August 2005
IMF Country Report No. 05/288

Benin: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Benin

In the context of the request for a three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the request for a three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on May 23, 2005, 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 July 22, 2005. 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 Press Release summarizing the views of the Executive Board as expressed during its August 5, 2005 discussion of the staff report that completed the request.

- a statement by the Executive Director for Benin.

The documents listed below have been or will be separately released.

Joint Staff Assessment of the Poverty Reduction Strategy Paper—Progress Report
Letter of Intent sent to the IMF by the authorities of Benin*
Memorandum of Economic and Financial Policies by the authorities of Benin*
Poverty Reduction Strategy Paper—Progress Report
Technical Memorandum of Understanding*

*May also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

BENIN

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the African Department

(In consultation with the Finance, Fiscal, Legal, Monetary and Financial Systems, Policy Development and Review, and Statistics Department)

Approved by David Nellor and Anthony R. Boote

July 22, 2005

- Discussions on a three-year program that could be supported under the Poverty Reduction and Growth Facility (PRGF) were held in Cotonou during March 20-April 4 and May 13-23, 2005. The staff team comprised Messrs. Maret (Head), Harmsen (Resident Representative), Youm, Monfort, and Rosa (all AFR), and Ms. Simonds (Research Assistant, AFR). Mr. Kpetigo, Advisor (OED), participated in the policy discussions. The team met with President Kérékou, the Senior Minister for Planning and Development, the Minister of Finance, the Director of the Cotonou Agency of the Central Bank of West African States (BCEAO), and other senior officials, as well as representatives of the donor community.
- Benin reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in March 2003, receiving total debt relief of U.S.$265 million in net present value (NPV) terms with a common reduction factor of 31.3 percent (Country Report No. 03/89, 04/03). The last three-year arrangement under the PRGF expired on March 2004, with the full amount drawn.
- In concluding the last Article IV consultation (Country Report No. 04/368, 11/24/04) and the ex post assessment of performance under Fund-supported programs (Country Report No. 04/371, 11/24/04) on October 6, 2004, Directors commended the authorities for the country's economic performance in recent years, but noted that progress on structural reforms had been slow. They urged the authorities to implement structural reforms to enhance competitiveness, strengthen the cotton sector, advance privatization, and promote export diversification. Directors concurred that Benin's main challenge was to achieve sustained high growth and to reduce poverty while preserving macroeconomic stability and reducing the economy's vulnerability to external shocks.
- The new PRGF arrangement (with a low access equivalent to 10 percent of quota) aims to help Benin address this main challenge. To this effect, the program focuses on (i) implementing an export-led development strategy to reduce the vulnerability of the economy to external shocks and its dependency on cotton and trade with Nigeria; (ii) reinforcing macroeconomic stability by conducting prudent economic and financial policies and strengthening public finances through mobilization of revenue and fiscal adjustment; (iii) deepening structural reforms to foster an environment conducive to private sector and trade development; and (iv) achieving progress in the implementation of Benin's poverty reduction strategy.

Contents ....Page

Appendices

Executive Summary

- Benin experienced a decade of good economic performance through the early 2000s but poverty reduction remains a concern. A combination of a deteriorating external environment and domestic policy slippages, in the budget and in structural reforms, saw economic performance weaken markedly after 2002. Moreover, these developments highlighted the vulnerability of the economy to external shocks because of its dependence on the cotton sector and on trade with Nigeria, its main trading partner.

- Economic performance weakened in 2004, with growth slowing to about 3 percent. Inflation remained low, at 2.6 percent by year-end. A decline in manufacturing, including cotton ginning, and an intensification of trade restrictions in Nigeria led to a slowdown in economic activity, a deterioration of the external current account deficit, and a loss of government revenues. Progress on the structural front was uneven, with minor advances in privatization and cotton sector reform. Policy decisions, including on civil service wages and a decision to provide a subsidy to farmers on account of the fall in world cotton prices, resulted in a weak underlying fiscal situation in 2005.

- The new PRGF arrangement (with a low access equivalent to 10 percent of quota) seeks to strengthen macroeconomic stability, implement an export led development strategy to reduce the vulnerability of the economy to shocks, deepen structural reforms to foster private sector development, and achieve progress in the implementation of the poverty reduction strategy. The authorities reform plan reflects the recommendations of the ex post assessment of performance under Fund-supported programs by focusing on macroeconomic stability and reforms to promote strong growth and diversification, as well as a restructuring of public expenditure to support poverty reduction.

- Policy discussions focused on immediate measures to stabilize and restore the fiscal situation and to get structural reforms, particularly in the cotton sector and the Port of Cotonou, back on track while establishing a stronger policy framework to meet medium term objectives. The strategy will initially focus on completing the cotton sector reform and giving new impetus to the privatization program while gradually implementing measures to promote and facilitate trade. Public sector management will focus on a strengthening of fiscal management and civil service reform.

- The program for 2005 aims at a modest economic recovery reflecting an economic environment that remains difficult. A tightening of fiscal policy through adjustment measures equivalent to 2.1 percent of GDP will partially offset the budgetary slippages mentioned above and limit the deterioration of the narrow primary deficit to 0.9 percent of GDP. The structural reform program aims to make progress in implementing the reform agenda of the cotton sector, the Port of Cotonou, and the telecommunications and electricity parastatals, as well as in improving public management.

- The government has strengthened its reform program through a series of strong prior actions that have validated the fiscal program for 2005 and provided new impetus to key structural reforms. Nonetheless, risks to the program remain, including the social resistance to reforms, particularly in the period leading up to the presidential elections scheduled for March 2006.

I. BACKGROUND

1. **Despite some progress in consolidating macroeconomic stability under past Fund-supported programs, Benin's economic and financial situation remains fragile and vulnerable to external shocks.** Its vulnerability reflects the economy's excessive dependence on the cotton sector and on trade with Nigeria, its main trade partner.[1] In the 1990s, Benin recorded high rates of growth in the context of a stable macroeconomic environment. However, delays in the implementation of key structural reforms weakened Benin's competitiveness and prevented it from establishing an environment conducive to private sector development and economic diversification. These developments

Benin: Key Indicators, 1995-2005
(In percent of GDP, unless otherwise indicated)

	1999	2000	2001	2002	2003	Est. 2004	Proj. 2005
GDP at constant prices 1/	6.0	4.9	6.2	4.5	3.9	3.1	3.9
Consumer price index 1/	14.5	4.2	4.0	2.4	1.5	0.9	2.5
Investment	22.2	19.5	20.3	17.2	19.6	19.0	20.3
Public	7.2	7.3	7.4	6.1	6.8	6.1	7.4
Private	14.9	12.2	12.9	11.1	12.8	12.8	12.9
Overall fiscal deficit (payment-order basis) 2/	-6.7	-3.4	-3.9	-3.3	-3.7	-3.7	-5.3
Overall fiscal deficit (cash basis) 2/	-8.3	-5.2	-3.9	-4.3	-3.7	-4.5	-6.1
Current account balance (minus = deficit) 2/	-7.4	-7.8	-7.5	-8.6	-8.5	-8.7	-8.7
CFA francs per U.S. dollar (period average) 1/	-10.1	15.6	2.9	-5.2	-16.5	-9.0	-5.4
Oil price (U.S.$ per barrel) 1/	7.9	57.0	-13.8	2.5	15.8	30.7	23.2
Price of ginned cotton (U.S.$ per pound) 1/	23.3	11.1	-18.7	-3.6	37.1	-2.3	-14.5
Production of cotton seed (in thoursands of tons)	350	337	401	338	333	425	417
Nominal GDP (in billions of CFA francs)	1,083	1,680	1,832	1,957	2,068	2,138	2,261

Sources: Beninese authorities, and IMF staff estimates and projections.
1/ Annual changes in percent.
2/ Excluding official grants.

[1] Cotton accounts for about two-thirds of Benin's exports, or about 5-5½ percent of GDP, and provides income to about 325,000 poor farmers, whose families represent slightly more than one-third of Benin's population. Exports to Nigeria consist essentially of informal reexports activities that are recorded in net terms under services and transfers in the balance of payments. Total exports and reexports to Nigeria are estimated to be equivalent to 6½-7½ percent of GDP.

have recently been exacerbated by declining international cotton prices and the intensification of trade restrictions imposed by Nigeria on imports from Benin, resulting in a deterioration of Benin's overall economic and financial performance since 2002.

2. **Moreover, as highlighted in the 2003 annual progress report (Country Report No. 05/283, 08/10/05) on the implementation of the poverty reduction strategy paper (PRSP), poverty remains an issue despite improvement in most poverty indicators since 1990 and Benin's satisfactory economic performance up to 2002.** One-third of the rural population and one-fourth of the urban population were classified as poor in 2000, and nearly half of Benin's population was unable to satisfy a number of basic needs. The poverty reduction strategy, implemented since 2003, has been assessed a sound and appropriate one for poverty reduction in Benin.[2]

3. **In the attached letter and memorandum of economic and financial policies (MEFP), Benin's Minister of Finance requests Fund support, in an amount equivalent to SDR 6.19 million (10 percent of quota), for the authorities' new economic and financial program for 2005-08 (Appendix I).** The program, fully rooted in Benin's poverty reduction strategy, aims to address the challenges facing Benin and takes into account the conclusions of the ex post assessment of performance under Fund-supported programs (EPA; Country Report No. 04/371, 11/24/04; Box 1). It will also contribute to regional integration in the context of the West African Economic and Monetary Union (WAEMU) by calling for greater compliance with the convergence criteria of the zone. The program objectives will be revisited when the poverty reduction strategy and its medium-term expenditure framework are revised at end-2006.

4. **If the full amount of the arrangement—to be disbursed in six equal installments of SDR 0.88 million, and a final disbursement of SDR 0.91 million—is drawn, Benin's outstanding disbursements will drop to SDR 25.35 million (41 percent of quota) at end-2008**, compared with SDR 42.04 million at end-2004 (Tables 1 and 2, and Appendix II). A summary of relations with the World Bank and statistical issues are presented in Appendix III and Appendix IV, respectively.

II. Recent Economic Developments and Progress in Structural Reforms

A. Developments in 2004

5. **Economic performance weakened in 2004, with real GDP growth decelerating to an estimated 3.1 percent**, from 3.9 percent in 2003 (Table 3, Figures 1 and 2). This slowdown stemmed mainly from the weak performance of the cotton ginning sector and a

[2] See the Joint Staff Advisory Note (JSAN; Country Report No. 05/283, 8/10/05) on the 2003 annual progress report on the implementation of the strategy.

Box 1. Benin: Lessons from the Ex-Post Assessment of Performance Under Fund-Supported Programs

1. What has worked.

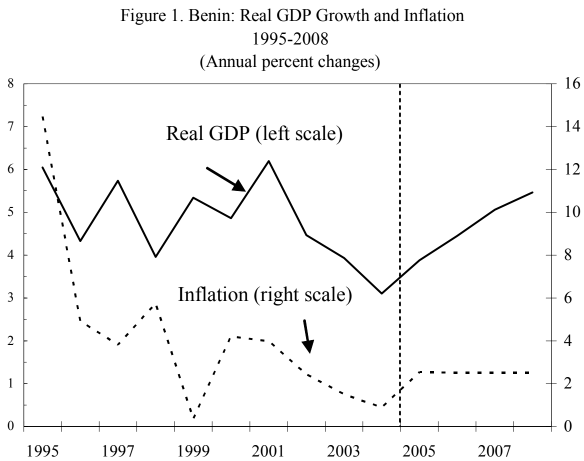
- Past program design was broadly appropriate and program implementation under Fund-supported programs was mostly successful. Major progress in macroeconomic stabilization was achieved over the period 1993-2003.
- Fiscal adjustment was the centerpiece of the stabilization strategy and benefited from substantial Fund technical assistance. Tax revenue increased from 7.2 percent of GDP in 1989 to 15.2 percent of GDP in 2003, primarily through substantial improvement in tax and customs administration. The wage bill-to-GDP ratio was reduced through a voluntary retirement program and attrition policy. Public expenditure management has improved since 2000.
- The financial sector has strengthened considerably since its rehabilitation in the early 1990s.

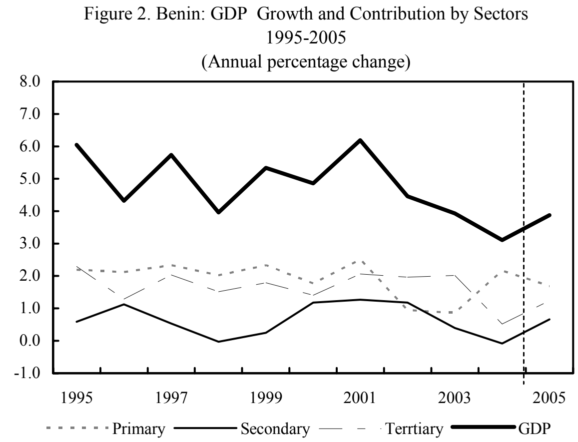
2. What has not worked.

- Program design underestimated the weaknesses in the authorities' administrative and implementation capacity, as well as the weak internal consensus in favor of structural reforms.
- Diversification of the economy has not been achieved, and the dependence on cotton and trade with Nigeria is high.
- Effective poverty reduction remained elusive. The PRSP was finalized after considerable delays and started to be implemented in the 2004 budget.
- Implementation of key structural measures was uneven. The second stage of civil service reform, including the introduction of a performance-based remuneration system, was stalled by strong labor union opposition. Divestiture from public utilities and the cotton sector was delayed.
- Policy framework was limited in addressing external shocks, but the programs included contingencies for shortfall in aid flows and flexibility was shown by adjusting fiscal targets ex-post.

3. Lessons and challenges. Building on the lessons from the EPA, the new PRGF-supported program:

- Will help the authorities prepare and implement the policies aimed at accelerating growth and reducing poverty. The program is aligned with PRSP objectives and provides a framework for sound policy response in the case of exogenous shocks.
- Aims at keeping the government deficit in line with the objectives of debt sustainability through increasing the tax-to-GDP ratio toward the WAEMU target of 17 percent, while increasing the level and quality of poverty-reducing spending.
- Gives a new impetus to the implementation of the uncompleted reform agenda to improve the overall efficiency of the economy and delivery of service to the population, and make the economy more competitive.
- Mitigates risks facing Benin in achieving its PRSP objectives through significant up-front actions.

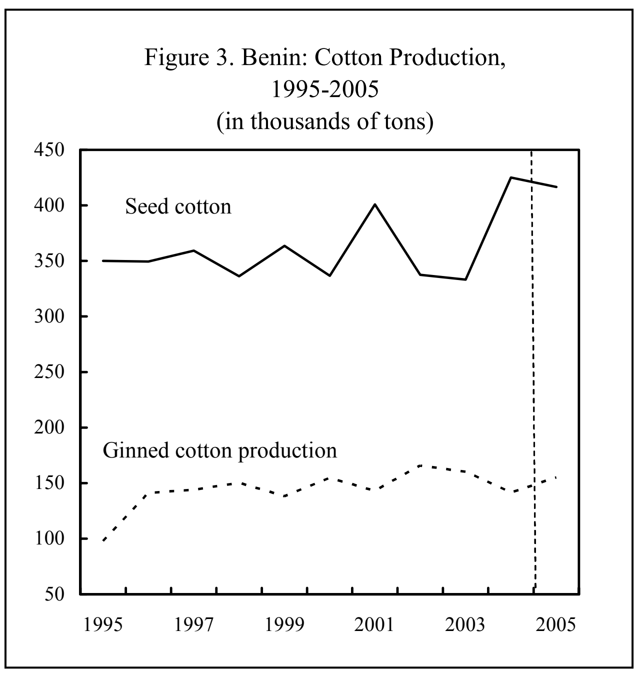




decline in trade activities with Nigeria that also affected transport and port activities. Average inflation remained under control at about 1 percent, well below the WAEMU convergence ceiling of 3 percent.

6. **Recent developments in the cotton sector contributed to the economic slowdown.** Controlling for the favorable climatic conditions that led to bumper crops in 2001 and 2004, the reform of the cotton sector initiated at the end of the 1990s has not yet boosted the production of seed cotton and ginned cotton above 350,000 tons and 150,000 tons, respectively (Figure 3).

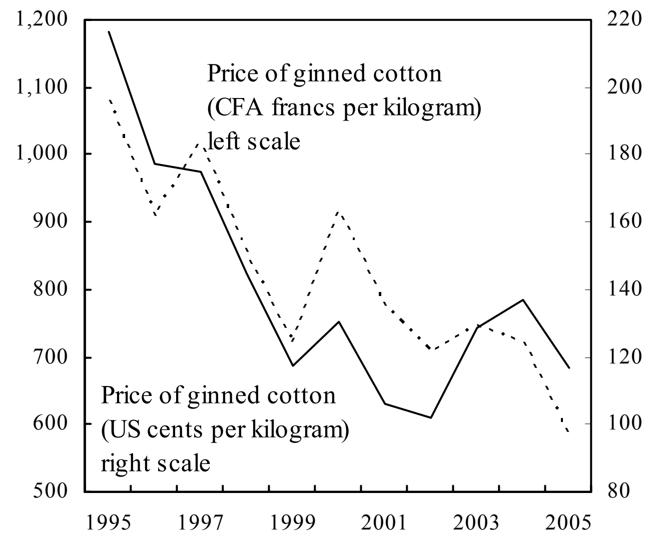
- **The framework defining the relationship among the various stakeholders in the cotton sector came under stress, which resulted in market uncertainties that interfered with the 2003/04 and 2004/05 crop seasons.** The transition from a framework based on a public monopoly to an integrated framework of multiple private operators was not completed. The absence of enforceable rules of conduct led to a breakdown of cooperation and discipline among stakeholders. Some operators started to circumvent the framework; the private sector



institution in charge of financing activities and payments among stakeholders faced financial problems that delayed the start of the crop seasons; and input supply problems resulted from distributors' dissatisfaction with the bidding system used to allocate import orders.

- **The domestic problems that contributed to managerial and institutional disarray in the sector were exacerbated by the slump in the international prices of cotton**. Although the price drop over the period 1996-2002 was limited to 22 percent in CFA francs because of the appreciation of the U.S. dollar against the CFA franc, the slight recovery of international cotton prices since 2002 has been more than offset by the depreciation of the U.S. dollar, causing cotton prices, which had been relatively stable in 2003 and 2004, to drop by a projected 19 additional percent in CFA francs in 2005 (Figure 4).

Figure 4. Benin: Price of Cotton, 1995-2005



- **In response to these developments, the government intervened in the sector to restore stability.** In mid-November 2004, the government established the conditions for "transitional" arrangements in 2004/05, including its setting of input prices. In January 2005, the government also decided to protect farmers from the social and poverty implications of the decline in cotton prices.[3] Moreover, the privatization of SONAPRA, the former cotton sector monopoly, which still accounts for about 50 percent of the country's ginning capacity, was postponed after initial progress that led to the awarding of its ginneries through a bidding process.

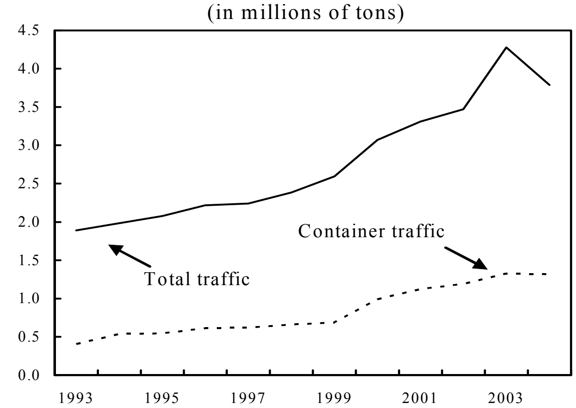
7. **Nigeria's introduction in August 2003 of an import ban on 44 items regularly imported from Benin, effected through border closures and strengthened border controls, contributed to a decline of total exports to Nigeria by an estimated one-fourth to one-third in 2004, to the equivalent of about 5 percent of Benin's GDP.** The ban, which the Nigerian authorities imposed to curb the predominantly informal trade flows between Benin and Nigeria, was meant to protect Nigeria's domestic industry and port activity, as well as address sanitary concerns about frozen meat. The reduction of Benin's

---

[3] Producer prices were set at about the same level as in previous years.

commercial activities with Nigeria curtailed transport and port activities, and lowered government revenue.

Figure 5. Benin: Traffic at the Port of Cotonou
(in millions of tons)



8. **The activities of the Port of Cotonou were affected by other problems:** the diversion of the international transit trade of neighboring countries to more efficient and competitive seaports in the region; pervasive corruption at customs; and the increasing number of roadblocks erected by police, customs, and local municipalities for control and revenue collection purposes (Figure 5). In late 2004, the government intervened to allow goods and services to move freely, and the port's authorities initiated measures to regain market share and improve services.

9. **Although the terms of trade improved and savings in interest obligations resulted from the HIPC Initiative completion point, the external current account deficit (excluding official grants) deteriorated slightly to about 8⅔ percent of GDP in 2004 (Table 4).** The trade balance deficit was stable at 11½ percent of GDP, despite a lower volume of cotton exports and a higher oil bill. However, lower interest obligations on public debt were more than offset by lower services and current transfers stemming from the decline in reexports to Nigeria.

