norms, will be a key component of the growth and development strategy of the country. Over the period leading up to 2008, my authorities also envisage to rehabilitate economic and social infrastructure as well as improve the business climate through reforms of the judicial and land tenure systems and greater access to credit for small and medium-sized enterprises.

Thanks to appreciable good governance, the authorities of Benin will benefit from resources from the Millennium Challenge Account, which will help finance these important reforms. Another milestone in the country's path to solid growth and development is the smooth political and social processes carried out since the early 1990s. Benin held successfully presidential elections earlier this year, confirming the progressive deepening of democratic institutions in this country. These efforts to strengthen democratic progress have absorbed significant financial resources, as has the support to the critical cotton sector.

Aware of the main challenges facing the Beninese economy, the newly elected administration has expressed a strong commitment to reforms, with great emphasis on fiscal discipline and privatization of state-owned companies. In this regard, my authorities have taken some remedial actions aimed at keeping the current PRGF program on track, notably reduction in customs exemptions to boost revenues, decisive government efforts to clear potential arrears in the first half of 2006, intensification of the audit of major taxes (including VAT and mobile telephone company royalties), streamlining of tax credit management, and efforts to enhance the effectiveness of the Directorate General of Customs and Indirect Taxes (DGDDI). On the expenditure front, corrective measures have also been undertaken, among which prohibition of ad hoc Treasury payment orders for extra budgetary spending, the setting of a treasury committee to track more closely revenue and expenditure and to match government resources with commitments. As a result of all these committed efforts, revenue should stabilize and expenditure contained to levels that make it possible to meet the primary fiscal deficit target.

My authorities recognize that Benin's economic and financial situation remains fragile and vulnerable to external shocks, notably those stemming from its high dependence on cotton. However, with further support from international community and perseverance in their adjustment efforts, Benin should continue to make progress in reversing the decelerating trend of GDP recorded in recent years, while striving to meet the MDGs. As regards the issue of competitiveness, we take good note of the exchange rate appreciation since the 1994 devaluation. However, as we have oftentimes stated on regional issues, this problem should be looked at from a regional perspective. At the same time, the structural reforms already undertaken or envisaged by the authorities are aimed to underpin competitiveness, notably facilitation of access to land and to credit, improvement of the business environment, privatization of the utilities and cotton sectors, greater effectiveness of the autonomous Port of Cotonou especially through a larger range of activities at the management center for the one-stop shop, and preparation for the involvement of the private sector in the management of port facilities.

As regards program implementation, my authorities -despite the difficulties highlighted above and that stemmed from factors much beyond their control- have succeeded to meet five of seven quantitative performance criteria at end-June 2006, in addition to the two indicative target. The criterion related to the accumulation of domestic payments arrears was not met for the fiscal difficulties outlined above, but measures have been taken to avoid further arrears as noted above. Weak capacities and low delivery of financial and technical assistance delayed the implementation of structural reforms and resulted in the nonobservance of structural performance criteria and benchmarks. However, structural performance criteria and benchmarks have all been implemented as of today, albeit with the delays. Moreover, prior actions for the completion of this first review have all been implemented. These actions include the adoption by the Council of Ministers of the strategies and timetable for government disengagement from the cotton, electricity and telecommunications sectors; the selection of an auditing firm to assess the viability of outstanding domestic arrears and to develop an arrears clearance strategy; and the formal reaffirmation of the government's commitment to neither guarantee nor contract nonconcessional loans. These actions as well as the proposed program conditionality for the rest of 2006 and 2007 demonstrate the authorities' strong commitment in the areas of governance, accountability and reforms.

In view of these strong actions and commitment, my authorities request waivers for nonobservance of missed performance criteria and the completion of the first review under the PRGF arrangement. As we note that external assistance has fallen short of expectations and is critically lacking despite the MDRI-related benefits, we call upon the international community to deliver on aid commitments and further increase financial assistance to Benin.

