Benin—Assessment Letter For The World Bank
January 21, 2016

Recent Economic Developments

1. **The generally positive macroeconomic trends under the ECF-supported program that expired in June 2014 continued in Benin, even though the implementation of the 2014 budget was hampered by declining customs revenues.**

- **Benin achieved the objective of enhancing growth,** closing the earlier gap with the sub-Saharan Africa (SSA) average in per capita GDP growth. Overall growth in 2014 is expected to reach 5½ percent for the third consecutive year. Commerce was a major contributor to growth. With favorable weather and high world prices, cotton production has recovered since 2012 and also contributed to higher growth. Meanwhile, inflation remained low.

- **Weak customs revenues in 2014 were largely offset by expenditure cuts, leading to a fiscal deficit broadly in line with budget projections**. A drop in informal re-exports to Nigeria led to a tax revenue shortfall projected at about ¾ percent of GDP compared to the budget. Despite higher-than-projected subsidies in the government's cotton sector management, tight control of other recurrent spending and lower public investment offset the revenue shortfall, leading to a fiscal deficit of about 3½ percent of GDP in line with budget projections. Benin's debt-to-GDP ratio is projected at about 30 percent—12½ percentage points below the average for non-resource intensive SSA countries in 2014 and consistent with a low risk of debt distress. However, the volatility of customs revenues underlines the need to strengthen domestic revenues.

- **The external position remained sound.** The import of equipment for oil exploration in 2013 as a one-off investment led to a sharp but temporary current account deterioration, which was broadly reversed in 2014. Concessional financing and foreign direct investment have been the main sources of external financing. The real effective exchange rate has remained broadly in line with fundamentals since the last Article IV consultation in 2012,[1] but many indicators on economic competitiveness remained weak.

- **The banking sector remained stable overall despite some deterioration in loan quality.** The share of non-performing loans increased in 2013, and the concentrated exposure of six banks to the Talon group, which faces financial problems, has created additional stress. The West African Monetary and Economic Union's (WAEMU) Banking Commission audited the six banks in May 2014 and found little systemic risk. A few banks may require recapitalization by their private shareholders, but the needs are manageable in view of past experiences. Similar to other WAEMU countries, there was significant regulatory forbearance

[1] IMF Country Report No.13/9.

in Benin, with a quarter of the banks not in compliance with some prudential norms. One of the two banks under protracted conservatorship was acquired by another bank in 2013.

Outlook and Macroeconomic Policies

2. **Going forward, Benin's challenge is to achieve strong and sustainable growth necessary to significantly reduce poverty**. Growth diagnosis shows that infrastructure bottlenecks and weak business environment are the binding constraints. The government presented a plan to address these challenges at a Round Table Conference with donors and private sector representatives in Paris in June 2014, and it includes the following:

- **An ambitious public investment program during 2015–19.** To address the large infrastructure gap, the government presented public investment projects equivalent to about 18 percent of GDP, mainly in energy, transport, and rural infrastructure. The investment path would bring Benin's public investment level in line with the WAEMU average over the medium term. In order to protect Benin against risks of debt distress, the financing for the scaling up of investment would need to be predominantly concessional. While donor pledges at the Round Table largely met this requirement, it is uncertain what financing amount and terms will materialize. The government also plans to use public-private partnerships (PPPs), although a PPP regulatory framework is not yet in place.

- **A package of structural reforms.** Building on the recent port reform, the government is implementing additional pro-business reforms—such as reducing the cost and time for business registration and for construction permits and establishing a new commercial court to facilitate dispute resolution. Initial reforms in this regard have led to an improved ranking in the World Bank's Doing Business Indicators from 167th to 151st among 189 economies, but more efforts are needed to improve access to credit and to ease the burden of paying taxes. Enhanced domestic revenue to reduce the dependency on informal re-exports to Nigeria and strengthened Public Financial Management (PFM), including for PPPs, are also key reform objectives.

3. **The 2015 budget adopted by parliament reflects government priorities of addressing infrastructure bottlenecks to growth while preserving macroeconomic stability**. The widening of the fiscal deficit to about 7¼ percent of GDP in 2015 is driven by an increase in public investment of 3½ percent of GDP, of which about 2 percent will be financed externally, predominantly through grants and loans with a significant concessionality component. The increase in domestic financing of projects by about 1½ percent of GDP partly reflects a carry-over from 2014 when revenue shortfalls required some cuts in investment spending. Domestic financing constraints are expected to ease in 2015 mainly by the projected privatization receipts of about 2 percent of GDP from the telecommunication sector.

4. **Risks for the 2015 budget stem from the following factors:**

- **Risks from global spillovers.** While efforts to enhance infrastructure and the business environment are expected to sustain the positive growth trend over the medium term, the outlook for 2015 is clouded by the impact of declining oil price on growth and national income in neighboring Nigeria which is the main destination of Benin's informal re-exports. The impact of declining world cotton prices on growth is minor, but it results in higher subsidies estimated at close to 1 percent of GDP in the 2015 budget. In view of these risks, the budget's GDP growth forecast of 6 percent is rather optimistic, and IMF staff projections are currently based on 5½ percent growth, assuming that the positive demand impact of investment spending will broadly offset negative spillovers on growth.

- **Risks from slippages in reform implementation.** Benin does not have a history of pronounced political spending cycles, but given the planned municipal, legislative, and presidential elections in 2015–16, a tense political environment could complicate reform implementation. To reverse the underperformance of tax revenues in 2014, the government is enhancing tax and customs administration, but most reforms are still at an early stage. Privatization proceeds could fall short of expectations, although the government has some buffer in domestic financing to at least partly offset possible shortfalls. The efficient implementation of higher investment spending requires improvements in PFM and project management capacities. Some progress has been made in procurement reform and in strengthening IT systems to improve the spending process. To further improve PFM, the government is working on a comprehensive action plan based on a recent Public Expenditure and Financial Accountability assessment and FAD technical assistance.

- **Financing the scaling up of investment.** The government has made progress in securing external financing that has a significant concessionality component and in preparing state-owned telecom companies for privatization. However, some uncertainties remain, including regarding the financial arrangements for large investments planned for 2016 and beyond, some in the form of PPPs. Implementation of scaling up of investment should be conditional on confirmed access to financing that is largely concessional and limits risks for future budgets.

IMF Relations

5. **After successfully completing an ECF-supported program in June 2014, the government indicated interest in a new program, but program negotiations have been delayed.** During the previous program, macroeconomic stability deepened and growth performance improved. The government has continued to express its interest in a new ECF-supported program. The timing of discussions has been delayed by a government reshuffling in August 2014 and by legislative elections planned for April and municipal elections for May 2015. Accordingly, the authorities have requested that the planned mission, to include both program and Article IV discussions, be held no earlier than June 2015. (The Article IV consultations should have been concluded by November 2014 according to the applicable consultation cycle.)