10. **In response to wage pressures and declining revenue collection, the government cut expenditure to stabilize the overall fiscal deficit (excluding grants) at 3⅔ percent of GDP in 2004 (Table 5).** Revenue collection fell by half a percentage point of GDP because of the economic slowdown. At the same time, the progressive aligning of wages to the current pay scale resulted in a 10 percent overrun in the wage bill. These negative factors were offset by reduced external interest obligations, a lower execution rate of the investment program, and measures that limited other expenditures while protecting, to the extent possible, priority sectors. The current fiscal surplus was reduced by ½ of 1 percent to 2½ percent of GDP, and the narrow primary surplus—the primary fiscal balance excluding externally financed capital expenditure—was eliminated.

11. **Domestic credit expansion reached 8.8 percent in 2004, with credit to the nongovernment sector rising by 4.5 percent (Table 6).** In light of credit demand pressures and negative net transfers to the rest of the world at the beginning of 2004, the Central Bank of West African States (BCEAO) increased Benin's reserve requirement from 9 percent to 13 percent in March of that year. Analysis of other developments in the monetary and balance of payments sectors has been hampered in the past few years by data problems. The BCEAO's official statistics indicate that currency in circulation in Benin declined from 12.2 percent of GDP at end-2001 to 1.6 percent of GDP at end-2004. The BCEAO has

acknowledged having difficulty estimating currency in circulation and net foreign assets of member countries, but it has not yet provided revised time series that would provide for a full analysis of monetary and balance of payments developments.[4]

12. **Progress on the structural front was uneven in 2004.** On the one hand, Benin made further progress in reforming its budget system and, in particular, in strengthening expenditure management. On the other hand, wavering commitment in the face of opposition from labor unions delayed the reform of the cotton sector and the privatization program. The electricity and water parastatal was separated into an electrical energy company (SBEE) and a water company (SONEB) in early 2004, but no progress was made in privatizing these two entities although a new electricity code to establish a legal framework for private participation in the sector was submitted to the parliament. No progress was made on the restructuring of the post and telecommunications public enterprise (OPT), except for the publication of a decree to separate postal and telecommunications activities. Moreover, resistance from trade unions blocked progress toward involving the private sector in the management of the Port of Cotonou.

B. Developments During the First Half of 2005

13. **The authorities have made progress in early 2005 in restoring trade relations with Nigeria.** A bilateral trade agreement was signed in April 2005 and the Joint Committee on Commerce (JCC) set up in May 2005 to improve trade relations between the two countries. Under this agreement, goods of Beninese origin that had been banned would be allowed in Nigeria, but goods manufactured outside of Benin—, that is, “reexports”—would continue to be banned. At end-May, 12 enterprises in the textile, edible oil, and construction materials sectors were granted export permits by the JCC.

14. **The 2005 budget approved by the parliament was in line with the projections discussed during the last Article IV consultation**. However, important budgetary pressures, in an amount of about 3 percent of GDP, resulted in early 2005 from (i) optimistic forecasts of 2005 revenue, (ii) slippages in the 2004 wage bill carrying over to 2005 and wage concessions made in early 2005 to end a prolonged teachers’ strike; (iii) the government’s decision to subsidize cotton producers, and (iv) various other measures that included an increase in allocations for public utilities to reflect actual consumption, preparation for the upcoming presidential elections, and the elimination of domestic payment arrears between the electricity parastatal and the general government. In addition, the government decided in early 2005 to recognize and settle its indebtedness vis-à-vis civil

[4] See Appendix IV on statistical issues. This breakdown of monetary statistics does not affect regional statistics and the conduct of monetary policy at the regional level, but it affects the assessment of monetary developments at the country level on which some decisions are made, such as for the reserve requirement.

servants for the financial incidence of automatic promotions whose payment had been suspended between 1987 and 1991 and gradually restored thereafter. If the government had not adopted offsetting measures, the overall budget deficit (excluding grants, on a cash basis) could have widened from 4.5 percent in 2004 to 8.4 percent of GDP in 2005.

Box 2. Benin: Settlement of Past Wage Liabilities and Civil Service Reform

Facing severe financial difficulties in the late 1980s, Benin's authorities froze civil service wages between 1987 and 1991 but not automatic promotions, which resulted in the nonpayment of the related financial benefits. Since then, general salary increases have been granted and the financial benefits of automatic promotions gradually restored, but the gap between actual salary payments and grade-based salaries was only closed in 2004.

Bowing to strong labor unions pressures, the government has agreed in early 2005 to compensate civil servants for the loss of income resulting from the delay in aligning salaries to their grade-based levels since the freeze of 1987. This agreement between the government and the labor unions is likely to have a major medium-term impact on Benin's fiscal position.

For 2005, the authorities aim to obtain a accurate assessment of the liabilities resulting from this regularization. On the basis of this assessment, they will define a strategy for the settlement of these unpaid benefits that will preserve fiscal and debt sustainability (MEFP, para. 25). They have included in the 2005 budget an allocation of about ½ of 1 percent of GDP for a partial settlement of this liability. Pending the assessment of the exact liabilities of the government and the adoption of an appropriate settlement strategy, the medium term program for 2006-08 includes provisions for the further settlement of this liability.

These developments underscore the importance of civil service reform. In this area, in which the World Bank has the lead, the focus is on revamping civil service regulations, designing an adequate recruitment policy, and introducing performance-base remuneration systems.

III. Policy Discussions

15. **Policy discussions focused on immediate measures to stabilize and restore the fiscal situation and to get structural reforms back on track, particularly in the cotton sector and the Port of Cotonou (see part B on the 2005 program), while establishing a stronger policy framework to meet medium term objectives (see part A below).** Discussions took place against the backdrop of heightened pressure on the government for social concessions that had contributed to delays in structural reforms and policy slippages. These slippages included a large increase in the 2004 civil service wage bill carried over into 2005 and the government's decision to maintain cotton producer prices broadly unchanged despite the sharp drop in cotton international prices.

A. Development Challenges and Medium-Term Objectives

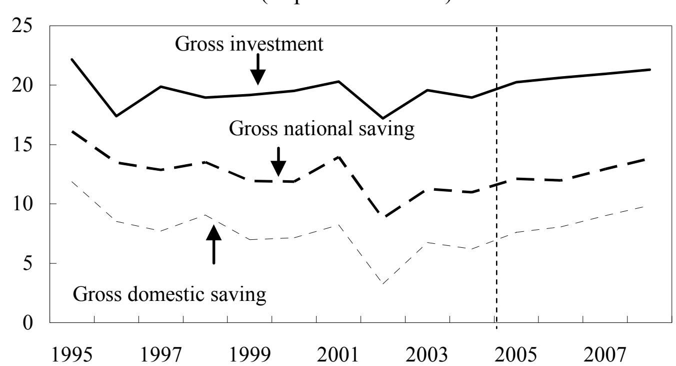
16. **The key challenges facing Benin are to achieve higher sustainable growth in a stable macroeconomic environment and to ensure that pro-growth, pro-poor policies translate into effective poverty reduction.** While recognizing that the continued implementation of the poverty reduction strategy and of prudent economic and financial policies was a prerequisite to address these challenges, the government focused its policy discussions on a development strategy driven by trade promotion and facilitation. The government's objectives are to diversify the economy and increase its resilience to external shocks in the medium term while ensuring that key economic sectors are developed in the short term, particularly the cotton sector, and that trade activities with Nigeria are reestablished.

Macroeconomic framework

17. **To implement this strategy, the Benin authorities have set the following basic macroeconomic objectives for the 2005-08 program** (i) achieve an average annual rate of growth of over 4½ percent, (ii) contain inflation to less than 3 percent a year, and (iii) improve the external current account balance (excluding official grants) to 7½ percent of GDP by 2008. The envisaged reforms of the cotton sector and the disengagement of the state from the sector will initiate an increase of cotton production toward its potential of about 600,000 tons of seed cotton. The progressive easing of trade restrictions in Nigeria will also restore and allow for an increase of trade and trade-related activities in the short run. These developments will be accompanied by the increased efficiency and restoration of the competitiveness of the Port of Cotonou through reforms that are being implemented. Moreover, the privatization of the telecommunications and energy parastatals will gradually contribute to higher growth by stimulating private investment and providing better services. Additional behind-the-border reforms, such as facilitating access to land and financial services, strengthening the judiciary system, developing public infrastructure and improving governance, will promote economic activities and trade in general.

18. **Benin's attainment of these objectives and targets will be supported by an increase in gross investment by nearly 2½ percentage points of GDP from 2004 to about 21½ percent in 2008.** More than two thirds of this increase will come from the public sector, in particular through expenditure in infrastructure and social sectors. Private sector investment will gradually increase as a result of the privatization and restructuring of key public

Figure 6. Benin: Saving and Investment
(In percent of GDP)



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

enterprises and improvement in the business environment (Figure 6). Gross domestic saving is projected to increase to about 14 percent of GDP by 2008, reflecting improvements in the financial positions of both the government and nongovernment sectors.

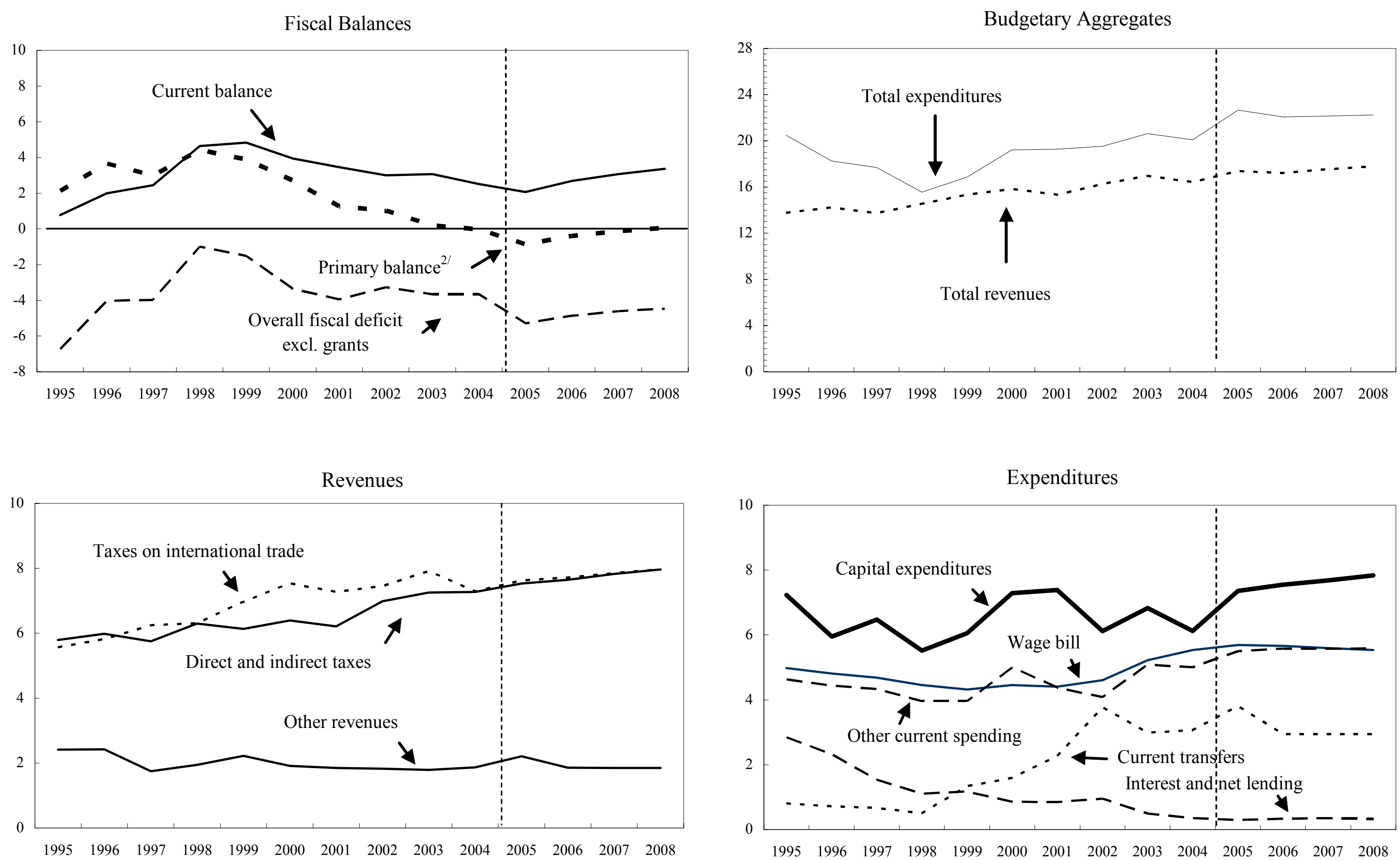
19. **Consistent with these objectives, the government's strategy will focus on** (i) strengthening public finances by mobilizing more revenue and restoring a narrow primary fiscal balance; (ii) maintaining a prudent monetary policy; (iii) deepening structural reforms to foster an environment conducive to private sector and trade development; and (iv) achieving progress in implementing the poverty reduction strategy.

20. **The fiscal strategy will be to maintain debt sustainability (with a ratio of the net present value of debt to exports around 140 percent), while implementing the expenditure plans in the PRSP.** The program targets a fiscal adjustment that also aims to correct for the projected deterioration of the budget outcomes in 2005 and to restore public finances on a sound path. The narrow fiscal primary deficit equivalent to 0.9 percent of GDP in 2005 is targeted to be eliminated by 2008 (Figure 7). This outcome is predicated on a revenue increase from 17.4 percent to 17.8 percent of GDP over the period and a decline in current primary expenditure of 0.9 percent of GDP—broadly the impact of the 2005 cotton subsidy—partially offset by an increase in domestically financed capital expenditure by 0.5 percent of GDP. The medium term fiscal framework also incorporates provisions for the settlement of government debt to civil servants. The program assumes that annual payments will be equivalent to about ½ of 1 percent of GDP per year over the program period. These projections will be revised when the verification of claims by civil servants is completed, and a clearance plan has been established.

21. **On the revenue side, the effort will focus on simplifying the tax system and widening the tax base through a reduction of exemptions, as well as further strengthening in tax and customs administration to enhance the system's buoyancy and elasticity**. The authorities have requested additional Fund technical assistance to achieve that objective. The tax revenue-to-GDP ratio is projected to return to the 2003 level in 2005, and increase steadily by one quarter of one percentage point of GDP per year thereafter to reach 16 percent by 2008.

22. **On the expenditure side, the program aims to stabilize current expenditure at 14½ percent of GDP and increase capital expenditure to nearly 8 percent of GDP**. Pending the 2006 update of the poverty reduction strategy and its medium term expenditure framework, the program reflects the priorities of the strategy in 2005 and provides for a restructuring of expenditure that will allow for an increase of expenditure on social and priority sectors beyond one-fourth of domestically financed expenditure. The wage bill will be contained at about 5.7 percent of GDP. Improvements in budgetary management will also contribute to increasing the quality of expenditure.

Figure 7. Benin: Selected Fiscal Indicators, 1995-2008 1/
(In percent of GDP)



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

1/ Data for 2005-08 are projections.
2/ Total revenue minus total expenditure, excluding foreign-financed investment and net lending.

23. **The medium term fiscal stance will allow Benin to comply with six out of nine convergence criteria of the WAEMU by 2008, compared with four in 2004 (Table 7)**, and to make good progress toward the achievement of the remaining three criteria (narrow fiscal deficit, tax revenue, and external current account balance targets).

Structural reforms

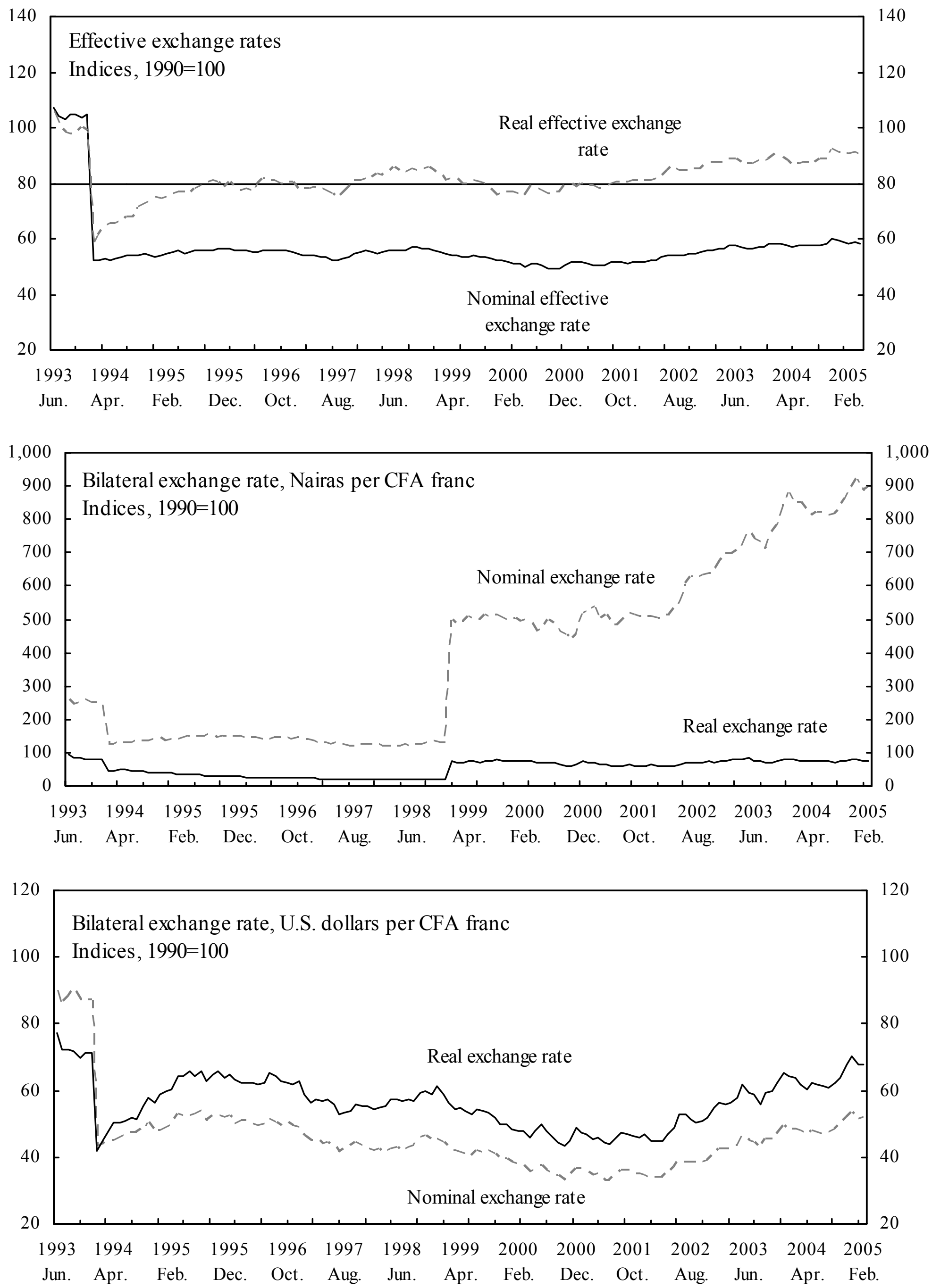
24. **In light of Benin's limited domestic market but advantageous location, the authorities concurred with the staff on the need to develop a trade-based growth strategy**. As Benin maintains a liberal trade and payments system, the discussions focused on the implementation of "behind the border" trade policies. These policies refer to institutional, regulatory, and structural reforms intended to support trade and investment liberalization by addressing domestic trade bottlenecks, such as high transport costs, limited access to inputs like land, and inadequate domestic regulations governing services, investment, and competition. Export development has, indeed, been hindered not only by the recent erosion of the competitive gains of the 1994 devaluation, but also by the lack of such policies (Figure 8).[5] The recommendations of a recent diagnostic trade integration study (DTIS) should help the authorities identify trade policy reforms with a view to including them in their development strategy as a complement to their structural reform agenda.

25. **The structural reform agenda will thus focus on the implementation of policies to facilitate and promote trade.** A priority of the program will be to complete the reforms of the Port of Cotonou and of the telecommunications and energy sectors. These reforms will be complemented, starting in 2006, by additional trade promotion measures that will emerge from the DTIS.

26. **Because the diversification of economic activities is likely to take time, another priority of the authorities' growth strategy will be to strengthen the competitiveness of existing activities, such as those in the cotton sector, and ensure the conditions for their development**. While expressing satisfaction with their decision to intervene in the sector and postpone the privatization of SONAPRA in 2004, the authorities agreed with the staff that it was not in the best interest of the country for the government to subsidize the sector and conduct commercial activities. They also expressed concerns about the sector's ability to

[5] Half of the competitive gains from the devaluation were lost by end-1995, and an additional one-fourth has eroded since 2001, reflecting the appreciation of the euro, to which the CFA franc is pegged. Recent estimates of the long-run equilibrium exchange rate point to some overvaluation of the current exchange rate and the need to foster productivity (Section IV of Country Report No. 04/370, 11/24/04, "Developments in the External Competitiveness of Benin"; and Box 3 of the paper on recent developments in the WAEMU).

Figure 8. Benin: Exchange Rate Indices, June 1993-April 2005



Sources: IMF, Information Notice System, and *International Financial Statistics,* various issues.

manage itself, the possible emergence of an oligopolistic structure for ginning activities, and the need to protect farmers. The authorities thus supported the need to implement further reforms to (i) strengthen the sectoral institutional framework, (ii) introduce a flexible domestic price mechanism that would reflect international prices and could be linked to a stabilization fund, and (iii) increase productivity in, and the competitiveness of, the cotton sector. Finally, the authorities agreed to abide by the rules of the memorandum of understanding that they signed with the other stakeholders in the cotton sector and that reaffirms the general framework and defines clear operational guidelines and responsibilities within the sector.