I. Recent economic developments

In recent years, the Beninese economy has on one hand been hit by exogenous factors involving sharp decline in international cotton prices and, consequently, falling cotton production, and the other hand faced internal factors including delays in structural reforms which affected the competitiveness of the economy. Consequently, real GDP growth rate is estimated to have reached 2.9 percent in 2005 against 3.1 percent in 2004, and 3.9 percent in 2003. However, a rebound of economic activities, following improvements in trade relations with Nigeria, along with an increase of traffic from the Port of Cotonou, has contributed to render the 2006 prospects more optimistic. The available data point to a projected growth rate of 4.5 percent in 2006. These favorable developments of economic activities are also due to the settlement of delayed debts to farmers, ginners and inputs suppliers in April 2006, which boosted the production of cotton in 2006. After an unusual surge of inflation in 2005 (3.7 percent), reflecting partly high oil prices, inflation is estimated to have been brought down to 2.5 percent in 2006.

Regarding the external sector, in spite of the loss of competitiveness, owing to the continued appreciation of Euro (to which CFA franc is pegged) against US dollar and, mostly, large terms of trade declines resulting from falling world cotton prices and escalating petroleum product prices, the current account deficit has been subdued in 2006 and Benin's share of the BCEAO's foreign exchange reserves reached 10 months of imports cover in 2006.

The regional central bank, the BCEAO, continues to prove its ability to ensure a relevant monetary policy. Indeed, in face of broad money and credit to private sector expansion, which increased respectively by over 22 percent and 20 percent in 2005, the BCEAO has tightened its monetary conditions by raising the reserve requirement ratio up to 15 percent, the highest level among the WAEMU member countries. As regard the financial system, it is worth noting that the sector has been steadily growing, that most banks meet key prudential norms, and that reforms to address governance and other portfolio weaknesses in two banks have been completed. The regional Banking Commission should be commended for its supervisory work.

On the fiscal front, as noted above, my authorities put in place in the second quarter of 2006 a set of corrective fiscal measures, including (i) the institution of treasury committee to monitor revenue collection, (ii) the strict respect of expenditure execution procedures; and (iii) a renewed commitment to not undertake extrabudgetary expenditures. Their efforts to improve revenue collection and contain expenditures cover a wide range of areas, including customs, tax administration, and expenditure management and monitoring.

II. Medium-term challenges and objectives

Down the road, as well documented in Staff Report, Benin faces at least four important challenges: (i) preserving or improving macroeconomic stability, (ii) reinvigorating growth by completing the reforms to revitalize the cotton sector, Port of Cotonou, and utility companies, (iii) improving the business climate, so as to strengthen the private sector, and (iv) accelerating poverty reduction. In this regard, my authorities remain committed to maintaining macroeconomic stability and accelerating structural reforms. My authorities also intend to raise the investment-to-GDP ratio from 20 percent in 2005 to 22.5 percent in 2008, in particular by using the fiscal space allowed by the debt relief and increased domestic revenue collection resulting from the positive effects of structural reforms palpable as early as 2006. As a result of these efforts, my authorities expect that over the three year period to 2008, the real GDP growth rate will average 4.5 – 5.5 percent, with inflation remaining within the WAEMU convergence ceiling of 3 percent.

Fiscal Policies

As a translation of the above medium-term macroeconomic framework into fiscal objectives, my Beninese authorities envisage to eliminate the narrowly defined primary deficit by 2008.

On the revenue side, while they expect a gradual positive fiscal impact of ongoing reforms, the authorities have taken a set of measures focused on the improvement of tax and customs administration. To that end, they envisage to (i) improve the management of medium-and-large-taxpayers units' activities, while computerizing tax assessment and collection operations; (ii) ensure a better customs control of imported goods; (iii) better exchange of taxpayers data between the General Tax Administration and Customs Directorates; (iv) modernize property tax ; and (v) introduce Unified Tax Identification Number. In order to reaffirm their commitment to implementing those measures, my authorities announced that in case of revenue shortfalls, they stand ready to take corrective measures, including expenditure cuts.