27. **Finally, the program will provide new impetus to the administrative reform of the civil service and deepen the reforms of the budget and public finance management, including the strengthening of governance**. Under the leadership of the World Bank, the reform of the civil service will focus on a revamping of civil service regulations and the establishment of a wage policy based on recognition of employee performance and an adequate recruitment policy (MEFP, paras. 9 and 15). Finally, the program also includes a reform of the pension fund for civil servants that aims at ensuring its financial viability.

B. Economic and Financial Program for 2005

Real sector

28. **Preliminary data suggest that economic growth in 2005 may be limited to 4 percent** because of the lingering effects of the trade restrictions imposed by Nigeria, the persistence of a difficult international environment, and the likely postponement of some private sector investment decisions in the period leading to the presidential elections. Moreover, the structural reforms to be implemented in 2005 will take some time to have an impact on economic activities and to remove impediments to higher growth. Inflation is expected to remain moderate.

Fiscal policy

29. **The fiscal stance in 2005 involves a tightening of fiscal policy to offset recent budgetary pressures and limit the deterioration of the narrow fiscal primary deficit to 0.9 percent of GDP in 2005, as originally envisaged in the budget law**. On the revenue side, measures equivalent to 1.1 percent of GDP have been taken to increase revenue to 17.4 percent in 2005. The ad hoc settlement of the electricity parastatal's obligations to the state—which arose because debt relief was not passed through—accounts for nearly half of this adjustment and increased nontax revenue by 0.5 percent of GDP.[6] The additional

---

[6] This settlement was used to cover the general government's own payment arrears for its electricity and water consumption.

increase in revenue reflects mainly improvements in tax and customs administration, because the tax measures introduced in the 2005 budget decreased revenue slightly. These tax measures consisted mainly in (i) adjusting income tax thresholds to reflect minimum wage increases, (ii) extending for another year existing exemptions on agricultural inputs and equipments and introducing a new exemption on seeds, and (iii) modifying various small taxes and clarifying the tax legislation. The administrative measures taken to strengthen the tax and customs administration include the introduction of a new taxpayer identification number, a strengthening of monitoring and controls of exemptions, and additional personnel and equipment. At the same time, the computerization of customs and the medium taxpayer unit of the tax department in Cotonou were improved. Nontax revenue will also be increased through the assessment and collection of fees from mobile telephone companies.

Benin: Fiscal Program, 2005

	2004	2005			
	Est.	Initial budget	Budgetary pressures	Adjustment measures	Revised budget
		(In percent of GDP)			
Total revenue	16.4	16.6	-0.3	1.1	17.4
Total expenditure	20.1	21.8	1.8	-1.0	22.6
Narrow primary expenditure	16.5	17.3	1.9	-1.0	18.2
Current primary expenditure	13.6	13.6	1.9	-0.5	15.0
Wages and pensions	6.8	6.5	0.5	0.0	7.0
Other current primary expenditure	6.8	7.1	1.4	-0.5	8.0
Domestically financed capital expenditur	2.9	3.8	0.0	-0.5	3.2
Externally financed capital expenditure	3.3	4.1	0.0	0.0	4.1
Interest payments	0.3	0.4	-0.1	0.0	0.3
Narrow primary balance	0.0	-0.8	-2.2	2.1	-0.9
Overall budget deficit (payment-order basis)	-3.7	-5.3	-2.1	2.1	-5.3
Payment arrears variation	-0.4	-0.1	-0.9	0.2	-0.9
Overall budget deficit (cash basis)	-4.5	-5.4	-3.0	2.3	-6.1

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

30. **On the expenditure side, the government approved reductions of budget appropriations by 1 percent of GDP to limit the increase in total expenditure to 22.6 percent of GDP in 2005.** It will reduce spending primarily by postponing some domestically financed capital expenditures and, secondarily, by cutting nonpriority current expenditures (MEFP, para. 20). Before the government adopted the measures—which represented a prior action designed to strengthen its ownership—it agreed with the IMF and World Bank staff on the structure and quality of the expenditure program.

31. **Taking into account the reduction of domestic payment arrears and government liabilities, the financing requirement of the budget is equivalent to 6 percent of GDP and will be mostly covered by external financing.** The government's recourse to domestic financing will be limited to 0.6 percent of GDP and reflects, in part, the net negative cash flow resulting from the privatization and restructuring of SONAPRA. The 2005 program is expected to be fully financed, because the African Development Bank (AfDB), the European Union, and France have expressed their intent to offer further assistance to close the financing gap.[7]

32. **The public finance reform program in 2005 aims to strengthen further expenditure management and address weaknesses identified by the recent country financial accountability assessment (CFAA) by the World Bank.** To this effect, the authorities have reinstated the automatic controls of the integrated computerized expenditure management system (SIGFIP) and strengthened the link between the budget and the treasury. In addition, they will substantially reduce treasury payments outside the regular budgetary expenditure management process (MEFP, para. 27). They also intend to better control their consumption of telephone services, water, and electricity with a view to reducing spending and avoiding any accumulation of domestic payments arrears (MEFP, para. 25). Finally, in an effort to improve transparency and good governance, they will improve the quality and reporting time of fiscal operations and accelerate the audit of the budget execution accounts and the completion of the budget settlement laws.

Monetary and financial sector issues

33. **The BCEAO will continue to conduct monetary policy at the regional level.** The program aims for a 12 percent pickup in credit to the private sector. The government is expected to keep a positive net credit position, despite a drawdown of its deposits in the banking system.

34. **The authorities, in close cooperation with the regional banking commission, will enforce all necessary measures to strengthen the financial system further.** Benin's banking system, comprising nine banks and two nonbank financial institutions at end-2004, is moderately sound. One bank is under provisional receivership and two institutions are under surveillance by the banking commission. In the context of strengthening the banking system, the banking commission will continue its close supervision of the system and intervene promptly if necessary. The government will also begin to disengage itself from the Continental Bank, in which it retains a 43 percent share. More broadly, the government will reform the civil service pension fund to eliminate its structural deficits.

---

[7] The program includes an adjustor that will allow for limited increase in domestic financing in the event of temporary delays in the disbursements of budgetary assistance to close the gap.

External sector policies

35. **The authorities' program aims to foster trade opportunities and activities for Benin.** In this context, they have been working with the private sector to set up export-processing zones (EPZs) and the related legislation is awaiting parliamentary approval. The staff cautioned the authorities about the risks of EPZs to government revenue and advised them to develop behind-the-border trade facilitating measures and incorporate the final DTIS recommendations in their trade development strategy, including to merge all government institutions assisting private investors into a single window for both investment and export promotion.

Structural measures

36. **In light of the recent economic slowdown and weak prospects, the authorities have indicated their commitment to give new impetus to structural reforms**. The main elements of the structural reform agenda for 2005 are (i) the implementation of a well-articulated reform program for the cotton sector, (ii) progress in reforming the Port of Cotonou, and (iii) progress in privatizing the electricity and telephone services and in implementing improved regulatory frameworks in these sectors.

37. **Under the 2005 program, the government will disengage from direct intervention in the cotton sector and has committed itself to a clear timetable for doing so.** To this effect and as a prior action for the circulation of its request for a Fund arrangement to the Board, the government has resumed transferring SONAPRA's ginneries to the private sector and signed sales protocols that commit it to completing these transfers by October 31, 2005. The authorities have also committed to giving full support to the other aspects of the cotton reform, such as strengthening the sector's institutional framework and introducing a transparent and flexible price system that could be coupled with a privately managed stabilization fund.

38. **The authorities will speed up the implementation of a centralized clearing and invoicing system at the Port of Cotonou and finish reviewing, by the end of 2005, the conditions for private sector participation in the management of the port**. These actions are expected to help restore the port's competitiveness. The centralized clearing and invoicing system will reduce delays in port clearance operations and minimize customs officers' harassment of port users. As a prior action to confirm their commitment to the program, the authorities have launched, with the assistance of the World Bank, a financial and physical audit of port activities that will result in a program for improving the port's competitiveness, and developing its activities. They have also taken steps to reduce costs and plan to open all port merchandise handling to competition and to restructure the public handling enterprise, SOBEMAP, with private sector participation (MEFP, para. 32).

39. **Finally, the program aims for substantial progress in the privatization of the telecommunications and electricity companies by end-2005.** The government has launched, as a prior action and with the assistance of the World Bank, the process of hiring a

new investment bank to advise the authorities in privatizing Benin Telecoms and strengthening the regulatory framework. The liberalization of telecommunications in Benin, where four mobile telephone licenses have already been awarded, preceded the development of an appropriate regulatory framework for the sector. The program seeks to correct such deficiencies. The World Bank is also assisting the authorities in bringing the electric power company to the point of sale (MEFP, para. 33).

IV. Debt Sustainability Analysis Update

40. **The new debt sustainability analysis (DSA) exercise, which was conducted jointly with the World Bank, incorporates updated data and reflects the new international environment**. The Beninese debt agency provided new data on the country's outstanding debt and related debt service at end-2003. The stock of debt outstanding is equivalent to 35 percent of GDP at end-2003, in line with previous projections.

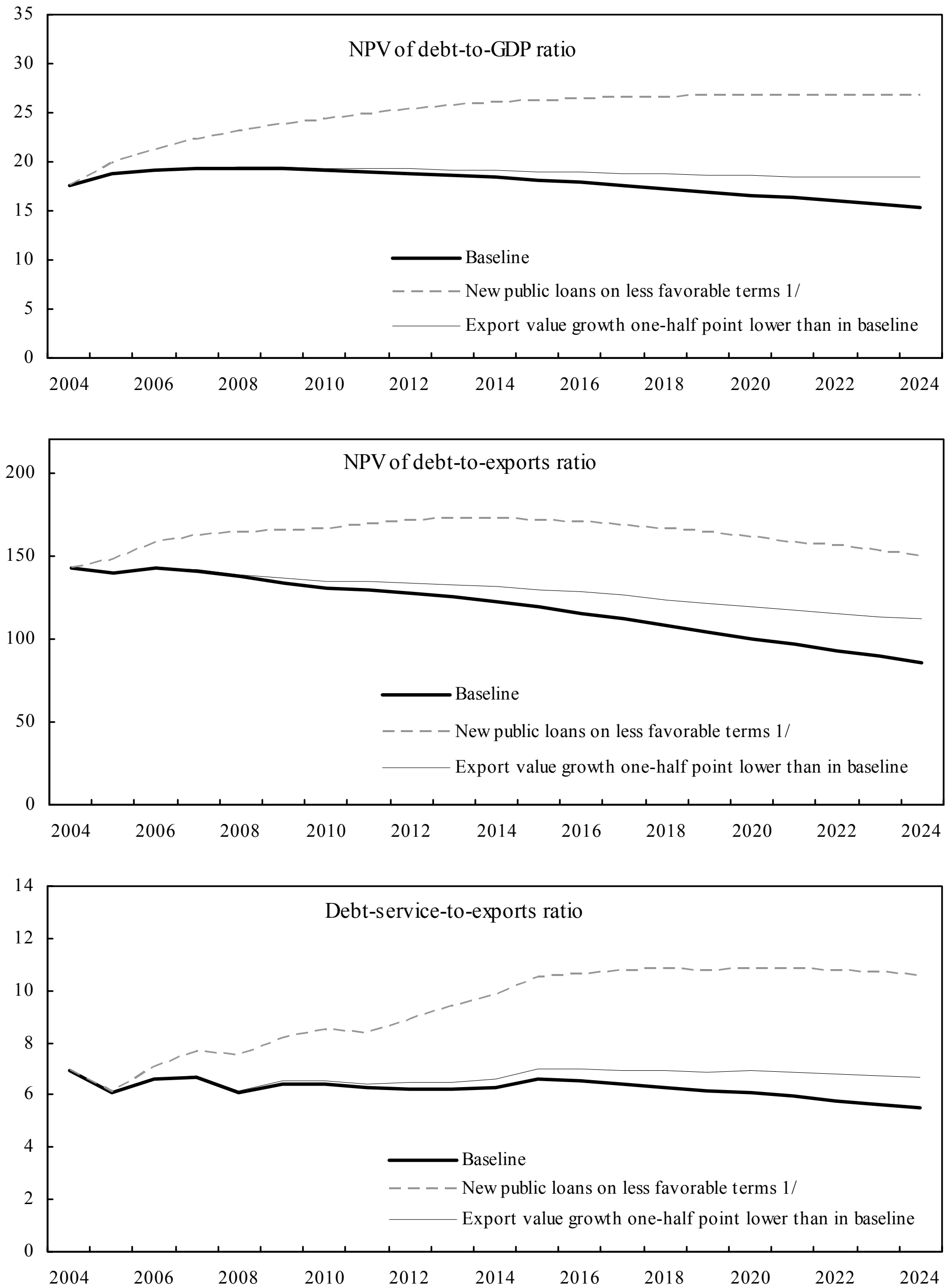
41. **Under the baseline scenario, Benin would remain on a sustainable path, despite a less favorable economic environment.**[8] Some of the downside risks previous DSAs considered possible have materialized. Exports, affected by the lower international price of cotton, would initially grow at a lower rate than previously projected. The fiscal stance would be slightly more expansionary, reflecting the settlement of past wage liabilities, and the overall fiscal deficit on a cash basis would average 4.5 percent of GDP. The path of GDP growth has also been revised downward, reflecting past delays in implementing the reform agenda. Nominal GDP growth would gradually converge toward 8 percent over the medium run with inflation under control at 2.5 percent. Despite the more difficult economic environment, the ratio of the net present value (NPV) of debt to exports would remain below 150 percent and decline over the projection period (Table 8). Public debt in terms of GDP should remain broadly constant at about 34 percent over the period 2005–07, and decline thereafter to reach 24 percent by 2024. The debt service is also projected to be sustainable, with the ratio of debt service to exports ratio remaining about 6.3 percent during the period under review.

42. **Sensitivity tests show that Benin's debt burden would worsen significantly in the event of an adverse macroeconomic shock**. In particular, less favorable terms on new public borrowing would increase the NPV of the debt-to-exports ratio beyond the sustainable threshold in the short and medium term. Another important downside risk consists of lower export growth, which would put Benin on an unsustainable path for a prolonged period. The risk is all the greater given Benin's dependence on cotton exports (Table 9 and Figure 9).

---

[8] The historical scenario presented in Table 9 results in a stronger debt sustainability trend than the current scenario mainly because of lower external current account and fiscal deficits in 1994-2003.

Figure 9. Benin: Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2004-24
(In percent)



Source: IMF staff projections and simulations.
1/ Assumes that the interest rate on new borrowing is 2 percentage points higher than in the baseline.

These tests highlight the need for Benin to maintain a prudent fiscal policy and to diversify its exports.

V. Program Monitoring

43. **The proposed PRGF-supported program will be monitored on the basis of the quantitative performance criteria and indicators presented in Section IV and Table 1 of the MEFP.** Understandings have been reached on quantitative performance criteria for end-September 2005 and indicative targets for end-December 2005. One structural performance criterion is proposed for the third disbursement and a number of structural benchmarks for the first year of the program, which were determined in close collaboration with the World Bank (Section IV and Table 2 of the MEFP; Box 3). The first review under the proposed arrangement, scheduled to be concluded no later than December 31, 2005, will be based on the end-September 2005 test date. The review will also assess Benin's progress in privatizing SONAPRA and in setting up the centralized clearing and invoicing center of the Port of Cotonou.

VI. Risks to the Program

44. **The success of the authorities' medium-term strategy will hinge on effective ownership of the program, including by broader society, as well as strong leadership to prevent program slippages**. The recent deterioration of economic conditions, reflecting in part slippages in fiscal policy and structural reforms, and the lack of progress in poverty reduction provided the authorities with a strong case for restoration of a sound policy framework.

45. **Policy developments in 2004 and early 2005 illustrate the main risks to the program.** Despite the comfortable majority supporting President Kérékou in parliament, Benin's track record shows that pressures from social partners and political resistance have contributed to delays in implementing the civil service reform and the privatization program. They have also threatened fiscal stability, such as in early 2005 when the government had to make wage concessions to end a prolonged strike by teachers and social workers. These social and political pressures may increase in the period leading up the presidential elections.

46. **The authorities have, nonetheless, shown their determination to maintain the renewed momentum in the implementation of reforms.** Cabinet endorsement of the program and the revised budget for 2005, the signing of protocols for the sale of the cotton parastatal ginneries by end-October 2005, publication of invitations to bid for the recruitment of a new advisor to take charge of the privatization of the telecommunications parastatal, and publication of invitations to bid for the realization of a development plan for the Port of Cotonou are all strong indications of the authorities' determination to restore sound policy. The disengagement of the state from the cotton parastatal by end-October 2005 will be an important signal especially in light of the importance of this parastatal in the rural sector. The authorities also believe that the support of their program under the PRGF will assist them in managing the economy, particularly in the period preceding the presidential elections.

Box 3. Benin: Structural Conditionality Under the Proposed PRGF Arrangement

Coverage of structural conditionality in the proposed program

Fund conditionality includes (i) for the cotton sector: completion of the privatization of SONAPRA's ginneries, including that a decision be made about the contested remaining lot of ginneries, (ii) for the Port of Cotonou: implementation of a single-invoicing software, setup of an operational centralized invoicing and clearing management center and elaboration of a development plan based on an operational audit of port activities, (iii) for the telecommunications parastatal Benin Telecoms SA: approval of a divestment strategy and launching of an international call for bids for its divestment, (iv) for the electricity parastatal SBEE: launching of an international call for bids for its divestment, and (v) for the budget: evaluation of the state liability vis-à-vis civil servants on account of the financial incidence of promotions and advances whose payments had been suspended in 1987-91 and then gradually restored; submission to the Audit Office of the 2004 budget execution accounts, and implementation of a new methodology to collect, compile, and report public finance statistics.

Status of structural conditionality included in previous programs

In the 2000-04 PRGF arrangement, structural conditionality focused on enhancing public expenditure management; strengthening tax administration; containing public spending, including the deficit of the pension fund; improving the financial situation of public enterprises; initiating the privatization program; and improving economic governance. The record of the structural reform program was mixed. On the positive side (i) the account balances of the treasury, foreign-financed projects, and agencies included in the financial operations of the central government were verified annually (thus improving expenditure management and control); (ii) Fund advice of the department of domestic taxes and for customs were implemented; (iii) the cross-debts of public enterprises with the government were audited; and (iv) the privatization process was initiated. However, civil service reform, the reform of the cotton sector, and the privatization of SONAPRA, SBEE, OPT, and the Port of Cotonou were not implemented.

Structural areas covered by World Bank lending and conditionality

World Bank support and conditionality concentrate on (i) private sector development and regulatory reforms; (ii) privatization; (iii) improvement in agricultural services, including in the cotton sector; (iv) improvement in public expenditure management; and (v) governance. The second Poverty Reduction Support Credit (PRSC-2) that was approved by the Bank in June 2005 supports (i) market transactions in agriculture; (ii) public expenditure management; and (iii) agricultural services, including for cotton.

VII. STAFF APPRAISAL

47. **Appropriate macroeconomic policies helped sustain Benin's robust economic growth and low inflation over the past decade to 2003 but further reduction in poverty has remained a concern.** Against that background, recent slippages in fiscal policy and structural reforms along with delays in implementing the 2002 PRSP are regrettable. Along with adverse external developments, these slippages contributed to a slowdown in growth and highlighted the vulnerability and dependence of Benin's economy on cotton and trade relations with Nigeria. The staff thus welcome the authorities' resolve, reflected in their reform program and recent policy actions, to reverse these slippages and establish a strong basis for growth and poverty reduction.

48. **The 2005-08 program aims to correct the recent policy slippages and restore sound public finances, while building on the recommendations of the ex post assessment of performance under Fund-supported programs and the thrust of the poverty reduction strategy.** To help Benin address the main challenge of achieving high, sustained growth and reducing poverty, the program focuses on (i) reinforcing macroeconomic stability by conducting prudent economic and financial policies and strengthening public finances through greater revenue mobilization and fiscal adjustment, (ii) implementing an export-led development strategy to reduce the vulnerability of the economy to external shocks and its dependency on cotton and trade with Nigeria, (iii) deepening structural reforms to foster an environment conducive to private sector and trade development, and (iv) achieving progress in the implementation of Benin's poverty reduction strategy.

49. **The authorities will need to implement prudent economic and financial policies.** The envisaged strengthening of public finances will help ensure debt sustainability while Benin is implementing its poverty reduction strategy that involves, among other objectives, improving the access to basic education, primary health care, and safe drinking water through a restructuring and increase of public expenditure to ensure better availability, use and quality of these social services. Increasing the tax-revenue-to-GDP ratio through a simplification of the tax system, an extension of the tax base, and a reinforcement of tax and customs administration is a pillar of the medium-term strategy. The government will have to avoid budgetary slippages including those related to interventions in the cotton sector. In this regard, it will be essential for the authorities to achieve better control and prevent repeated overruns of the wage bill. Monetary policy at the regional and country levels should keep inflation moderate.

50. **The staff understands the government's need to settle the outstanding obligations to civil servants.** Nonetheless, settling these obligations that accrued over the period 1987-2004 constitutes a threat to medium term fiscal sustainability that will need to be addressed carefully. Priority should be given to an accurate estimate of the government's liability in this regard and development of a settlement strategy that (i) preserves debt and

fiscal sustainability, and (ii) is linked to progress in the implementation of civil service reform, including the streamlining of the civil service that would permit competitive compensation while containing the wage bill. Staff urges the authorities to take early actions, agreed with the World Bank, to address these issues.