On the expenditure side, the authorities have clearly expressed the urgent need to improve the poor's access to basic services through higher and more efficient spending in priority sectors. In this regard, they intend to devote most of freed resources through MDRI to finance priority spending sectors, including education, health, and infrastructure projects. My authorities pay due attention to the staff's advice recommending to be cautious in contracting new loans in order to preserve debt sustainability, improved significantly after MDRI debt relief from Fund, World Bank and African Development Bank. The government, in collaboration with development partners, is considering a clearance plan to solve the long-standing problems of wage arrears. At the same time, my authorities are taking necessary actions to accelerate the preparation of civil service reform undertaken, with World Bank and other development partners' assistance. The authorities are still exploring a new direction to restore in the medium-term the viability of the civil service pension fund and would appreciate Fund's technical assistance.

Structural Reforms

My authorities have demonstrated their strong commitment to structural reforms by implementing the prior actions for the completion of this first review under the PRGF program and are resolved to implement the proposed conditionality for the remainder of this program. Indeed, in their strategy to maintain close collaboration with partners, an agreement on a revised structural agenda has been reached between the authorities, the World Bank and Fund's staff. The objectives set out in this agreement invite the authorities to (i) to complete government withdrawal from commercial activities in the cotton sector by mid-2007; (ii) bring to the point of sale the electricity company by the end of August 2007; (iii) start operations of the consolidated electronic billing system at the centralized clearing and invoicing management center by end of December 2006. As for the telecommunications, the authorities have a slightly different point of view from the World Bank in the timing of privatization. As rightly underscored above, the authorities expect to break off with the recurrent discussions made on this issue in the past and require necessary time to make a relevant assessment of the company situation, put in place a new management team, prepare a diagnostic of the telecom parastatal, and restructure the company first. In this context, they suggest to bring the company to the point of sale by end-January 2009.

My authorities have taken note of slow progress in improving the business environment and the high costs of doing business in Benin. They intend to take the necessary measures to reverse this trend, notably by reducing the burdensome regulations, addressing the institutional weaknesses, and implementing the reforms as envisaged, including in the cotton sector. In order to ensure a full success of the reform agenda, they have elaborated second-generation reforms aimed at removing critical obstacles to the implementation of structural reforms. The program aims to improve access to land, markets, and business environment. Taking into account staff's recommendations, my authorities are taking steps to create a favorable climate of business, conducive to the needed development of private sector.

Regarding the financial sector, despite progress made in this area, as evidenced by the Banking prudential indicators, my authorities are also aware of the need to monitor closely the high concentration of loans observed in a limited number of sectors (and companies) in Benin.

Poverty Reduction

Important progress has been made in the implementation of the PRSP. Since the adoption of the document in 2003, two annual progress reports have been performed and the third one is projected to be achieved by December 2006. A revision for a PRSP II is underway and should be completed by end-December 2006. An emphasis on the development of the private sector and the role it can play in increasing growth has been included in the revised project.

III. Conclusion

Since 1990, Benin has embarked on far-reaching reforms, focused on the need to put in place an efficient market-based economy. Important efforts have also been made to stabilize and reduce the country's vulnerability to exogenous shocks. Delays in implementing structural reforms have not been due to lack of ownership, but rather to limited capacity. My authorities recognize that further efforts are still needed to attain this objective. In particular, they recognize that the Beninese economic situation requires vigorous measures to enhance its diversification so as to render it more resilient to shocks. In this regard, my authorities have shown their commitment to move forward by taking critical measures to push ahead the reforms underway. They are, therefore, requesting the completion of the first review of the PRGF arrangement and waivers for the missed performance criteria, for which they have already taken the necessary steps to address.

My beninese authorities remain fully determined to preserve the country's debt sustainability gained from debt relief under the HIPC and MDRI initiatives, and they are grateful to the international community for this assistance. However, there has not been additional assistance on the part of the donors to underpin their daunting efforts towards strong and sustained growth. The financial and technical assistance of the international community, including the Fund, remains critical to address these challenges. My authorities are hopeful that they will benefit from increased support from all development partners.