51. **The revision of the poverty reduction strategy and its related medium term expenditure framework should be initiated without delay** and draw on recent experiences in the implementation of the strategy, putting a stronger emphasis on improving delivery of services to the population. A closer integration of the poverty reduction strategy monitoring and evaluation process with the policy cycle will also contribute to greater alignment of the budget with the medium term expenditure frameworks and the PRSP within an integrated framework.

52. **Benin's macroeconomic management would benefit from improving the statistical system.** An issue on which the staff places significant weight is improvement in monetary statistics. In particular the estimation of currency in circulation would allow for a better analysis of recent developments and provide more appropriate support for monetary policy decisions at the country level. The envisaged strengthening of public finance data collection and reporting will also improve transparency and promote good governance.

53. **The success of Benin's export-led development strategy depends on the implementation of structural reforms to restore its external competitiveness, especially in the cotton sector, and lay the groundwork for private sector investment**. Behind-the-border policies to promote and remove impediments to trade are an appropriate priority. The envisaged strengthening of the cotton sector to improve its competitiveness is particularly important, as are the programmed reforms of the Port of Cotonou and the privatization of the telecommunications and energy parastatals.

54. **In the cotton sector, the government should disengage from direct productive activities, respect the recent sectoral agreement signed by all stakeholders, and strengthen the institutional framework**. Given foreseeable market developments, speedy privatization of all commercial activities in the cotton sector and rapid improvement in the effectiveness of extension services will be crucial to maintaining the viability of cotton production in Benin. The government needs to create a level playing field for private participants, raise market confidence, and lay the groundwork for higher productivity.

55. **The authorities should benefit from the recommendations of the integrated framework initiative to facilitate and promote trade.** Benin could be a hub for Nigeria and the main transit point for the international trade of landlocked neighboring countries. Trade and trade-related services, such as transportation, could contribute to the acceleration of growth needed to reduce poverty and meet the Millennium Development Goals (MDGs; Table 10). Efforts to restore and further develop trade relations with Nigeria should be actively pursued. The establishment of EPZs could add to Benin's difficulties in fighting corruption in customs without significantly improving its export performance, and should thus be strictly ring-fenced.

56. **The reform of the Port of Cotonou is another key element of Benin's development strategy.** Easing the bottleneck created by inefficient harbor activities is a prerequisite for increased trade. The specific measures envisaged in 2005 would improve the efficiency and competitiveness of harbor operations while laying the groundwork for further development of the port in the context of a larger private sector role in managing the port.

57. **The reforms envisaged in the telecommunications and energy sectors would help restore Benin's economic competitiveness, improve the delivery of services and reduce business costs.** The privatization of the telecommunications and electricity parastatals should be accompanied by a strengthening of the regulatory frameworks to ensure the success of these reforms. The restructuring of the water, power, and telephone companies, including the participation of the private sector in managing them, should help accelerate the development of infrastructures that will make basic services accessible to the population.

58. The authorities' program represents a renewed commitment to recover lost ground and establish a sold foundation for sustainable growth and poverty reduction. Recent economic developments alerted the authorities to the consequences of policy slippages and their program, to be supported by the proposed PRGF arrangement, is a statement of their renewed commitment to change reflected also in strong prior actions.[9] The program also offers a formal framework for policy decisions that would allow the government to manage the economy effectively, particularly in the period preceding the presidential elections. On this basis, the staff believe that the authorities' adjustment and reform efforts deserve to be supported under the PRGF.

[9] The implementation of those measures was a condition for circulating the request for a new arrangement to the Executive Board.

Table 1. Benin: Proposed Schedule of Disbursements Under the PRGF Arrangement, 2005-2008 1/

Amount	Available Date	Conditions Necessary For Disbursement 2/
SDR 0.88 million	August 5, 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 0.88 million	June 10, 2006	Observance of performance criteria for March 31, 2006, completion of the second review under the arrangement.
SDR 0.88 million	December 10, 2006	Observance of performance criteria for September 30, 2006, completion of the third review under the arrangement.
SDR 0.88 million	June 10, 2007	Observance of performance criteria for March 31, 2007, completion of the fourth review under the arrangement.
SDR 0.88 million	December 10, 2007	Observance of performance criteria for September 30, 2007, completion of the fifth review under the arrangement.
SDR 0.91 million	June 10, 2008	Observance of performance criteria for March 31, 2008, completion of the sixth review under the arrangement.

Source: International Monetary Fund.

1/ Assuming access equivalent to 10 percent of quota, or SDR 6.19 million.
2/ Other than the generally applicable conditions under the Poverty Reduction and Growth Facility (PRGF) arrangement, including the performance clausde on the exchange and trade system.

Table 2. Benin: Indicators of Fund Credit, 2004-15
(In millions of SDRs, unless otherwise specified) 1/

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Outstanding Fund credit, end of period	42.0	37.8	33.7	30.1	25.3	19.0	13.5	9.4	6.2	3.8	2.5	1.3
Based on outstanding credit at end-2004	42.0	36.1	30.1	24.8	19.2	12.8	7.4	3.8	1.3	0.1	0.0	0.0
Based on new PRGF arrangement	0.0	1.8	3.5	5.3	6.2	6.2	6.1	5.7	4.9	3.7	2.5	1.3
Change in Fund credit outstanding		-4.2	-4.2	-3.6	-4.8	-6.4	-5.5	-4.1	-3.2	-2.4	-1.4	-1.1
Disbursements under PRGF arrangement		1.8	1.8	1.8	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments		-5.2	-5.9	-5.3	-5.6	-6.4	-5.5	-4.1	-3.2	-2.4	-1.4	-1.1
Total debt service due to the Fund (before HIPC Initiative)		5.6	6.3	5.7	6.0	6.7	5.8	4.3	3.5	2.6	1.6	1.2
Principal		5.2	5.9	5.3	5.6	6.4	5.5	4.1	3.2	2.4	1.4	1.1
Interest		0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.1
Debt service on stock of debt at end-2004												
Principal		5.2	5.9	5.3	5.6	6.4	5.4	3.6	2.4	1.2	0.1	0.0
Interest		0.4	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.1
Debt service on new PRGF arrangement												
Principal		0.0	0.0	0.0	0.0	0.0	0.1	0.4	0.8	1.1	1.2	1.1
Interest		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Approved HIPC Initiative assistance		-0.8	-0.9	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total debt service due to the Fund after HIPC Initiative		4.8	5.4	4.8	6.0	6.7	5.8	4.3	3.5	2.6	1.6	1.2
Net use of Fund resources after HIPC Initiative 2/		-3.0	-3.6	-3.0	-5.1	-6.7	-5.8	-4.3	-3.5	-2.6	-1.6	-1.2
Memorandum items:												
Debt service to the Fund												
As percent of total public debt external debt service		40.2	38.9	31.4	35.9	35.6	27.9	19.8	14.5	9.9	5.3	3.7
As percent of exports of goods and services		2.5	2.7	2.2	2.2	2.3	1.8	1.2	0.9	0.6	0.3	0.2
As percent of GDP		0.3	0.4	0.3	0.3	0.3	0.3	0.2	0.1	0.1	0.1	0.0
As percent of total revenues		1.9	2.1	1.7	1.8	1.8	1.5	1.0	0.7	0.5	0.3	0.2
As percent of gross reserves		4.1	4.9	4.5	5.0	5.6	4.9	3.6	2.9	2.1	1.3	1.0
Fund credit outstanding (percent of quota)	67.9	61.1	54.4	48.6	41.0	30.7	21.8	15.2	10.0	6.2	4.0	2.1
Benin's quota in the Fund	61.9											
U.S. dollars / SDR (end of period)	1.54	1.52	1.52	1.52	1.52	1.52	1.52	1.52	1.52	1.52	1.52	1.52

Sources: IMF, Finance Department; and IMF staff estimates and projections.

1/ Data for 2005-15 are projections.
2/ Disbursements under PRGF arrangement minus debt service to the Fund.

Table 3. Benin: Main Economic and Financial Indicators, 2002-08

	2002	2003	2004	2005	2006	2007	2008
			Est.	Prog.		Proj.	
			(Annual changes in percent, unless otherwise indicated)				
National income							
GDP at current prices	6.8	5.7	3.4	5.8	6.5	7.3	8.1
GDP at constant prices	4.5	3.9	3.1	3.9	4.4	5.1	5.5
GDP deflator	2.2	1.7	0.3	1.8	2.0	2.2	2.5
Consumer price index (average)	2.4	1.5	0.9	2.5	2.5	2.5	2.5
Consumer price index (end of period)	1.2	0.8	2.6	2.5	2.5	2.5	2.5
Production of cotton (in '000 of tons)	400.7	337.5	333.1	425.0	416.5	437.3	463.6
Central government finance							
Revenue	13.2	10.2	0.2	11.8	5.6	9.4	9.6
Expenditure and net lending	8.2	11.6	0.7	19.2	3.8	7.7	8.5
Money and credit							
Net domestic assets 1/	4.6	11.3	4.2	11.1	...	...	...
Domestic credit 1/	7.5	12.8	4.4	11.1	...	...	...
Net claims on central government 1/	2.3	-0.2	1.8	3.0	...	...	...
Credit to the nongovernment sector	16.1	33.0	4.5	12.1	...	...	...
Broad money	-3.8	-12.7	-5.0	5.8	...	...	...
Velocity (GDP relative to average M2)	3.4	3.6	4.4	4.7	...	...	...
External sector (in terms of CFA francs)							
Exports, f.o.b.	-3.9	14.2	3.0	7.3	4.1	10.1	11.8
Imports, f.o.b.	13.8	3.6	3.9	5.8	6.0	5.9	7.3
Export volume	10.4	11.6	-13.6	28.1	6.0	7.3	6.9
Import volume	5.5	4.7	3.0	3.6	4.6	5.3	5.9
Terms of trade	-19.3	3.4	18.1	-18.0	-3.1	2.1	3.2
Nominal effective exchange rate (minus = depreciation)	6.4	4.8	3.2	...	...	...	...
Real effective exchange rate (minus = depreciation)	5.5	4.1	2.6	...	...	...	...
			(In percent of GDP, unless otherwise indicated)				
Basic ratios							
Gross investment	17.2	19.6	19.0	20.3	20.6	21.0	21.3
Government investment	6.1	6.8	6.1	7.4	7.5	7.7	7.8
Private sector investment	11.1	12.8	12.8	12.9	13.1	13.3	13.5
Gross domestic saving	3.3	6.7	6.2	7.6	8.1	9.0	9.9
Government saving	6.1	6.3	3.8	4.4	5.2	5.1	5.4
Nongovernment saving	-2.8	0.5	2.4	3.2	2.8	3.9	4.5
Gross national saving	8.8	11.2	11.0	12.1	12.0	12.9	13.8
Central government finance							
Revenue	16.3	17.0	16.4	17.4	17.2	17.5	17.8
Expenditure and net lending	19.5	20.6	20.1	22.6	22.1	22.2	22.2
Primary balance 2/	1.0	0.2	0.0	-0.9	-0.4	-0.1	0.1
Primary balance (narrow definition) 3/	1.0	0.2	0.0	-0.9	-0.4	-0.1	0.1
Overall fiscal deficit (payment-order basis, excluding grants)	-3.3	-3.7	-3.7	-5.3	-4.9	-4.6	-4.5
Overall fiscal deficit (cash basis, excluding grants)	-4.3	-3.7	-4.5	-6.1	-5.5	-5.1	-4.9
Debt service (after debt relief) in percent of revenue	4.5	3.2	1.6	1.3	1.9	2.0	1.9
External sector							
Trade balance	-12.2	-11.3	-11.4	-11.3	-11.4	-10.9	-10.5
Current account balance (excluding grants)	-8.6	-8.6	-8.7	-8.7	-8.7	-8.0	-7.5
Current account balance	-8.4	-8.3	-8.0	-8.2	-8.7	-8.0	-7.5
Overall balance of payments	-3.6	-5.6	-2.5	-1.7	-2.5	-2.1	-1.5
Debt-service-to-exports ratio 4/	12.5	6.9	6.9	6.1	6.6	6.7	6.1
Net present value of debt-to-exports ratio 4/	244.2	147.0	142.1	139.4	142.3	140.4	137.2
Debt-to-GDP ratio 4/	42.8	34.7	32.4	34.1	34.3	34.1	33.7
Gross reserves in months of imports	8.8	7.9	6.1	5.1	4.5	4.2	4.0
Nominal GDP (in billions of CFA francs)	1,956.7	2,067.9	2,138.2	2,261.5	2,408.7	2,585.7	2,794.6
CFA francs per U.S. dollar (period average)	694.6	580.1	527.6	499.2	499.5	499.1	498.9
Population (midyear, in millions)	6.8	7.0	7.2	7.4	7.6	7.9	8.1

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

1/ In percent of broad money at the beginning of the period.
2/ Total revenue minus all expenditures, excluding interest due.
3/ Total revenue minus all expenditures, excluding foreign-financed capital expenditure and interest due.

Table 4. Benin: Balance of Payments, 2002-08

	2002	2003	2004	2005 Est.	2006 Proj.	2007 Proj.	2008 Proj.
	(In billions of CFA francs)						
Trade balance 1/	-239.7	-232.8	-243.3	-255.0	-274.1	-281.9	-293.2
Exports, f.o.b.	147.3	168.1	173.1	185.7	193.3	212.9	238.0
Cotton and textiles	99.3	116.2	114.2	118.1	115.0	125.2	139.8
Other	48.0	52.0	58.9	67.6	78.3	87.7	98.1
Imports, f.o.b.	-387.0	-400.9	-416.4	-440.8	-467.4	-494.8	-531.1
Of which: petroleum products	-53.0	-61.9	-80.6	-95.3	-93.7	-92.2	-94.2
Services (net)	-33.1	-32.9	-29.1	-30.9	-28.9	-27.0	-26.1
Credit	117.7	114.7	111.7	118.8	131.4	143.4	156.5
Debit	-150.8	-147.6	-140.8	-149.7	-160.3	-170.4	-182.6
Income (net)	-18.1	-24.7	-22.0	-22.8	-25.7	-27.3	-28.2
Of which: interest due on government debt	-14.3	-11.3	-5.8	-5.0	-8.0	-9.1	-9.3
Current transfers (net)	125.9	117.7	123.6	124.3	120.2	129.0	138.5
Unrequited private transfers	55.3	50.8	57.5	58.7	62.9	67.4	72.3
Public current transfers	70.6	66.9	66.1	65.6	57.2	61.6	66.3
Of which: program grants	3.7	3.5	14.8	12.4	0.0	0.0	0.0
Current account balance	-165.0	-172.6	-170.9	-184.4	-208.5	-207.2	-208.9
Current account balance (excl. program grants)	-168.7	-176.1	-185.7	-196.8	-208.5	-207.2	-208.9
Capital account balance	22.7	103.2	40.9	53.2	56.7	60.8	66.7
Official project grants	22.7	35.6	40.9	53.2	56.7	60.8	66.7
Debt cancellation 2/	0.0	67.6	0.0	0.0	0.0	0.0	0.0
Financial account (net)	71.5	-46.9	76.3	92.2	91.9	90.8	99.8
Medium- and long-term public capital	39.9	27.3	42.8	56.7	37.1	38.5	43.3
Disbursements	58.6	47.4	52.1	66.6	46.6	49.8	54.4
Project loans	58.6	41.0	32.6	43.9	46.6	49.8	54.4
Program loans	0.0	6.3	19.5	22.7	0.0	0.0	0.0
Amortization due	-18.8	-20.1	-9.3	-9.9	-9.6	-11.3	-11.1
Principal not yet due 2/	--	-67.6	--	--	--	--	--
Medium- and long-term private capital	8.8	18.8	25.0	6.8	34.7	22.2	25.3
Deposit money banks	-3.0	37.4	-7.8	0.0	-1.0	-1.0	-2.0
Short-term capital	19.6	37.9	20.0	28.7	21.1	31.1	33.2
Errors and omissions	6.2	-100.7	-3.7	0.0	0.0	0.0	0.0
Overall balance	-70.9	-116.3	-53.6	-38.9	-60.0	-55.6	-42.4
Financing	70.9	116.3	53.6	25.0	10.0	5.0	-5.0
Change in net foreign assets (minus = increase)	53.1	99.3	53.6	25.0	10.0	5.0	-5.0
Of which: net use of Fund resources	-6.8	-3.4	-2.6	-1.9	-5.2	-4.8	-5.0
Debt relief obtained	17.8	17.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	13.9	50.1	50.6	47.4
Identified financing	0.0	0.0	0.0	13.9	0.0	0.0	0.0
Remaining financing gap	0.0	0.0	0.0	0.0	50.1	50.6	47.4
Memorandum items:	(In percent of GDP, unless otherwise indicated)						
Current account balance	-8.4	-8.3	-8.0	-8.2	-8.7	-8.0	-7.5
Current account balance (excl. program grants)	-8.6	-8.5	-8.7	-8.7	-8.7	-8.0	-7.5
Trade balance	-12.2	-11.3	-11.4	-11.3	-11.4	-10.9	-10.5
Exports	7.5	8.1	8.1	8.2	8.0	8.2	8.5
Imports	-19.8	-19.4	-19.5	-19.5	-19.4	-19.1	-19.0
Services and income (net)	-2.6	-2.8	-2.4	-2.4	-2.3	-2.1	-1.9
Current transfers (net)	6.4	5.7	5.8	5.5	5.0	5.0	5.0
Capital account balance	1.2	5.0	1.9	2.4	2.4	2.4	2.4
Financial account balance	3.7	-2.3	3.6	4.1	3.8	3.5	3.6
Overall balance	-3.6	-5.6	-2.5	-1.7	-2.5	-2.1	-1.5
Financing gap	0.0	0.0	0.0	0.6	2.1	2.0	1.7
GDP (in billions of CFA francs)	1,956.7	2,067.9	2,138.2	2,261.5	2,408.7	2,585.7	2,794.6

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

1/ Excluding reexports amd imports for reexports whose net balance is allocated between services and public transfers.

2/ The entry in 2003 is for the stock of debt operation at the HIPC Initiative completion point.

Table 5. Benin: Consolidated Central Government Operations, 2002-08

	2002	2003	2004	2005	2006	2007	2008
			Est.	Prog.		Proj.	
	(In billions of CFA francs)						
Total revenue	318.2	350.7	351.4	392.8	414.6	453.6	497.0
Tax revenue	282.5	313.6	311.4	342.9	369.9	405.7	445.4
Tax on international trade	145.9	163.6	155.9	172.6	185.8	203.2	222.8
Direct and indirect taxes	136.6	150.0	155.5	170.3	184.1	202.5	222.6
Nontax revenue	35.7	37.1	40.0	49.9	44.7	47.9	51.6
Total expenditure and net lending	382.1	426.3	429.5	512.2	531.8	572.8	621.6
Current expenditures	259.3	287.2	297.8	345.8	350.0	374.3	402.7
Current primary expenditures	243.7	274.9	290.8	339.1	341.8	365.0	393.3
Wages	90.1	108.0	118.3	128.7	136.4	144.6	154.8
Pensions and scholarships	21.5	25.7	26.7	28.8	30.9	33.2	35.9
Transfers and current expenditures	132.2	141.3	145.8	181.6	174.4	187.2	202.7
Current transfers	73.7	61.8	65.5	86.1	71.0	76.2	82.4
Other current expenditure	58.4	79.5	80.3	95.5	103.4	111.0	120.3
Interest	15.5	12.3	7.0	6.7	8.2	9.3	9.4
Internal debt	1.2	1.0	1.2	1.7	0.2	0.2	0.2
External debt	14.3	11.3	5.8	5.0	8.0	9.1	9.3
Capital expenditures and net lending	122.9	139.1	131.7	166.4	181.8	198.5	218.9
Investment	119.6	141.1	131.0	166.4	181.8	198.5	218.9
Financed by domestic resources	54.5	71.8	61.2	73.1	82.4	91.9	101.9
Financed by external resources	65.1	69.3	69.8	93.3	99.3	106.6	117.0
Net lending (minus = reimbursement)	3.2	-2.0	0.7	0.0	0.0	0.0	0.0
Overall balance (payment order basis, excl. gra	-63.9	-75.7	-78.1	-119.4	-117.1	-119.2	-124.7
Change in arrears	-6.7	-2.1	-8.5	-15.4	-15.0	-13.0	-13.0
External debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic debt	-6.7	-2.1	-8.5	-15.4	-15.0	-13.0	-13.0
Payments during complementary period/floa	-13.8	1.3	-10.7	-4.0	0.0	0.5	1.0
Overall balance (cash basis, excl. grants)	-84.4	-76.4	-97.3	-138.8	-132.1	-131.7	-136.7
Financing	84.4	76.5	97.2	124.9	82.1	81.1	89.3
Domestic financing	11.4	-3.2	2.4	6.4	-7.7	-14.3	-16.6
Bank financing	13.7	-1.2	8.9	14.4	-16.7	-9.3	-10.6
Net use of Fund resources	-6.8	-3.5	-2.8	-2.1	-2.7	-2.3	-3.6
Other	20.4	2.3	11.7	16.5	-14.0	-7.0	-7.0
Nonbank financing	-2.3	-2.0	-6.5	-8.0	9.0	-5.0	-6.0
Privatization	0.0	3.8	1.6	25.0	15.0	0.0	0.0
Restructuring	-1.7	-3.4	-5.3	-13.0	-6.0	-5.0	-6.0
Other	-0.6	-2.4	-2.8	-20.0	0.0	0.0	0.0
External financing	73.1	79.6	94.8	118.5	89.8	95.3	105.9
Project financing	70.4	69.3	69.8	93.3	99.3	106.6	117.0
Grants	15.3	31.9	40.9	53.2	56.7	60.8	66.7
Loans	55.1	37.4	28.9	40.1	42.7	45.8	50.3
Amortization due	-18.8	-17.9	-9.3	-9.9	-9.6	-11.3	-11.1
Program aid	3.7	11.2	34.3	35.1	0.0	0.0	0.0
Grants	3.7	4.9	14.8	12.4	0.0	0.0	0.0
Loans	0.0	6.3	19.5	22.7	0.0	0.0	0.0
Debt relief obtained	17.8	17.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	13.9	50.1	50.6	47.4
Identified financing	0.0	0.0	0.0	13.9	0.0	0.0	0.0
Remaining financing gap	0.0	0.0	0.0	0.0	50.1	50.6	47.4
Memorandum items:	(In percent of GDP, unless otherwise indicated)						
Total grants and revenue	17.2	18.7	19.0	20.3	19.6	19.9	20.2
Grants	1.0	1.8	2.6	2.9	2.4	2.4	2.4
Revenue	16.3	17.0	16.4	17.4	17.2	17.5	17.8
Total expenditure	19.5	20.6	20.1	22.6	22.1	22.2	22.2
Of which: wage bill	4.6	5.2	5.5	5.7	5.7	5.6	5.5
Capital expenditure	6.1	6.8	6.1	7.4	7.5	7.7	7.8
Overall balance (payment order basis, excl. gra	-3.3	-3.7	-3.7	-5.3	-4.9	-4.6	-4.5
Overall balance (payment order basis, incl. gra	-2.3	-1.9	-1.0	-2.4	-2.5	-2.3	-2.1
Primary balance	-2.5	-3.1	-3.3	-5.0	-4.5	-4.3	-4.1
Primary balance (narrow definition) 1/	1.0	0.2	0.0	-0.9	-0.4	-0.1	0.1
Current balance	3.0	3.1	2.5	2.1	2.7	3.1	3.4
Debt relief (in billions of CFA francs)	15.9	14.8	20.0	19.6	21.9	22.4	24.0
GDP (in billions of CFA francs)	1,956.7	2,067.9	2,138.2	2,261.5	2,408.7	2,585.7	2,794.6

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

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

Table 6. Benin: Monetary Survey, 2000-05

	2000	2001	2002	2003	2004 Est.	2005 Prog.
	(In billions of CFA francs)					
Net foreign assets	352.7	476.8	426.7	290.0	244.2	219.2
Central Bank of West African States (BCEAO)	261.5	371.2	318.1	218.8	165.1	140.1
Banks	91.2	105.6	108.6	71.2	79.1	79.1
Net domestic assets	172.9	115.7	143.1	207.3	228.1	280.3
Domestic credit	181.7	133.4	178.1	251.0	273.1	325.3
Net claims on central government	-12.3	-60.1	-46.5	-47.7	-38.8	-24.4
Credit to the nongovernment sector	194.0	193.5	224.6	298.7	312.1	349.8
Other items (net)	-8.8	-17.7	-35.1	-43.5	-45.0	-45.0
Broad money (M2)	525.6	592.5	569.8	497.3	472.3	499.5
Currency	211.2	223.8	170.9	80.0	35.0	37.0
Bank deposits	308.3	360.1	391.9	409.9	429.2	453.9
Deposits with postal checking accounts	6.1	8.6	7.0	7.4	8.1	8.6
	(Change in percent of beginning-of-period broad money, unless otherwise indicated)					
Net foreign assets	10.7	23.6	-8.5	-24.0	-9.2	-5.3
Net domestic assets	10.5	-10.9	4.6	11.3	4.2	11.1
Domestic credit	9.4	-9.2	7.5	12.8	4.4	11.1
Net claims on government	0.3	-9.1	2.3	-0.2	1.8	3.0
Credit to nongovernment sector	9.1	-0.1	5.2	13.0	2.7	8.0
Broad money (percentage change over beginning of period)	21.2	12.7	-3.8	-12.7	-5.0	5.8
Velocity of broad money (GDP relative to average M2)	3.5	3.3	3.4	3.9	4.4	4.7
Credit to the nongovernment sector (annual change in percent)	25.5	-0.3	16.1	33.0	4.5	12.1
Broad money as share of GDP	31.3	32.3	29.1	24.0	22.1	22.1
Nominal GDP (in billions of CFA francs)	1,679.7	1,832.2	1,956.7	2,067.9	2,138.2	2,261.5
GDP growth in nominal terms (annual change in percent)	9.6	9.1	6.8	5.7	3.4	5.8

Sources: BCEAO; and IMF staff estimates and projections.

Table 7. Benin: Compliance with Convergence Criteria
of the West African Economic and Monetary Union, 2001-08

	Convergence criteria	2001	2002	2003	2004	2005	2006	2007	2008
Primary criteria									
Basic fiscal balance (in percent of GDP) 1/	≥ 0.0	0.4	0.1	-0.3	-0.4	-1.2	-0.7	-0.5	-0.3
Inflation (in percent, annual average)	≤ 3.0	4.0	2.4	1.5	0.9	2.5	2.5	2.5	2.5
Total debt (in percent of GDP) 3/	≤ 70.0	55.5	42.8	34.7	32.4	34.1	34.3	34.1	33.7
Nonaccumulation of domestic arrears 4/	≤ 0.0	-6.7	-6.7	-2.1	-8.5	-15.4	-15.0	-13.0	-13.0
Nonaccumulation of external arrears 4/	≤ 0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Secondary criteria									
Wage bill (in percent of tax revenue)	≤ 35.0	32.7	31.9	34.4	38.0	37.5	36.9	35.7	34.7
Domestically-financed investment (in percent of tax revenue)	≥ 20.0	22.4	19.3	22.9	19.7	21.3	22.3	22.6	22.9
External current account deficit, excluding Program grants (in percent of GDP)	≤ 5.0	6.4	8.4	8.3	8.0	8.2	8.7	8.0	7.5
Tax revenue (in percent of GDP)	≥ 17.0	13.5	14.4	15.2	14.6	15.2	15.4	15.7	15.9

Sources: Beninese authorities; and IMF staff estimates.

1/ The basic fiscal balance is defined as total revenue minus total expenditure, excluding foreign-financed investment.
2/ Basic fiscal balance, excluding the use of enhanced HIPC Initiative resources.
3/ Includes domestic and external debt.
4/ In billions of CFA francs.

Tableau 8. Benin: External Debt Sustainability Framework, Baseline Scenario, 2003-2024 1/
(In percent of GDP, unless otherwise indicated)

	2003	Historical average 6/	Standard deviation 6/	Est. 2004	Projections 2005	2006	2007	2008	2009	2010	2004-10 Average	2014	2024	2011-24 Average
External debt (nominal) 1/	**34.7**			**32.4**	**34.1**	**34.3**	**34.1**	**33.7**	**33.1**	**32.5**	**33.6**	**29.9**	**24.0**	**27.7**
Of which: public and publicly guaranteed (PPG)	34.7			32.4	34.1	34.3	34.1	33.7	33.1	32.5	33.6	29.9	24.0	27.7
Change in external debt	-8.1			-2.3	1.7	0.2	-0.1	-0.5	-0.6	-0.6	-0.3	-0.7	-0.5	-0.6
Identified net debt-creating flows	-2.2			2.1	4.5	5.0	4.2	3.4	3.0	3.0	3.7	3.1	1.1	3.0
Noninterest current account deficit	**8.1**	**5.1**	**2.6**	**7.7**	**7.8**	**8.3**	**7.7**	**7.2**	**6.8**	**6.5**	**7.6**	**6.3**	**3.8**	**5.4**
Deficit in balance of goods and services	13.9			13.7	12.6	12.6	12.0	11.4	11.0	10.8	12.2	10.2	7.2	9.2
Exports	12.6			12.4	13.5	13.5	13.8	14.1	14.4	14.7	13.6	15.1	17.9	16.0
Imports	26.5			26.1	26.1	26.1	25.7	25.5	25.4	25.4	25.8	25.4	25.2	25.3
Net current transfers (negative = inflow)	-5.7	-6.1	0.7	-5.8	-5.5	-5.0	-5.0	-5.0	-4.9	-4.8	-5.2	-4.6	-3.9	-4.3
Other current account flows (negative = net inflow)	-0.2			-0.2	0.7	0.7	0.7	0.7	0.7	0.6	0.5	0.6	0.5	0.5
Net FDI (negative = inflow)	**-1.3**	**-2.0**	**0.9**	**-2.0**	**-2.5**	**-1.5**	**-1.5**	**-1.5**	**-1.4**	**-1.4**	**-1.8**	**-1.2**	**-1.1**	**-1.2**
Endogenous debt dynamics 2/	**-9.0**			**-3.6**	**-0.8**	**-1.8**	**-2.0**	**-2.3**	**-2.3**	**-2.2**	**-2.1**	**-2.0**	**-1.6**	**-1.2**
Contribution from nominal interest rate	0.3			0.3	0.3	0.3	0.4	0.3	0.2	0.3	0.3	0.3	0.3	0.3
Contribution from real GDP growth	-1.3			-1.0	-1.2	-1.4	-1.6	-1.7	-1.7	-1.7	-1.4	-1.6	-1.2	-1.4
Contribution from price and exchange rate changes	-7.9			-3.0	0.1	-0.7	-0.8	-0.8	-0.8	-0.8	-1.0	-0.7	-0.6	-0.6
Residual 3/	**-5.8**			**-7.4**	**-2.7**	**-5.5**	**-5.0**	**-4.7**	**-4.5**	**-4.4**	-5.0	**-4.5**	**-2.2**	**-3.7**
Of which: exceptional financing	0.0			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 4/	18.5			17.6	18.8	19.2	19.3	19.4	19.3	19.1	18.9	18.4	15.4	17.3
In percent of exports	147.0			142.1	139.4	142.3	140.4	137.2	133.7	130.5	139.2	122.0	85.9	109.0
NPV of PPG external debt	**18.5**			**17.6**	**18.8**	**19.2**	**19.3**	**19.4**	**19.3**	**19.1**	**18.9**	**18.4**	**15.4**	**17.3**
In percent of exports	147.0			142.1	139.4	142.3	140.4	137.2	133.7	130.5	139.2	122.0	85.9	109.0
Debt service-to-exports ratio (in percent)	6.9			6.9	6.1	6.6	6.7	6.1	6.4	6.4	6.5	6.3	5.5	6.1
PPG debt service-to-exports ratio (in percent)	6.9			6.9	6.1	6.6	6.7	6.1	6.4	6.4	6.5	6.3	5.5	6.1
Total gross financing need (billions of U.S. dollars)	296.4			285.7	277.9	370.4	367.7	363.0	380.9	400.9	340.9	540.1	717.8	621.1
Noninterest current account deficit that stabilizes debt ratio	16.2			10.0	6.1	8.1	7.8	7.6	7.4	7.2	7.8	6.9	4.2	6.0
Key macroeconomic assumptions														
Real GDP growth (in percent)	3.9	4.7	1.3	3.1	3.9	4.4	5.1	5.5	5.5	5.5	4.6	5.5	5.5	5.5
GDP deflator in US dollar terms (change in percent)	22.7	10.7	20.8	9.4	-0.3	2.0	2.2	2.5	2.6	2.6	3.1	2.5	2.5	2.5
Effective interest rate (percent) 5/	0.7	2.0	1.1	1.0	1.1	1.0	1.1	1.0	0.8	1.0	1.0	1.0	1.2	1.1
Growth of exports of G&S (U.S. dollar terms, in percent)	27.8	17.5	36.9	10.7	13.0	6.6	9.8	10.8	10.6	10.1	10.2	9.3	10.4	9.7
Growth of imports of G&S (U.S. dollar terms, in percent)	23.1	16.9	23.4	10.8	3.8	6.4	6.0	7.4	7.8	8.2	7.0	8.0	8.1	8.0
Grant element of new public sector borrowing (in percent)	...	...	...	45.5	45.6	45.6	45.7	45.9	46.0	46.0	45.7	46.0	46.0	46.0
Memorandum item:														
Nominal GDP (billions of US dollars)	3874.8			4370.5	4527.0	4824.0	5181.6	5604.0	6064.6	6563.7	5095.3	8967.9	19567.8	11987.9

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ 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.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments devided by previous period debt stock.
6/ Historical averages and standard deviations are derived over the past 10 years.

Table 9. Benin: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2004-24
(In percent)

	Est.	Projections							
	2004	2005	2006	2007	2008	2009	2010	2014	2024
NPV of debt-to-GDP ratio									
Baseline	18	19	19	19	19	19	19	18	15
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2004-23 1/	18	17	15	13	12	11	10	6	7
A2. New public sector loans on less favorable terms in 2004-23 2/	18	20	21	22	23	24	24	26	27
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	18	19	19	20	20	20	19	19	16
B2. Export value growth 1/2 percentage point lower than in baseline 7/	18	19	19	19	19	19	19	19	18
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	18	23	30	30	30	30	30	29	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	18	20	20	20	20	20	20	19	16
B5. Combination of B1-B4 using one-half standard deviation shocks	18	23	30	30	30	29	29	27	20
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	18	27	27	28	28	28	27	26	22
NPV of debt-to-exports ratio									
Baseline	142	139	142	140	137	134	130	122	86
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2004-23 1/	142	125	109	95	84	74	65	38	38
A2. New public sector loans on less favorable terms in 2004-23 2/	142	148	157	162	164	165	166	172	149
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	142	139	142	140	137	134	130	122	86
B2. Export value growth 1/2 percentage point lower than in baseline 7/	142	139	142	141	139	136	134	132	112
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	142	139	142	140	137	134	130	122	86
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	142	147	150	148	144	140	137	126	87
B5. Combination of B1-B4 using one-half standard deviation shocks	142	198	280	273	265	257	249	223	141
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	142	139	142	140	137	134	130	122	86
Debt service ratio									
Baseline	7	6	7	7	6	6	6	6	5
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2004-23 1/	7	6	6	6	5	5	5	3	1
A2. New public sector loans on less favorable terms in 2004-23 2/	7	6	7	8	8	8	8	10	11
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2004-05	7	6	7	7	6	6	6	6	5
B2. Export value growth 1/2 percentage point lower than in baseline 7/	7	6	7	7	6	7	7	7	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004-05	7	6	7	7	6	6	6	6	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004-05 4/	7	6	7	7	6	7	7	7	6
B5. Combination of B1-B4 using one-half standard deviation shocks	7	8	11	12	11	11	11	13	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	7	6	7	7	6	6	6	6	5
Memorandum item:									
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	33	33	33	33	33	33	33	33	33

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.

7/ The additional borrowing is equally financed by loans with a grant element and grants.

Table 10. Benin: Millennium Development Goals

	1990	1995	2001	2002	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	..	100.0	
- Percentage of cohort reaching grade 5	55.0	60.9	84.0	..		
- 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	..	..	75.0	100.0	
- Ratio of young literate females to males (percent ages 15-24)	43.6	47.3	52.0	52.9		
- Proportion of seats held by women in the national parliament (percent)	3.0	7.0	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	..	61.7	
- Infant mortality rate (per 1,000 live births)	111.0	104.0	94.0	92.0		
- Immunization against measles (percent of children under 12-months)	79.0	65.0	65.0	..		
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	<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	27.0	

Sources: Benin's authorities and World Bank estimates.

July 21, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington, D.C. 20431
USA

Dear Mr. de Rato:

1. The arrangement approved in July 2000 by the Executive Board of the International Monetary Fund under the Poverty Reduction and Growth Facility (PRGF) in support of the economic reform policies of the government of the Republic of Benin expired on March 31, 2004.

2. Despite the encouraging results obtained when this program was implemented, a major challenge for Benin remains that of ensuring sustainable, high economic growth by diversifying its economy and reviving the private sector. Recent economic and financial developments have been marked by negative external shocks in the form of a significant drop in the international prices for cotton, and Nigeria's intensification, from August 2003, of restrictions on trade with Benin. The impact of these external shocks was magnified by delays in the implementation of structural reforms aimed at diversifying Benin's economy and improving its competitiveness. Economic growth slowed, and the expected progress in adjusting the balance of payments and budget could not be achieved. Within a stable macroeconomic framework, measures to diversify the economy and revive the private sector will form the basis for providing durable solutions to the vulnerability of Benin's economy to external shocks and its disproportional dependence on the cotton sector and on trade with Nigeria.

3. The second challenge for Benin is to obtain convincing results in its fight against poverty, not only through higher growth but also through more resolute implementation of economic and social policies designed to achieve those ends. The first annual report on progress made in 2003 in implementing the poverty reduction strategy drawn up in September 2002 revealed a need for more strenuous efforts so as to not stray from the path leading to the Millennium Development Goals by 2015.

4. To meet these challenges, the government of Benin has drawn up a new program of economic reforms for the three-year period that began April 2005. This program, for which the government is seeking the financial support of its development partners, aims at restoring sustainable, high growth in a stable macroeconomic environment, as well as tangible results in the effort to reduce poverty. The principal components of the program are based on the policies set forth in the poverty reduction strategy paper (PRSP) of September 2002.

5. In the attached memorandum on economic and financial policies (MEFP), the government presents the objectives and policies it intends to pursue within the framework of its medium-term strategy and specifies the objectives and measures for the first year of the program. In this context, the government of Benin hereby requests a three-year arrangement under the PRGF in the amount of SDR 6.19 million.

6. The government believes that the policies set out in the MEFP are adequate to achieve the program objectives; however, it stands ready to take any further measures that may prove necessary. The government of Benin will continue to provide the staff of the IMF with the information required to properly evaluate Benin's progress in executing the policies contained in the attached MEFP. It will also continue to consult with the IMF on its economic and financial policy, in accordance with the provisions and practices of the Fund governing such consultations.

Sincerely yours,

/s/
Cosme Sehlin

Minister of Finance and the Economy
Republic of Benin

BENIN

Memorandum on Economic and Financial Policies for 2005-2008

July 21, 2005

I. Introduction

1. In the context of implementing its poverty reduction strategy, the government of the Republic of Benin undertook discussions with the staff of the International Monetary Fund about a medium-term economic and financial program for the period April 1, 2005 to March 31, 2008. Building on the progress made and results obtained in 2004, the discussions focused on a program designed to stimulate Benin's economy, and, more specifically, on the prospects and measures for the remainder of 2005, including the major components of the budget. Aware of the challenges facing the economy if it is to achieve strong and lasting growth, reduce its vulnerability to external shocks, and accelerate the reduction of poverty, the government reaffirms its resolve to implement all the policies described in the present document.

II. Recent Economic Developments

2. Because of the dependence of Benin's economy on cotton and trade with Nigeria, both of which were affected by external shocks, and delays in the implementation of structural reforms, economic performance continued to deteriorate in 2004. Growth slowed, exports weakened, and a drop in fiscal revenues forced the government to tighten fiscal policy. Inflation was moderate, however, the household consumer price index rising by about 1 percent on average.

3. Preliminary estimates show that GDP growth in real terms was only 3.1 percent, compared with an average of 4.2 percent in the preceding two years and with the objective in Benin's poverty reduction strategy paper (PRSP) of about 6.5 percent. This slowing of growth is mainly attributable to three factors: (i) the drop in production of cotton fiber that is due, in part, to the disorganization of the sector stemming from the failure of some participants to honor the provisions governing the relations between stakeholders; (ii) border closings and the intensification of trade restrictions imposed by Nigeria; and (iii) the loss of competitiveness of the port of Cotonou, together with multiple roadblocks and highway controls that discourage transiting Benin with goods intended for neighboring countries.

4. The external current account deficit, excluding grants, deteriorated slightly to 8.7 percent of GDP in 2004, despite an increase in private current transfers and the gains realized from servicing the external debt as a result of the recording of this debt service net of any relief. This development reflects, on the one hand, a deterioration in the trade balance linked to an increase in the oil bill and stagnation of cotton exports and, on the other hand, a minor reduction in public current transfers resulting from reexportation activities.

5. Benin's overall fiscal deficit on a commitment basis and excluding grants was limited to 3.7 percent of GDP, unchanged from 2003. Nevertheless, on a cash basis, the fiscal deficit worsened by 0.8 percent of GDP and the slippages would have been even greater, given a substantial rise in the wage bill, had the government not taken measures to reduce other expenditures by about 0.3 percent of GDP. It made those reductions while preserving priority poverty reduction spending to the extent possible.

6. Analysis of the changes in the monetary aggregates is extremely difficult owing to technical problems encountered over the past several years in estimating currency in circulation and the net foreign assets of the national branch of the Central Bank of West African States (BCEAO). To solve these problems, the BCEAO has begun revising the methodology it uses to estimate currency in circulation. According to available data, which reflect these technical difficulties, the money supply contracted by 5 percent in 2004; in parallel, the BCEAO's net foreign assets contracted by CFAF 54 billion, or more than 2.5 percent of GDP. Credit to the economy rose by merely 4.5 percent, against a 33 percent expansion in 2003 and the government's credit position toward the banking sector continued to contract.

7. Overall, the banking system, assessed on the basis of its adherence to the prudential ratios, remained sound, although the number of non-performing loans increased from 4.7 percent to 7.2 percent of private sector credit. This change reflected, in particular, problems at the National Agricultural Promotion Company (SONAPRA). In addition, Continental Bank, in which the government retains a 43 percent share, continues to experience financial difficulties. In 2004, two new banks were licensed to operate in Benin, while two other institutions lost their operating licenses and are now in liquidation. At end-December 2004, the national banking system consisted of nine banks and two nonbank financial institutions. One bank remained under provisional receivership, ordered by the Minister of Finance and the Economy, and the number of institutions subject to surveillance by the Banking Commission was reduced from four to two.

8. While the Beninese authorities continued to make progress in implementing budget reforms and improving social services, other structural reforms were again delayed in 2004, in part owing to resistance from trade unions. The sale of SONAPRA's ginning plants was not completed, although the lots were awarded by bid. Preparations for the privatization of the national telecommunications company, Bénin Télécoms S.A.—a result of the splitting of the Office of Postal Services and Telecommunications (OPT) into postal services and telephone services—continued to be delayed. The strategy for privatizing the electricity company, Société Béninoise d'Énergie Électrique (SBEE), was not adopted. The action plan to enhance the competitiveness of the port of Cotonou—entailing the creation of a "centralized clearing and invoicing center" and the participation of the private sector in port management—and its implementation calendar were not finalized.

9. The modernization of the administration and reform of the civil service, including development of a merit-based compensation system, did not advance meaningfully in 2004. Following the updating of the single reference database that makes it possible to track the

number of paid civil servants, the government shifted the responsibility for managing personnel administration from the Ministry of the Civil Service to the ministries in charge of education and created a technical commission to integrate and coordinate administrative reforms. The government also continued to seek the cooperation of social partners in promoting these wide-ranging reforms, supported for the past several years by the World Bank; the reforms are considered necessary to the better functioning of the program budgets and the use of management by objectives by the government.

III. Medium- Term Framework

10. The new medium-term economic and financial program forms part of the poverty-reduction strategy the government adopted in September 2002. The first annual progress report on Benin's implementation of its Poverty Reduction Strategy Paper (PRSP) covered the period 2002-03. The conclusions of that report do not question the basic principles of the strategy, whose four pillars continue to guide the government. The program takes into account the report's recommendations to strengthen ownership of the PRSP by the staff and agencies charged with implementing the PRSP's measures and to infuse new energy into the implementation of the structural reforms. Benin's poverty reduction strategy is scheduled to be updated and a new PRSP prepared in 2006, and the medium-term program will be modified, if necessary to address new priorities and actions that have arisen in the country's pursuit of the Millennium Development Goals (MDGs).

11. While benefiting from the lessons learned from implementing the poverty reduction strategy since 2003, the 2005-08 program aims to meet the pressing economic and financial challenges facing Benin. These challenges include (i) maintaining a stable macroeconomic environment by adopting prudent economic and financial policies and, in particular, by consolidating public finances; (ii) ensuring Benin's economic recovery by improving its competitiveness through wide-ranging structural reforms; and (iii) gradually increasing the resilience of the economy and expanding its export base by diversifying Benin's economic activities and promoting exports.

12. The government has set as its objectives the gradual resumption of growth with a target of 5.5 percent in real terms by 2008, while keeping inflation below 3 percent on average. These objectives are ambitious but realistic and underscore the government's resolve to implement the structural reforms and policies that can contribute to a gradual acceleration of growth. To guarantee the sustainability of this strategy over time, the government also intends to contain the external current account deficit, excluding grants, to 7.4 percent of GDP by 2008 and to gradually reduce the burden of foreign debt as a percentage of GDP. With those objectives in view, the government will strive to enhance the competitiveness of the economy in order to better integrate Benin into regional and world trade and boost private investment in the productive sectors. A prudent monetary policy, conducted at the regional level should enable Benin to limit inflation to about 2.5 percent annually.

13. In support of these macroeconomic objectives, the government's fiscal policy will aim for fiscal consolidation, increased support for the implementation of the PRS, and a positive contribution to the economic recovery.

- For Benin to achieve fiscal consolidation, the government must (i) ensure that its fiscal policy and external public debt policy are sustainable and (ii) improve compliance with fiscal convergence criteria of the West Africa Economic and Monetary Union (WAEMU). This will result from improving fiscal balances over the program period, while continuing to settle government liabilities and payment arrears. The program seeks to reduce the overall fiscal deficit to 4.5 percent of GDP and achieve a primary surplus (excluding externally financed investment expenditure) by 2008. To achieve these objectives, the government will intensify its efforts to mobilize revenues by reforming the tax system and strengthening the General Directorate of Taxes and Public Lands (DGID) and the General Directorate of Customs and Indirect Taxation (DGDDI). These measures should boost the tax effort to 17.8 percent of GDP by 2008. That increase in the tax ratio will allow overall expenditures to stay at 22.2 percent of GDP by 2008 and keep primary expenditures at 17.7 percent of GDP over the period 2006-08. Taking into account the envisaged fiscal consolidation and the programmed strengthening of the government's net credit position vis-à-vis the banking system, the financing gaps over the period 2006-08 will be about 2 percent of GDP.

- In the context of the fiscal consolidation, the program takes into account the government's decision to assume responsibility for the financial impact of automatic promotions and advances of civil servants, which were not paid because such payments had been suspended between 1987 and 1991 then gradually restored after 1992. These obligations are now being assessed and, when the process is complete, the authorities will draw up a strategy to eliminate them. This strategy will take into account the government's financing constraints within the framework of the country's poverty reduction strategy and will aim to prevent any deterioration in the sustainability of fiscal policy.

- The medium-term budget program will aim to streamline expenditures and improve their quality, as well as to call for effective implementation of the priorities and objectives of the poverty reduction strategy. In this regard, the institutional capacity for budget preparation and programming will be strengthened, to improve the preparation of budget programs—which currently cover 17 out of the 21 ministries—and to better integrate the medium-term expenditure framework (MTEF) of each ministry into the overall government budget. The budgetary expenditure program will favor the priority sectors, notably the social sectors. At the same time, the wage bill will be contained at 5.6 percent of GDP. Public investments will be concentrated in the sectors contributing to the improvement of public services, the strengthening of basic infrastructures, the quality of the service provided by the education system, access by all citizens to primary health care, and the effectiveness of the legal system.

- The contribution of fiscal policy to the economic recovery will be increased by improving governance and intensifying the fight against corruption. The ongoing administrative budgetary reforms—especially the strengthening of the public financial agencies—the reform of government contracting, and the modernization and management of the civil service will result in improved transparency and governance. Finally, the government intends to initiate a reform of the tax system in 2006 to simplify and broaden Benin's tax base, while contributing to the revenue objectives and the restoration of an environment conducive to private sector development. To that end, the government is seeking assistance from its development partners and in particular the IMF.

14. To ensure economic recovery and reduce the economy's vulnerability to external shocks, the government will strengthen the competitiveness of existing activities and implement an economic diversification strategy through expanded regional and international trade. The government will therefore focus on concluding the structural reforms already under way in the cotton sector, ensuring lasting development of formal trade with Nigeria, and completing the reforms of the transportation (including the port of Cotonou), telecommunications, and energy sectors to improve their competitiveness. These urgent reforms will be accompanied by an effort to identify the growth sectors and to implement a more effective development strategy based largely on foreign trade. Starting in 2005, the development of such a strategy will benefit from a number of studies on the competitiveness of Benin's economy and its sources of growth, along with a study on integrating Benin into international trade. To eliminate internal barriers that prevent Benin from participating fully in world trade, the government needs to strengthen ongoing structural reforms, such as the reform of the legal system. The entire range of these reforms will be bolstered by a strengthened banking and financial sector, especially microfinance. To anchor growth in the sectors in which Benin has a clear competitive advantage, the trade development strategy will be strengthened in light of the prospects for accelerated integration into the WAEMU, and gradually, into the Economic Community Of West African States (ECOWAS). The mainstay of this strategy will be the enhanced competitiveness of the port of Cotonou, with the effective operation of the centralized clearing and invoicing center and the expansion of its activities. Benin is seeking technical and financial assistance in modernizing the legal and regulatory environment for investment, transportation, trade, and other services, which should attract private investment and ensure accelerated economic growth.

15. The government believes that performance-based management requires appropriate administrative reform based, in particular, on a revamping of the civil service personnel regulations and the development of performance-based compensation. Consequently, the government intends to obtain the cooperation of all social partners in the new performance-based management methods and administrative reform. Such a reform will pave the way for the establishment of a wage policy based on recognition of employee performance and an adequate recruitment policy. In 2005, the government will adopt an action plan for 2005-07 consisting of a sustainable framework for a staff turnover strategy and the finalization of new civil service personnel regulations that introduces elements of performance-based management.

16. The medium-term program calls for strengthening the government's institutional capacity to improve the development and monitoring of economic and financial policy and to ensure implementation of the poverty reduction strategy. As a complement to the budgetary and administrative reforms mentioned above, the capacity of sector ministries to monitor and assess policy implementation will be enhanced. The statistical systems for collecting and processing data will be improved to ensure the availability of reliable and timely statistics to help in the making of decisions and policies.

IV. Policies and Measures for the Remainder of 2005

17. The first year of the program supported by the Poverty Reduction and Growth Facility (PRGF) extends from April 1, 2005 to March 31, 2006. Economic growth for 2005 is projected at 3.9 percent; inflation at 2.5 percent; and the external current account deficit (excluding grants) unchanged at 8.7 percent of GDP. The 2005 growth target takes into account the buoyancy of activities in the secondary sector linked to the strong rebound of cotton production, improved relations with Nigeria, and the effect of the gradual restoration of competitiveness of the port of Cotonou. The recovery of the construction and public works sector and of the tertiary sector—in particular, telecommunications, trade and transportation—will contribute to the realization of the growth target. Some stabilization of the prices of petroleum products on the world markets in the course of the year, together with enough rain for normal growth of food production, should enable Benin to contain inflation at less than 2½ percent. The external current account deficit is not expected to improve in 2005 owing to the decline in international prices for cotton and the appreciation of the CFA franc against the U.S. dollar, combined with the swelling oil bill and the reduction of trade with Nigeria despite some expected improvement. Consequently, despite the surpluses in financial and capital accounts, official reserves are expected to decline further.

A. Public Finance and Fiscal Reform

18. In light of the poverty reduction strategy, the 2005 budget adopted by the National Assembly reflects the policy priorities of the government as set forth in the new Government Action Program and the PRSP. The budget is broadly consistent with the objectives of the poverty reduction strategy of (i) increasing use of the program budget and unified budget approaches, (ii) improving revenue collection, (iii) giving priority to current and capital spending in the social sectors and to economic infrastructure, and (iv) strengthening capacities for management and absorption of the available resources.

19. Immediately after its adoption, however, the 2005 budget came under intense pressure because of, on the one hand, the less favorable economic outlook and, on the other, the government's decisions to protect cotton producers against the impact of the significant drop in international prices, amplified in local currency terms by the weakness of the U.S. dollar; to increase the compensation of some categories of personnel; and to consolidate public finances. This fiscal consolidation involves clearance of utilities and telephone bills representing claims on the central government, and on local governments and other public

institutions, as well as implementation of the government's program to recognize debts incurred when promotions and advancements for civil service employees were suspended between 1987 and 1991.

20. These budget pressures called for vigorous measures to increase revenue and for expenditure reductions in an amount equal to 1.1 percent of GDP to contain the narrow primary fiscal deficit at 0.9 percent of GDP and the overall deficit, on a commitment basis and excluding grants, to 5.3 percent of GDP. The Council of Ministers adopted the adjustments required in the 2005 budget on June 6, 2005, and the Minister of Finance and the Economy communicated them to the appropriations managers.

21. On the revenue side, the new tax measures introduced by the 2005 budget law were limited essentially to the extension of customs exemptions to farming equipment and machinery and a downward revision of the tax on wages and salaries in light of the increase in the minimum wage and wage demands of workers. Consequently, the increase in total budget revenues to 17.4 percent of GDP reflects, especially, the continuation of efforts to strengthen tax administration and the inclusion of exceptional revenues linked to the settlement of the cross debts between the government and the water and electricity company. In terms of administrative measures, the government intends to: (i) continue to strengthen the DGID, particularly the large enterprises directorate (DGE), and expand the computerization of the medium-size enterprise centers (CMEs); (ii) improve coordination between the DGDDI and the DGID by introducing a new tax identification number for taxpayers and improving data sharing between the two administrations; (iii) tighten customs valuation controls; (iv) track exemptions by computer; and (v) step up the calendar for establishing the centralized clearing and invoicing center at the port of Cotonou. In addition, in 2004 the government renegotiated and signed a new agreement with mobile telephone companies. This agreement establishes a provider licensing fee of CFAF 5 billion each, with payment spread out over six years. The public treasury is to collect, on a regular basis, both of these user fees and royalties for the use of designated bandwidths and frequencies.

22. In 2005, total expenditure and net lending are expected to reach CFAF 512 billion, or 22.7 percent of GDP. This amount takes into account the budgetary pressures noted above and the offsetting measures designed to limit the increase in expenditures. Despite the budgetary restrictions, the 2005 budget will nonetheless contribute to poverty reduction while maintaining macroeconomic stability and long-term fiscal viability.

23. The wage bill will be allowed to reach CFAF 128.7 billion, or 5.7 percent of GDP, taking into account the government's decisions to grant additional benefits to teachers and personnel in the health sector, undertake new recruitment in the social sectors, and complete the adjustment of wages so that civil servants are paid in line with their administrative positions. Additional teachers and health care personnel will also be recruited locally, using a portion of resources from the Heavily Indebted Poor Countries Initiative in the form of transfers.

24. Current expenditures, excluding the wage bill and educational grants and allowances, will be nearly 25 percent higher than in 2004, reflecting fiscal consolidation and support for rural producers affected by the drop in the prices of cotton. Transfers will increase by 31 percent in 2005, mainly because of subsidies to cotton producers. The government's decision to assist of the cotton industry is creating a charge on public finances of about CFAF 26 billion (that is, 1.2 percent of GDP), in the form of (i) a subsidy of about CFAF 19 billion to soften the impact of external price shocks on the rural poor while maintaining producer prices at a reasonable level and (ii) another CFAF 6 billion subsidy to cover SONAPRA's operating deficit for the 2004-05 crop year in the context of the privatization by end-2005 of its ginning units. Besides the CFAF 19 billion subsidy, the other current transfers and expenditures will increase by 12 percent compared with 2004, while the increase in domestically financed capital expenditure—including the Administrative Services Capital Budget—will be limited to 9 percent.

25. Following an agreement with trade unions within the framework of efforts to align wages and salaries with the actual wages of regular government employees starting on January 1, 2005, the government has focused on assessing its obligations resulting from the retroactive application of the actual wage scales. In that context, the 2005 budget incorporates an allocation of CFAF 10 billion (about ½ of 1 percent of GDP) to allow payment this year of a part of verified claims made by regular government employees—both actively employed and in retirement. The objective is to liquidate obligations of less than CFAF 500,000 to each employee, or to make a partial payment of CFAF 500,000 to eligible employees whose back pay will exceed that amount. The government will impose conditions on subsequent payments such as (i) completion of the assessment of government overdue wage debt; (ii) development of a plan to bring its commitments into line with its financial capacities; and (iii) progress in the implementation of the administrative reforms. Similarly, with a view to containing expenditures for consumption of water, electricity, and telephone services, the Ministry of Finance and Economy has signed a contract with an audit firm charged with reconciling the invoices of the water, electricity and telecommunications companies with the actual consumption of government departments and agencies.

26. The government is awaiting budgetary support in the form of concessional loans and grants that will enable it to contain to CFAF 14 billion the financing gap resulting from these consolidation operations. Rather than finance its operations through domestic borrowing, the government is seeking additional financial support in the amount of CFAF 13 billion from the African Development Fund. Budgetary assistance from France is expected to provide the remaining CFAF 1 billion.

27. In the context of strengthening fiscal management, the government intends to go beyond the measures taken in recent years to improve the execution of public expenditures. For example, in 2005 the government will take measures aimed at (i) deepening budgetary reforms, in particular in the area of government procurement; (ii) extending the coverage of the integrated budget management system (SIGFIP) to externally financed expenditures and restore automatic expenditure control mechanisms; and (iii) tighten its control of financial and physical execution of infrastructure expenditures. The government will also tighten

controls over expenses not just to reduce the number of expenditures executed outside normal procedures, but also to improve the quality of expenditures. The amount of expenditures without prior payment authorization—and therefore without payment orders—must not exceed 10 percent of current appropriations for equipment, supplies, and transfers. Moreover, the government will grant high priority to the preparation of a strategy to safeguard the financial viability of the National Pension Fund (FNRB). To that end, it will expand the actuarial study of the FNRB and decide on key measures to restore its long-term financial equilibrium before December 2005. Finally, prior to end-2005, the government will complete preparation of the 2004 budget accounts and forward them to the audit office; the budget review laws for 2001 and 2002 will be submitted to the National Assembly by end-December 2005.

28. To strengthen the monitoring of budget execution, the government has charged the secretariat of the National Commission for Development and the Fight against Poverty (CNDLP) to formalize the methodology for collecting, processing, and presenting government finance statistics, including the government financial operations table. To that end, it has assigned three newly recruited professional staff to the CNDLP's permanent secretariat and charged them with implementing the methodology.

B. Monetary Policy and the Financial System

29. Monetary policy, which is the responsibility of the BCEAO at the regional level, will aim at strengthening official reserves and maintaining price stability. In light of the foreseeable trends in economic activity and financial intermediation, the rate of growth of money supply could be about 6 percent in 2005. Net domestic assets are expected to increase by 19 percent in 2005, reflecting a 12 percent increase in credit to the private sector and a further steep decline in government deposits with the banking system equal to 37 percent, or 3 percent of the beginning money stock.

30. As part of its effort to correct the weaknesses of Benin's financial system, the government will take the necessary steps to strengthen the management of financing institutions, in line with the recommendations of the Banking Commission of the WAEMU. The government will closely monitor Continental Bank and will strive to improve and motivate its management; before end-2006, the government will propose a plan to sell off its shares. In addition, the Banking Commission will monitor all financial institutions' observance of prudential ratios, especially those related to equity capital. In the case of institutions engaged in micro financing, the government will, by end-2005 strengthen the unit responsible for their prudential oversight to help it improve its monitoring of the two major networks, FECECAM and FENACREP.

C. Other Structural Reforms

31. In response to the economic slowdown, the government reaffirms its determination to reenergize the implementation of structural reforms, so as to restore the conditions for strong, sustainable growth and, thus, significant poverty reduction. Consequently, it intends to

accelerate privatizations and promote the private sector in order to attract private investors from within Benin and from abroad.

32. The port of Cotonou is the lifeline of the national economy; its competitiveness affects the development of Benin's transportation and trade activities. For that reason, the government is supporting efforts to improve the port's productivity and establish a development strategy that will enable the port to play fully its role in the economic development of the country and the region. The port's centralized clearing and invoicing center, to be established by the Cosmos company under a government contract, will constitute the interface between users of port services and port operators. The center, which will be in operation by end-2005, will allow single invoicing for all services provided by the port's operators to the users of the port. The management of the centralized clearing and invoicing center will consist of a general directorate accountable to a committee including representatives of all port operators. Parallel to the setting up of the centralized clearing and invoicing center, the government has taken measures to improve the port's competitiveness, in particular by reducing the costs of services charged by the public operators (i.e., PAC and SOBEMAP). The autonomous port will request technical assistance from a port with a recognized international reputation to improve its competitiveness and develop a plan to expand its activities, on the basis of a physical and financial assessment of the entire range of its operations. The terms of reference for this assessment will be developed with the technical assistance of the World Bank, and will be sent to a short list of ports chosen in consultation with the World Bank to invite them to offer bids. A proposal for a program to develop the port's activities and boost its productivity will be communicated to the IMF staff before the end of the discussions on the first review of the PRGF arrangement. Handling activities already open to the private sector for the handling of containers, will be completely deregulated by year's end. To prepare SOBEMAP for these developments, the government will draw up a plan to strengthen its competitiveness.

33. Telephone services are very expensive in Benin. The liberalization of the sector of telecommunications began, with the granting of four mobile telephone licenses, in the absence of an adequate regulatory framework. To complete the sector's deregulation and ensure its effectiveness, the government has not renewed the contract with the investment bank involved to date but has instead asked for technical assistance from the World Bank to hire a new consultant for the preparation of appropriate regulatory and institutional framework. The World Bank has assisted in drawing up a short list of investment banks and the terms of reference for the call for bids. The draft legislation and decrees governing the sector will be adopted by the Council of Ministers before October 31, 2005, and the draft legislation will be submitted to the National Assembly for the end-year session. The new regulatory framework for telecommunications is therefore expected to be in place before the end of the year. Before end-2005, the bid documents for privatization of Benin's Télécoms S.A. will be ready. The bidding will begin in December 2005, and a bidder will be selected by June 2006 at the latest. Simultaneously, the government designed a sizable telecommunications infrastructure development program to improve national coverage of telephone services. Work on this program will follow a calendar aligned with the entry of private operators into the capital of Bénin Télécoms S.A. in 2006.

34. A plan to revive the financial activities of the postal service will be drawn up to enable it to play its part fully in financial intermediation across the nation.

35. With the help of the World Bank, the government will continue to strengthen the institutional and regulatory framework for water and electricity and will accelerate the privatization process. With the technical and financial assistance of the World Bank, the government intends to prepare for its withdrawal from the management of the SBEE and to launch an international call for bids for a strategic partner prior to end-2005.

36. The government has sent a letter to the successful bidders of the three lots of ginneries inviting them to resume the privatization of the cotton ginning plants. The successful bidders confirmed their interest in purchasing this industrial facility and agreed to the terms of the specifications. The government signed sales agreements that committed the parties to completing the transfer of the cotton ginning facilities by October 31, 2005. The transaction will be concluded at the price agreed to when the bids were awarded, adjusted for any depreciation of equipment and losses observed in the course of the joint inspection. If a disagreement arises about this sale price, the parties agreed to appeal to an independent expert and accept their estimate of the sale price. The transfer of personnel will take place in accordance with the specifications accompanying the sale contracts; in line with its responsibilities, the government has resumed negotiation of a social and reintegration plan for the remaining staff. Benin has asked its development partners to finance a portion of this plan. The revenues resulting from this transfer of assets will be used, in order of priority, to (i) pay off the bridge loan of CFAF 20 billion that was not honored by SONAPRA and for which a government guarantee was activated; (ii) settle SONAPRA’s obligations, in particular its 2005 operating deficit; and (iii) contribute to the social plan being negotiated. The residual revenues will be used within the framework of the fiscal consolidation program, drawn up in consultation with the staff of the International Monetary Fund.

37. The government showed due diligence in its efforts to resolve the legal dispute impeding the final lot (lot #3) of the ginning plants managed by SONAPRA. It will decide before September 30, 2005, on its strategy for transferring these assets to the private sector. In any event, the ginning of the 2005/06 cotton crop will be undertaken entirely by the private sector.

38. Within the framework of the development of the cotton sector, the government has set itself the objective of restoring and maintaining the integrated nature of the sector in a context of private management. Faced with the dysfunction and tentativeness of the industry, the government’s interventions in the 2004/05 crop year ensured that the 2004/05 harvest went smoothly, and it is important that this crop year be concluded under the best possible conditions. With that phase behind them, for the 2005/06 crop year, the government will aim to return accountability to the players in the industry and to guide their return to the idea that the cotton sector should be independently managed—the idea that underlies the current reform. Self-management implies abiding by the framework agreement signed at end-2004, which, however, will fall short of realization unless the industry principals (i) confirm the

government's policy of nonintervention in the industry and (ii) take action to strengthen the industry's institutional framework and operating efficiency.

39. Actions to strengthen the cotton sector's management by the Interprofessional Cotton Association (AIC) include (i) strengthening the industry's organizational structures of the industry and (ii) setting producer prices, with confirmation by the government. These actions will benefit from the audit of the bidding system for supplying sector inputs and for drawing up a pricing formula (to be applied to the 2006-2007 crop) based on international prices (cotton fiber and seed cakes) using a mechanism that distributes any gains and losses of overall industry operations among all participants industry. The AIC will hire an independent consultant to conduct an audit of the operation of the bidding system for providing industry inputs for the crop years 2003/04 and 2004/05. The results of this audit will be communicated to the staff of the IMF before end-September 2005. The AIC has requested technical assistance in developing the pricing formula. Concurrently, the AIC and the government have appealed to Benin's development partners for help in creating a price stabilization mechanism for the cotton industry. This mechanism will be based on a jointly managed fund that could be given initial financial support mobilized by the government from among its development partners. For its operations, the fund's financing will come from the levies imposed on members of the industry when international prices exceed a certain threshold, and its established uses of funds will be the rebates offered to producers when international prices fall below an agreed threshold.

40. In the context of its action program for promoting good governance, the government has prepared, in consultation with the various national stakeholders in Benin, a draft national strategy for the fight against corruption. In addition, the government has adopted regulations for the organization of relations between government departments and users procedural manuals for government agencies.

V. Prior Actions and Program Monitoring

41. Circulation of the documents for purposes of review of Benin's PRGF request by the Executive Board of the IMF was contingent on several prior actions, namely (i) approval by the Council of Ministers of this memorandum of economic and financial policies: (ii) approval by the Council of Ministers of budgetary restrictions supporting the budget program for 2005; (iii) signing of a memorandum of understanding including a commitment to transfer ownership of SONAPRA's ginning plants before October 31, 2005, between the government and each of the successful bidders on lots 1, 2, and 4; (iv) launching of a limited competition to recruit an investment bank to handle the privatization of Bénin Télécoms S.A. and draw up of a regulatory framework for telecommunications, with the assistance of the World Bank; and (v) launching of a limited competition for the preparation of a development program to improve the productivity of the port of Cotonou, in consultation with the World Bank. As of July 21, 2005, all these actions have been completed.

42. To monitor progress in program implementation, the government reached understandings with the IMF staff on the quantitative performance criteria and benchmarks (Table 1), in addition to structural performance criteria and benchmarks (Table 2). On a monthly basis, the government will also provide the International Monetary Fund with the statistical data and information listed in the attached technical memorandum of understanding, as well as any information it deems necessary or that the Fund staff requests in order to monitor the program. During the program period, the government will not introduce restrictions on payments and transfers on current international transactions, or tighten any such restrictions, without the approval of 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 the purpose of balance of payments.

43. To evaluate progress made in the course of the first year of the program, the government, together with the IMF staff, will undertake two reviews of the program with the Fund, the first of these to be completed by end-December 2005, and the second by end-June 2006. The first review will reassess and establish quantitative and structural performance criteria and benchmarks for end-December 2005 and the remainder of the first year of the program.

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

	End-December 2004 Actual	End-September 2005 performance criteria Program	End-December 2005 indicative targets Program
A. Quantitative Performance Criteria and Indicative Targets (cumulative from December 31, 2004)			
Net domestic financing of the government 1/ 2/		11.0	6.5
Primary fiscal balance (excluding grants)		-12.5	-19.5
Accumulation of domestic payments arrears		0.0	0.0
Memorandum items:			
Budgetary assistance		30.6	49.0
Restructuring spending		6.0	13.0
B. Continuous quantitative performance criteria			
Accumulation of external payments arrears		0.0	0.0
External debt contracted or guaranteed by government with maturities of 0-1 year		0.0	0.0
Nonconcesional external contracted or guaranteed with maturities of over one year		0.0	0.0
C. Indicative Targets (Cumulative from december 31, 2004)			
Total revenue	351.7	276.3	392.8
Wage bill	118.3	96.5	128.7

1/ The ceiling on bank financing will be adjusted pro tanto if the amount of disbursed budgetary assistance falls short of program forecast up to a limit of CFAF 7.5 and 15 billion at end-September and end-December, respectively.
2/ 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 3 billion, unless they are used to absorb domestic arrears.

Table 2. Benin: Prior Actions, Structural Performance Criteria and Benchmarks for the 2005 Program

Measures	Date	Status
Prior actions for circulation of the request for a new arrangement to the Fund Executive Board		
Forwarding to Fund staff of the minutes of the Cabinet meeting approving the MEFP and 2005 budget spending adjustments		Completed
Signing by the government of memoranda od understanding with successful bidders on the three lots of ginneries proving for the transfer of plants by end-October		Completed
Launching, to a short list of investment bankers, of invitations to bid for advising in the preparation of the privatization of Benin telecoms SA		Completed
Preparation of terms of reference to conduct an audit, develop the productivity and expand the activites of the port of Cotonou; and launching of invitations to bid to a short list of firms		Completed
Structural performance criteria		
Start up the centralized clearing and invoicing management center of the port of Cotonou	End-December	
Structural benchmarks		
Adoption of a strategy to divest the final lot of ginneries	End-September	
Installation of the software for the centralized clearing and invoicing management center of the port of Cotonou	End-September	
Approval of a strategy to divest Benin Telecoms SA and launching of invitations to bid for the implementation of the strategy	End-December	
Transmittal to Fund staff of the proposed program to develop the and expand the activities of the port of Cotonou	End-December	
Launching of the invitation to bid for the implementation of the government strategy for divesting the SBEE	End-December	
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	
Transmittal to the Audit Chamber of the relevant accounts of the 2004 budget; transmittal to the National Assembly of the settlement laws for the 2001 and 2002 budgets.	End-December	
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	

INTERNATIONAL MONETARY FUND
BENIN

Technical Memorandum of Understanding

July 21, 2005

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. The external debt excludes treasury bills and bonds issued in CFAF on the regional financial market of the West African Economic and Monetary Union (WAEMU).

(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 7.5 billion at end-September 2005, CFAF 15 billion at end-December 2005. 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 11.0 billion at end-September 2005, and CFAF 6.5 at end December 2005. The ceiling is a performance criterion as at end-September 2005 and an indicative target as at end-December 2005.

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 12.5 billion at end-September 2005, and a deficit not higher than CFAF 19.5 billion at end December 2005. The ceiling is a performance criterion as at end-September 2005 and an indicative target as at end-December 2005.

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 non accumulation 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 external payments owed to non residents due and not paid on external liabilities of the government and on foreign debt held or guaranteed by the government. The definition of external 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 definition of external debt excludes bonds issued in the regional market and disbursements under the PRGF arrangement.

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 will be zero throughout the 2005/6 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, guarantee, or secure 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 276.3 billion at end-September 2005, and CFAF 392.8 at end-December 2005 (cumulative since end-December 2004).

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 96.5 billion at end-September 2005, and CFAF 128.7 billion at end-December 2005.

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 A NEW ARRANGEMENT

32. The following actions have been taken before the circulation of the staff report on the new arrangement to the Excecutive Board of the Fund:

- Forwarding to Fund staff of the minutes of the Cabinet meeting approving the MEFP and 2005 budget spending adjustments;

- Signing by the government of memoranda od understanding with successful bidders on the three lots of ginneries proving for the transfer of plants by end-October;

- Launching, to a short list of investment bankers, of invitations to bid for advising in the preparation of the privatization of Benin telecoms SA;

- Preparation of terms of reference to conduct an audit, develop the productivity and expand the activites of the port of Cotonou; and launching of invitations to bid to a short list of firms.

V. STRUCTURAL PERFORMANCE CRITERION

33. Activating the centralized clearing and invoicing system of the port of Cotonou, before end-December 2005.

VI. STRUCTURAL BENCHMARKS

34. The government will complete the following actions by end-September 2005:

- Adoption of a strategy to divest the final lot of ginneries;

- Installation of the software for the centralized clearing and invoicing management center of the Port of Cotonou.

35. The government will complete the following actions by end-December 2005:

- Approval of a strategy to divest Benin Telecoms SA and launch invitations to bid for the implementation of the strategy;

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

- Launching of the invitation to bid for the implemenattion of the government strategy for divesting the SBEE;

- 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 2004 budget; transmittal to the National Assembly of the settlement laws for the 2001 and 2002 budgets;

- 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.

VII. Other Data Requirements for Program Monitoring

C. Public Finance

36. 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

37. 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

38. 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

39. 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

40. 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.

Benin: Relations with the Fund

(As of May 31, 2005)

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

II. General Resources Account:	**SDR Million**	**% of Quota**
Quota	61.90	100.00
Fund holdings of currency	59.72	96.48
Reserve position in the Fund	2.19	3.53

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	9.41	100.00
Holdings	0.01	0.08

IV. Outstanding Purchases and Loans:	**SDR Million**	**% Quota**
Poverty Reduction and Growth Facility (PRGF) Arrangements	38.60	62.35

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
PRGF	07/17/2000	03/31/2004	27.00	27.00
PRGF	08/28/1996	07/16/2000	27.18	16.31
PRGF	01/25/1993	05/21/1996	51.89	51.89

VI. Projected Payments to Fund (without HIPC Assistance)

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	2.54	5.93	5.33	5.64	6.35
Charges/interest	0.31	0.40	0.37	0.34	0.31
Total	2.85	6.33	5.70	5.98	6.66

Projected Payments to Fund (with Board-approved HIPC Initiative assistance)
(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	2.15	5.01	4.41	5.64	6.35
Charges/interest	0.31	0.40	0.37	0.34	0.31
Total	2.46	5.41	4.78	5.98	6.66

VII. Implementation of HIPC Initiative:

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	Jul 17, 2000
Assistance committed (net presentation value terms)	End-1998
Total assistance (US$ million)	265.00
Of which: Fund assistance (US$ million)	24.30
(SDR equivalent in millions)	18.40
Completion point date	March 2003

Delivery of Fund assistance (SDR million)

Amount disbursed	18.40
Interim assistance	11.04
Completion point	7.36
Additional disbursement of interest income	1.66
Total disbursement	20.06

VIII. Safeguards Assessments:

The Central Bank of West African States (BCEAO) is the common central bank of the west African states, which includes Benin. An on-site safeguards assessment of the BCEAO proposed specific remedies to alleviate vulnerabilities that were identified by staff. Although the Fund staff and BCEAO authorities disagreed on the initial modalities of the recommendations, the following specific understandings were subsequently reached regarding the key remedies:

- **Financial reporting framework.** Fund staff recommended that the BCEAO formally adopt International Accounting Standards (IAS) and publish a complete set of financial statements, including detailed explanatory notes. It was agreed between the BCEAO and Fund staff that the **BCEAO would strive to improve its financial and accounting reporting by aligning its practices with those recommended by IAS**, as adopted internationally by other central banks.

- **Internal controls system.** The staff noted that the absence of oversight of the bank's governance, financial reporting, and internal control practices by an entity external to the management of the BCEAO represented a significant risk. It was agreed between the BCEAO and Fund staff that, after seeking the opinion of the external auditor (Commissaire Contrôleur), BCEAO staff would propose to the BCEAO Board of Directors that it adopt a resolution whereby **the external auditor would be required to apprise the Board of Directors, during its annual review and approval of the financial statements, of the state and quality of internal controls within the bank.**

Based on the 2002 financial statements, the staff noted that the BCEAO had improved the explanatory notes to the financial statements, and further changes were scheduled for the next fiscal year, with a view toward a graduate alignment of central banks with IAS accounting, to the extent applicable, by 2005. The external auditor apprised the Board of Directors of the BCEAO of the quality of internal controls in June 2003, and the financial statements for the year 2002 were published on the bank's website. The staff will continue to follow up on the progress of the BCEAO in implementing the proposed recommendations as part of the ongoing safeguards monitoring process.

IX. 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. 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 May, 2005, the rate of the CFA franc in terms of the SDR was SDR 1= CFAF 784.61.

X. Article IV Consultations:

The last Article IV consultation discussions were held in Cotonou during June 7-18, 2004. The staff report (Country Report No. 04/368; 11/24/04), together with selected issues and a statistical appendix (Country Report No. 04/370; 11/24/04), was discussed by the Executive Board, and the 2004 Article IV consultation was concluded on October 6, 2004.

XI. 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 No. 02/217, 10/04/02).

XII. 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

Department	Type of Assistance	Time of Delivery	Purpose
			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.

XIII. Resident Representative:

Mr. Harmsen has been the Resident Representative since November 1, 2002.

Benin: Relations with the World Bank Group

(As of June 15, 2005)

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.

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 2000 and expired in March 2004, addressed 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 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 the Private Sector Development Project and through the now-closed Transport Sector Project. 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 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 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 Bank HIV/AIDS project was approved in January 2002.

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.

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 this context, 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, until March 2004, 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 Bank prepared a new Country Assistance Strategy (CAS), which was discussed at its Board on July 3, 2003. The overriding objective of the Bank's assistance in the years ahead 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]

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 become 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.

Benin: Status of World Bank Portfolio
(In million of U.S. dollars, as of June 15, 2005)

	Effectiveness Date	Original Principal (IDA)	Disbursed (IDA)
Labor Force Development	3/13/01	5.0	4.7
Private Sector	8/31/00	30.4	23.8
Cotton Sector Reform	9/12/02	18.0	7.9
HIV/AIDS Multisector	7/17/02	23.0	16.9
Energy Service Delivery	4/25/05	45.0	1.4
National CDD	5/2/05	50.0	1.7
PRSC-2	Not yet effective	30.0	-
Total		201.4	56.4

[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.

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) are preparing budget support operations, in close coordination with the Bank's PRSC preparation process.

22. As of June 15, 2005, the Bank lending portfolio consisted of seven operations, with a net commitment of US$201.4 million and an undisbursed balance of US$111.9 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. David Craig, Country Director for Benin, ext. 32589; or Ms. Nancy Benjamin, Country Economist for Benin, ext. 30189.

Benin: Statistical Issues

(As of end-June, 2005)

1. Core statistical indicators are generally provided to the Fund on a timely basis (see attached table). 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 Benin's 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 them in implementing 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

2. Beninese national statistics agencies were represented at two GDDS seminars, one in Yaoundé in October 1998 and another in Bamako in April 2001. As a follow-up to the GDDS workshop in Bamako, significant initiatives have been taken in order to upgrade Benin's national income accounting system, which is 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. Starting with January 1998, Benin has been producing the WAEMU harmonized consumer price index (CPI), in compliance with WAEMU standards.

Public finances

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. Benin currently does not report public finance data for publication in *International Financial Statistics (IFS)* or the *Government Finance Statistics Yearbook (GFSY).*

Monetary statistics

5. Benin's monetary statistics are compiled and disseminated by the regional Central Bank of West African States (BCEAO). The BCEAO has experienced difficulties in estimating currency in circulation for the individual member countries, partly because of delays in processing cash in its vaults. Currency issued in a country of the WAEMU can circulate in any other member country and the country of emission can be identified on BCEAO banknotes. Currency in circulation in a given country is estimated as the *currency issued in that country* minus the *currency issued in that country that is in the vaults of the various national agencies of the BCEAO*. However, as the stocks of currency in the vaults of the national agencies are not sorted out continuously, the central bank applies sorting coefficients (established in 1990) to these stocks to evaluate the amounts of currency issued by each country. These amounts are used to estimate currency in circulation and adjust net foreign assets of each member country. The sharp downward trend in currency in circulation (and net foreign assets) in Benin since 2001 would thus reflect a breakdown of the methodology (obsolete sorting coefficients) and the absence of sorting of banknotes by Benin for the past few years, which has resulted in a large stock of unsorted banknotes in Benin. However, evidence that this problem has persisted for Benin for data through November 2004 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 that are being undertaken to improve the situation.

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.* A comprehensive plan to improve monetary statistics in the BCEAO area was agreed with the 2003 mission, which included (i) completion of sectorization of the institutional units and classification of financial instruments, (ii) expansion of the coverage of other depository corporations to the microfinance institutions, (iii) compilation of a new monetary aggregate, M3, and a liquidity aggregate, (iv) reclassification of SDR allocation from foreign liabilities to share and other equity, (v) reduction of the stock of unsorted notes and improvement of the compilation of currency in circulation, (vi) improvement in the structure of monthly returns of commercial banks, (vii) reinforcement of the measures to ensure that the commercial banks comply with the official 30-day deadline for submitting accurate monthly returns, (viii) reduction of time lag of the central bank's balance sheet, (ix) strengthening of staff and data processing resources for monetary and financial data collection and compilation in all National Directorates and the BCEAO headquarters, (x) design of a system to compile flow data for the central bank and the commercial banks, and (xi) adoption of the new framework of the *MFSM* for the compilation and presentation of monetary data.

Balance of payments

7. 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.

8. Data consistency has significantly improved over the past few years, with a full transition to the *Balance of Payments Manual, Fifth Edition (BPM5).* Technical assistance provided by STA (statistical advisor posted at the BCEAO headquarters in Dakar from July 1996 through July 1999) contributed to the improved reporting of yearly balance of payments data in the framework of the *BPM5* for the period 1996-2001. With the backward revision of data to 1988, a consistent series was created. 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.

9. Regarding trade data, the ASYCUDA[1] customs computer system was upgraded in 1999, and its installation in all main border customs houses is being completed; this should allow for a better monitoring of import data.

10. 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.

11. 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 annual, exhaustive survey for the reporting of foreign direct investment transactions in Benin is still at a very preliminary stage. The BCEAO has recently updated the compilation system for reporting by commercial banks of report data on payments involving nonresidents, however these data are not used to produce annual balance of payments estimates, but rather to assess existing information.

12. A technical assistance mission on balance of payments statistics visited Cotonou during November 11-23, 2004. The main findings of the mission was that there is a lack of human resources at the national agency of the BCEAO, but there is a well developed and consistent reporting system. Regarding trade in goods, and the recording of informal transactions, the statistical adjustments to Customs data appear methodologically sound;

[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.

however, the hypotheses and reference bases on which they rest are largely untested. Other weaknesses in the current account concern transport services whose exports seem largely underestimated, and receipts of public current transfers with an opposite bias. In the financial account, the coverage of direct investment is poor, and the issue of unsorted banknotes already mentioned in the paragraph on monetary statistics has also a significant impact on the compilation of net external assets in the balance of payments and international investment position of Benin.

Poverty data

13. 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.

External debt

14. 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 July 15, 2005

	Date of latest observation	Date received	Frequency of Data[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]	10/04	1/10/05	M	M	M
Reserve/Base Money	3/05	6/1/05	M	M	M
Broad Money	3/05	6/1/05	M	M	M
Central Bank Balance Sheet	3/05	6/1/05	M	M	M
Consolidated Balance Sheet of the Banking System					
Interest Rates[2]	6/05	7/05/05	M	M	M
Consumer Price Index	05/04	07/04	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]					
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	03/04	06/04	M	M	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]					
External Current Account Balance	12/03	06/04	A	A	A
Exports and Imports of Goods and Services	12/03	06/04	A	Q	A
GDP/GNP	2003	06/04	A	A	A
Gross External Debt	2003	06/04	M	M	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.

Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

Press Release No. 05/190
FOR IMMEDIATE RELEASE
August 5, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$9.1 Million Three-Year Arrangement for Benin Under the Poverty Reduction and Growth Facility

The Executive Board of the International Monetary Fund (IMF) today approved a three-year arrangement for Benin under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent of SDR 6.19 million (about US$9.1 million). The first disbursement under the arrangement will amount to the equivalent of SDR 0.88 million (about US$1.3 million).

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. The last three-year arrangement under the PRGF expired on March 2004 with the full amount drawn.

Following the Executive Board's discussion of the request by Benin, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair stated:

“The Beninese authorities’ prudent macroeconomic policies can be credited for a decade of sustained economic growth and low inflation. Since 2003, however, adverse external developments, along with budgetary slippages and delays in implementing key structural reforms, have contributed to a weakening in economic performance.

“In a welcome response, the authorities have adopted a new economic and financial program that seeks to strengthen economic performance, implement an export-led development strategy, reduce the vulnerability of the economy to shocks, deepen structural reforms to foster private sector development, and reduce poverty. Building broad support for reforms under the program will be key to its success.

“Underpinning the achievement of these objectives, fiscal policy appropriately aims at correcting recent budgetary slippages, strengthening public finances, ensuring debt sustainability, and implementing the poverty reduction strategy. In that context, the authorities’ decision to limit the deterioration of the 2005 fiscal deficit is promising.

“The authorities’ ongoing efforts to raise the revenue-to-GDP ratio through better tax administration and to restructure expenditure towards the social sectors are critical elements of the medium-term fiscal program. The settlement of wage liabilities that arose from past delays in aligning civil servants’ pay with their grade-based wages will need to be accompanied by civil service reforms to enhance fiscal sustainability through a greater control of the wage bill. Benin will also need further improvements in public expenditure management to enhance transparency and governance in public finances.

"To achieve higher levels of growth, reduce the vulnerability of the economy to external shocks, and achieve lasting inroads against poverty, the authorities' program aims at strengthening the cotton sector and removing key impediments to growth. Sustained reform efforts to stimulate private sector growth, and improve the business environment will be needed, particularly in transportation infrastructure, telecommunications, and energy.

"In 2005, important reforms will be carried out to raise the cotton sector's productivity and contribute to its further development. In particular, the government will withdraw from productive and commercial activities in the sector, and take steps to strengthen the sector's institutional framework.

"Medium term economic prospects will be enhanced by the implementation of a strategy to promote and facilitate trade that will benefit from the recommendations of a recent diagnostic trade integration study. The overall competitiveness of the economy and the business environment will also improve as a result of strengthened governance including, the envisaged reforms of the telecommunications and energy sectors, as well as the Port of Cotonou and the transportation sector in general," Mr. Kato said

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.

ANNEX

Recent Economic Developments

Benin experienced a decade of good economic performance through the early 2000s but poverty reduction remains a concern. A combination of a deteriorating external environment and domestic policy slippages, in the budget and in structural reforms, saw economic performance weaken markedly after 2002. Moreover, these developments highlighted the vulnerability of the economy to external shocks because of its dependence on the cotton sector and on trade with Nigeria, its main trading partner.

Economic performance weakened in 2004, with growth slowing to about 3 percent. Inflation remained low, at 2.6 percent by year-end. A decline in manufacturing, including cotton ginning, and an intensification of trade restrictions in Nigeria led to a slowdown in economic activity, a deterioration of the external current account deficit, and a loss of government revenues. Progress on the structural front was uneven, with minor advances in privatization and cotton sector reform. Policy decisions, including on civil service wages and a decision to provide a subsidy to farmers due to the fall in world cotton prices, resulted in a weak underlying fiscal situation in 2005.

Program Summary

The program for 2005 aims at a modest economic recovery, reflecting an economic environment that remains difficult. A tightening of fiscal policy through adjustment measures equivalent to 2.1 percent of GDP will partially offset past budgetary slippages and limit the deterioration of the narrow primary deficit to 0.9 percent of GDP. The structural reform program aims to make progress in implementing the reform agenda of the cotton sector, the Port of Cotonou, and the telecommunications and electricity parastatals, as well as in improving public management.

The new PRGF arrangement seeks to strengthen macroeconomic stability, implement an export-led development strategy to reduce the vulnerability of the economy to shocks, deepen structural reforms to foster private sector development, and achieve progress in the implementation of the poverty reduction strategy. The authorities' reform plan reflects the recommendations of the ex post assessment of performance under Fund-supported programs by focusing on macroeconomic stability, and reforms to promote strong growth and diversification, as well as a restructuring of public expenditure to support poverty reduction.

The authorities' strategy aims at stabilizing and restoring the fiscal situation, and getting structural reforms back on track, particularly in the cotton sector and the Port of Cotonou, while establishing a stronger policy framework to meet medium term objectives. The strategy will initially focus on completing the cotton sector reform and giving new impetus to the privatization program while gradually implementing measures to promote and facilitate trade. Public sector management will focus on a strengthening of fiscal management and civil service reform.

The government has strengthened its reform program through a series of strong prior actions that have validated the fiscal program for 2005 and provided new impetus to key structural reforms, particularly in the period leading up to the presidential elections scheduled for March 2006.

Table 3. Benin: Main Economic and Financial Indicators, 2002–08

	2002	2003	2004	2005	2006	2007
			Est.	Program	Proj.	
National income						
GDP at current prices	6.8	5.7	3.4	5.8	6.5	7.3
GDP at constant prices	4.5	3.9	3.1	3.9	4.4	5.1
GDP deflator	2.2	1.7	0.3	1.8	2.0	2.2
Consumer price index (average)	2.4	1.5	0.9	2.5	2.5	2.5
Consumer price index (end of period)	1.2	0.8	2.6	2.5	2.5	2.5
Production of cotton (in '000 of tons)	400.7	337.5	333.1	425.0	416.5	437.3
Central government finance						
Revenue	13.2	10.2	0.2	11.8	5.6	9.4
Expenditure and net lending	8.2	11.6	0.7	19.2	3.8	7.7
Money and credit						
Net domestic assets 1/	4.6	11.3	4.2	11.1	...	...
Domestic credit 1/	7.5	12.8	4.4	11.1	...	...
Net claims on central government 1/	2.3	-0.2	1.8	3.0	...	...
Credit to the nongovernment sector	16.1	33.0	4.5	12.1	...	...
Broad money	-3.8	-12.7	-5.0	5.8	...	...
Velocity (GDP relative to average M2)	3.4	3.6	4.4	4.7	...	...
External sector (in terms of CFA francs)						
Exports, f.o.b.	-3.9	14.2	3.0	7.3	4.1	10.1
Imports, f.o.b.	13.8	3.6	3.9	5.8	6.0	5.9
Export volume	10.4	11.6	-13.6	28.1	6.0	7.3
Import volume	5.5	4.7	3.0	3.6	4.6	5.3
Terms of trade	-19.3	3.4	18.1	-18.0	-3.1	2.1
Nominal effective exchange rate (minus = depreciation)	6.4	4.8	3.2	...	...	...
Real effective exchange rate (minus = depreciation)	5.5	4.1	2.6	...	...	...
Basic ratios						
Gross investment	17.2	19.6	19.0	20.3	20.6	21.0
Government investment	6.1	6.8	6.1	7.4	7.5	7.7
Private sector investment	11.1	12.8	12.8	12.9	13.1	13.3
Gross domestic saving	3.3	6.7	6.2	7.6	8.1	9.0
Government saving	6.1	6.3	3.8	4.4	5.2	5.1
Nongovernment saving	-2.8	0.5	2.4	3.2	2.8	3.9
Gross national saving	8.8	11.2	11.0	12.1	12.0	12.9
Central government finance						
Revenue	16.3	17.0	16.4	17.4	17.2	17.5
Expenditure and net lending	19.5	20.6	20.1	22.6	22.1	22.2
Primary balance 2/	1.0	0.2	0.0	-0.9	-0.4	-0.1
Primary balance (narrow definition) 3/	1.0	0.2	0.0	-0.9	-0.4	-0.1
Overall fiscal deficit (payment-order basis, excluding grants)	-3.3	-3.7	-3.7	-5.3	-4.9	-4.6
Overall fiscal deficit (cash basis, excluding grants)	-4.3	-3.7	-4.5	-6.1	-5.5	-5.1
Debt service (after debt relief) in percent of revenue	4.5	3.2	1.6	1.3	1.9	2.0
External sector						
Trade balance	-12.2	-11.3	-11.4	-11.3	-11.4	-10.9
Current account balance (excluding grants)	-8.6	-8.6	-8.7	-8.7	-8.7	-8.0
Current account balance	-8.4	-8.3	-8.0	-8.2	-8.7	-8.0
Overall balance of payments	-3.6	-5.6	-2.5	-1.7	-2.5	-2.1
Debt-service-to-exports ratio 4/	12.5	6.9	6.9	6.1	6.6	6.7
Net present value of debt-to-exports ratio 4/	244.2	147.0	142.1	139.4	142.3	140.4
Debt-to-GDP ratio 4/	42.8	34.7	32.4	34.1	34.3	34.1
Gross reserves in months of imports	8.8	7.9	6.1	5.1	4.5	4.2
Nominal GDP (in billions of CFA francs)	1,956.7	2,067.9	2,138.2	2,261.5	2,408.7	2,585.7
CFA francs per U.S. dollar (period average)	694.6	580.1	527.6	499.2	499.5	499.1
Population (midyear, in millions)	6.8	7.0	7.2	7.4	7.6	7.9

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

1/ In percent of broad money at the beginning of the period.
2/ Total revenue minus all expenditures, excluding interest due.
3/ Total revenue minus all expenditures, excluding foreign-financed capital expenditure and interest due.
4/ After debt relief.

Statement by Damian Ondo Mañe, Executive Director for Benin
August 5, 2005

On behalf of my Beninese authorities, I would like to thank the staff for the constructive policy discussions with my authorities, and the well-written staff documents provided to the Board. The staff report on recent economic developments and the request for a new Three-Year PRGF Arrangement, due to the fact that outstanding challenges still remain, present a picture of the economic developments since our last Board discussions in October 2004. Also, the “Joint Staff Advisory Note on Poverty Reduction Strategy Paper- Annual progress Report” highlighted well the long way Benin has come over the last decade of cooperation with the Fund. Under this program my authorities seek to consolidate progress achieved so far under the previous PRGF programs.

In spite of progress made, Benin’s economic and financial situation remains fragile and vulnerable to external shocks due to the high dependence on cotton sector and trade with Nigeria, both of which were affected by external shocks. The persistence of unfavorable international environment affected Benin cotton sector and contributed to delay some structural reforms.

Over a decade through early 2002, Benin had made an impressive progress in economic performance aimed at strengthening the cotton sector, keeping the momentum of privatization process, and promoting export diversification. However, the last two years and half achievements have been rather less bright. Adverse external shocks caused by drop in the international prices for cotton, and restrictions on Beninese exports to Nigeria, have led to slowdown in economic growth and affected competitiveness. Economic growth in 2004 declined to about 3.1 percent from 3.9 percent in 2003, while inflation remained low at 2.6 percent. My authorities are however determined to address steadfastly the challenges facing the country, mainly through diversification of the economy and more resolute implementation of economic and social policies. For this effect, the Beninese authorities are keen to embark on a new Fund-supported PRGF program that will permit to carry out the needed economic reforms. A new PRGF arrangement with a low access would aim essentially at strengthening macroeconomic stability and implementing an export-led development strategy in order to reduce the vulnerability of the economy and achieve poverty reduction objectives.

Recent economic developments -- 2004 and the first half of 2005

In the fiscal area, economic slowdown resulted in a fall of revenue collection, while the wage bill has increased. Over the year 2004, Benin made continued progress in reforming the budget system and rationalizing expenditure management. The authorities have had to postpone some fiscal measures in the 2005 budget in order to take into account the optimistic forecasts of 2005 revenue, slippages in the wage bill that was inflated in view to diffuse teachers’ strike, subsidy to cotton producers, and costs of preparation of the 2006 presidential elections. Overall, these changes are likely to widen the budget deficit to 8.4

percent of GDP in 2005 from 5.2 percent in 2004.

Furthermore, the continued drop of cotton price has exacerbated the price slump that began in 1996. Against these developments, my Beninese authorities should be commended for their prompt response. Without delays the government set out input prices as a first step of a series of actions to preserve the producers incentive, followed by the maintaining of prices at the previous level with a view to protecting farmers. As a result, the privatization of the former public cotton sector monopoly, SONAPRA, was postponed.

Improvement in the cotton sector is taking time to materialize despite efforts made. The authorities are however prepared to privatize right away at least 10 ginning plants, pending to move to reform SONAPRA. For the government, SONAPRA plays a central role by assisting, not only cotton producers, but also the farmers in general. The government stands ready to eliminate uncertainties within the sector stemming from the nature of the relationship among the various shareholders and intends to sweep off the stress emerging from the transition from public monopoly to an integrated framework of multiple private operators. Due to the strong opposition of the trade unions, reform of the cotton sector as well as other public services was however delayed. These services include the electrical energy company as well as the post and telecommunications public enterprises.

Since 2003, the Port of Cotonou has continued to loose its competitiveness, causing the diversion of transit trade to more efficient and competitive regional ports. However, although major public finance administrations, mainly the customs and tax administrations were experiencing some difficulties, strong measures taken by the government have permitted goods and services to move freely.

The regional trade shock is unsustainable for Benin since Nigeria is an important neighboring country and plays a crucial part in Benin’s exports. Benin’s exports to Nigeria comprise a large amount of informal reexports of about 7 percent of GDP. The introduction by Nigeria of a ban on 44 imported items from Benin in 2003 has led to a decline of total exports to Nigeria which has a substantial impact on Benin’s economy. The government was conscious of the seriousness of this development, and as early as April 2005 the authorities signed a trade agreement with their Nigerian partners that allows in Nigeria only goods of Beninese origin, while banning all reexports goods. The next month, a Joint Committee on Commerce was put in place to monitor and improve trade relations between the two countries.

Overall, the external current account deficit deteriorated somewhat as a reflection of lower volume of cotton exports, a higher oil bill, and decline in exports to Nigeria.

The program for the remainder of 2005

For the remainder of the year, my Beninese authorities will forcefully pursue their actions to get things right. As the 2005 budget, just after adoption, came under pressure, the authorities will need to take vigorous measures to increase revenue and to reduce expenditure in an amount equal to 1.1 percent of GDP. Particularly, they are working to contain the narrow primary fiscal deficit at 0.9 percent of GDP and the overall deficit at 5.3 percent of GDP.

Specifically, fiscal policy will be tightened to contain the budgetary pressures as well as the deteriorating primary deficit. The government is ready to take strict actions to increase revenue to at least 17.4 percent of GDP for the whole year 2005 that integrates the settlement receipt of the electricity company. It is also expected a significant improvement in customs and tax administration during the remaining of 2005. In parallel, a number of reforms in the fiscal area will accompany these measures, notably the introduction of a new taxpayer identification number, the improvement of the computerization of customs and the taxpayer unit, and a strengthening of monitoring and controls of tax exemptions.

For the year as a whole, total spending and net lending are expected to attain 22.7 percent of GDP as a result of measures designed to limit the increase in expenditures. Despite the number of budgetary restrictions, this budget will nonetheless contribute markedly to reducing poverty, while, at the same time, helping maintain macroeconomic stability and long-term fiscal viability.

For the rest of year 2005, the authorities will continue to address difficulties stemming from trade restrictions, and the postponement of some investment decisions regarding private sector.

Medium-Term challenges and objectives

Down the road, Benin faces at least three important challenges: maintaining and improving macroeconomic stabilization, reviving the cotton sector and coping with vulnerability caused by the drop in cotton price, and advancing poverty reduction. The new program seeks to address these challenges. Indeed, the PRGF–supported program’s goal is to keep the government fiscal deficit in line with the objectives of debt sustainability. At the same time, efforts are needed to improve the level and quality of poverty-reducing spending. The authorities are well aware that the gap between the MDG poverty line and the trend observed in Benin is still considerable, with respect to depth and gravity of poverty. As such, poverty remains an important issue despite improvement in most poverty indicators since 1990 and Benin’s satisfactory economic performance up to 2002. Indeed, dependence on cotton sector and fall in cotton prices affect the farmer’s incentive as regards the production.
The Beninese authorities are conscious that taking strong macroeconomic policy measures and adopting pro-poor policies are crucial to achieve higher sustainable growth that can translate into effective poverty reduction. They realize that during almost a decade, although the country has experienced a high growth rate of about 6 percent a year, poverty has not receded significantly. They have drawn the conclusion that high growth only without pro-poor measures may not be sufficient to help reduce poverty. To this end, they turn to develop a new strategy susceptible to integrate priorities pertaining to increase of expenditure on social and priority sectors. Also, they view that diversification and increased resilience of the economy to external shocks in the medium term are essential to ensuring the sustainability of growth.

In this respect, the authorities are determined to achieve, in the context of basic macroeconomic objectives for the next three years, an annual growth rate of more than 4 ½ percent, contain inflation at a very low level, and reduce significantly the external current account deficit to about 7 percent of GDP by 2008. The government intends to achieve within the three-year period a production of about 600,000 tons of raw cotton, and pursue discussions with the Nigerian government to ease exports conditions free from restrictions and boost trade-related activities which are beneficial to the whole economy. The government assures that two thirds of increase of investment will be directed to infrastructure and social sectors expenditures.

Under these circumstances, the authorities are confident that the program is endowed with all the necessary ingredients to provide new impetus to deepen the reforms of the budget and public finance management and to support the government reform of civil service.

In the fiscal sector, the authorities are working to maintain debt sustainability in the range of 140 percent. At the same time, they will implement the expenditure plan in line with the PRSP. The authorities' objective is also to correct the budget from deteriorating and to restore public finances back on a sound path, to eliminate the fiscal primary deficit within 2008, while revenue will increase slightly. On the revenue side, the authorities' strategy envisages to simplify the tax system and widen the tax base. At the same time, tax and customs administration will be strengthened with a view to enhancing the fiscal yield. Also importantly, tax exemptions will scale down dramatically. On the expenditure side, while current spending is projected to attain 14 ½ of GDP, the capital expenditure will stabilize around 8 percent of GDP. The strategy which anticipates the containment of the wage bill at 5.7 percent of GDP, will however make room for an increase in expenditure on social and priority sectors. All these objectives will be made possible in the context of on-going improvement in budgetary management.

The government is expecting budgetary support to attain 6 percent of GDP in the form of concessional loans and grants. Moreover, from the consolidated Central Government operations for 2005 it comes out a financial gap of CFAF13.9 billion that the authorities seek to finance from multilateral and bilateral sources, instead of domestic borrowing. There will be a reduced domestic contribution which will amount to only 0.6 percent of GDP. The authorities intend to further strengthen expenditure management through reactivation of automatic controls of expenditures, thanks to the integrated computerized management system (SIGFIP). They are determined to sharpen the quality and reporting time of fiscal operations as the reflection of their efforts to improve transparency and governance.

In the financial system, my Beninese authorities should be commended for their continued efforts to strengthen the financial system further. As a result, the financial institutions are quite sound and the banking commission will continue its close watch on the system.

With respect to **structural reforms,** it is worth noting that trade continues to play an important role in Benin's economy, mainly facilitated by the proximity of the large market of the neighboring Nigeria, so that there appears essential that structural reform agenda needs to focus on implementation of policies to ease and promote trade. In order to take better advantage of trade, my Beninese authorities are prepared to eliminate the various domestic bottlenecks, including reducing high transportation costs, facilitate access to lands, improving domestic regulations governing services, and streamlining private sector environment. They are confident that these measures will likely help to bring back the full competitiveness of the economy. Last but not the least, the diversification of the economy should press ahead and add up to the various actions underway.

The government had attached and continues to attach a great importance to its disengagement from direct intervention in the cotton sector. It is therefore encouraging to note that the government has started transferring SONAPRA' s ginneries to the private sector. They are also prepared to introduce a transparent and flexible price system in order to guarantee a better and easier management of the sector. Efforts are underway to strengthen the management of the Port of Cotonou, paving the way for private sector participation in the management of the port. In the same vein, the privatization of the telecommunications and electricity companies will be completed by end-2005. There is assurance that the Parliament will pass as soon as possible the export-processing zones (EPZ) legislation.

Conclusion

Benin has done much to achieve debt sustainability. The ratio of the NPV of the debt-to-exports ratio would remain below 150 percent and decline over the projection period, assuming that international environment for cotton sector and donor grants remain adequate. Moreover, public debt in terms of GDP is projected to be constant at about 34 percent over the three years of the new program. It is supposed to continue to decline over the time. However, there are anticipations that the country's debt burden would worsen substantially, should an adverse macroeconomic shock emerge. A lower export growth could be one of its major causes, particularly since Benin's dependence on cotton exports is high. Other challenges remain, as highlighted above. Benin belongs to the group of low-income countries that will benefit from the 100 percent multilateral debt cancellation decided by the G-8 countries. This constitutes an additional input that could further help Benin achieve the MDGs. My authorities, consequently, are requesting a three-year arrangement with the Fund under the PRGF, with low access. They call on the international community' strong support to help them appropriately conduct the program towards the attainment of projected goals.