Also Available in French

Benin—Assessment Letter for Donors

December 8, 2009

1. This letter provides an assessment of recent macroeconomic developments in Benin and an update on the discussions of Fund staff with the Beninese authorities on macroeconomic policies and structural reforms that could form the basis for the authorities' request for a new arrangement supported by the International Monetary Fund.

Background

2. The last three-year arrangement with Benin under the Poverty Reduction and Growth Facility (PRGF) expired on August 4, 2009. At the time of the approval of the sixth and last review under the PRGF arrangement on June 24, 2009, the IMF Executive Board approved the authorities' request for an augmentation of access of 15 percent of quota (equivalent to about $15 million) to help mitigate the impact of the global economic crisis on Benin. The authorities' program presented with the sixth review included quarterly indicative targets for 2009 and a plan to complete three outstanding structural benchmarks by end-2009. A copy of the staff report for the sixth review is available on the IMF website at http://www.imf.org/external/pubs/cat/longres.cfm?sk=23187.0. In addition, the IMF provided Benin with a general SDR allocation of about $77 million on August 28, 2009 to alleviate further the negative impact of the global economic crisis.

Recent Economic Developments

3. The global economic crisis continues to adversely affect the near term prospects of the Beninese economy. Real GDP growth is projected to slow to 2.5 percent and 3.0 percent in 2009 and 2010, respectively, a significant decline from 5.0 percent in 2008. The slowdown is mainly driven by weak prospects for cotton production and exports, and trade with neighboring countries. Inflation continues to decline because of lower agricultural prices, thanks to a good cereal harvest, and a decline in international food and fuel prices. Notwithstanding improvement in the terms of trade, the external current account deficit, excluding grants, is expected to widen to about 13 percent of GDP in 2009, reflecting on one hand the decline in cotton exports and, on the other hand, expansionary fiscal policy.

4. The fiscal situation deteriorated significantly in the first half of 2009. The slowdown in economic activity resulted in a 5 percent decline in fiscal revenues compared with the same period of 2008. At the same time, the wage bill grew by 35 percent mainly driven by a doubling of the cost to the budget of bonuses and other fringe benefits to civil servants. Domestic capital spending nearly tripled, compared to the first half of 2008, due in part to a CFAF 81 billion carryover of expenditure commitments from 2008, as the authorities sought to stimulate growth. Overall, compared to the authorities' program, expenditure slippages

amounted to about 4 percent of GDP, which resulted in a significant increase in the overall deficit and strong pressures on the treasury.

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

6. Following an IMF mission to Cotonou in September 2009, the authorities have taken additional measures to contain public spending and mobilized additional donor support to reduce the financing gap for the remainder of 2009. In particular, the authorities: 1) stopped most expenditure commitments for capital investment from September 28, 2009; 2) scaled back stipends and pensions by CFAF 5.3 billion in line with the pace of execution up to end-September 2009; 3) reduced other expenditures and transfers; and 4) postponed about CFAF 50 billion in capital spending to the 2010 budget. In addition, the authorities have mobilized the following resources totaling CFAF 83.5 billion (2.7 percent of GDP): 1) the domestic counterpart of the SDR allocation equivalent to CFAF 32.8 billion; 2) the bond refinancing guaranteed by the regional central bank of CFAF 36.5 billion; 3) the transfer of 17.5 percent of shares owned by the state in the ginning company SODECO to the strategic investor; 4) the reimbursement of unused grants for free nursery and primary education for the school year 2008/09; and 5) the compensation of customs revenue losses by ECOWAS as part of the common tariff agreement. Notwithstanding these efforts, the overall cash deficit (excluding grants) is expected to reach 10.1 percent of GDP, a fiscal deterioration of 3.4 percent of GDP compared with the authorities' program approved by the IMF Executive Board in June 2009.

7. The assessment by Fund staff is that the fiscal situation will continue to be difficult for the remainder of 2009 and early in 2010. Tax revenue collections are weak, mostly reflecting a decline in customs revenue. The proposed spending cuts to reduce the financing gap seem ambitious, given the high level of transfers and capital spending by end-October 2009. In addition, some of these cuts will be achieved by postponing spending to the 2010 budget, entailing additional financing pressures in early 2010. The timing of donor disbursements to reduce the residual financing gap is also unclear. The authorities have assured Fund staff that the proposed spending cuts will not affect priority spending for the social sectors.

8. Fund staff considers the draft 2010 budget presented to the National Assembly to be optimistic. The draft budget, which was not discussed with Fund staff, is based on a 36 percent increase in revenues compared with the authorities' revised estimates for 2009. The increase in tax and nontax revenue is projected at 31 percent and 80 percent,

respectively. On this basis, total revenue are expected to reach CFAF 788.2 billion (23.8 percent of GDP), compared to CFAF 577.7 billion (18.3 percent of GDP) projected for 2009. Part of this increase is explained by a new tax on international telephone calls, an increase in the tax rate on cement from 10 percent to 18 percent, a projected expansion of taxable transit trade induced by the reduction in the tax on re-export from 8 percent to 4 percent, and the planned sale of three 3G GSM licenses in 2010. Total expenditures would expand by 21 percent vis-à-vis the authorities' expected outturn of 2009, to CFAF 1,052.6 billion (31.8 percent of GDP), compared to CFAF 870.2 billion (27.7 percent of GDP) projected in 2009. Accordingly, the overall cash deficit (excluding grants) would be equivalent to 8.5 percent of projected GDP. In addition, the draft budget shows a financing need of CFAF 165 billion (5 percent of projected GDP), and does not take into account CFAF 50 billion in carryover spending from 2009.

9. On November 24, 2009, the Beninese authorities and Fund staff reached understandings on a revised fiscal policy for 2010, as confirmed by the attached letter from Finance Minister Daouda dated December 1, 2009. Revenue projections have been revised to a more prudent 19 percent increase from 2009, to CFAF 686.7 billion (20.7 percent of GDP); the overall expenditure envelope on a payment-order basis would be limited to CFAF 883.2 billion (26.6 percent of GDP), including the expenditure carryover of CFAF 50 billion from 2009. This is in line with the expected available financing, which includes CFAF 50 billion still to be identified. Accordingly, the overall cash deficit (excluding grants) is projected to decline to CFAF 213.9 billion (6.5 percent of GDP), from CFAF 317.9 billion (10.1 percent of GDP) projected in 2009. Expenditure could be further increased if the authorities are able to mobilize additional revenues or additional external concessional financing on top of the one needed to cover the CFAF 50 billion financing gap. Fund staff believes that this revised fiscal policy for 2010, if implemented as planned, will result in the necessary adjustment to avoid the financing problems experienced in 2009 and will make progress toward a sustainable fiscal stance.

10. Finance Minister Daouda also confirmed in his letter that the following structural reforms measures were completed: 1) the financial audit of the accounts of the electricity company (SBEE) has been completed and a copy has been provided to Fund staff; 2) the use of the single taxpayer identification number (*identifiant fiscal unique)* has been extended to all importers and exporters and all major companies; and 3) the data interconnection between the tax department (DGID) and the customs department (DGDDI) has been made operational. The letter also noted that two outstanding measures from the previous PRGF arrangement will be completed with delays: 1) the expansion of the ASYCUDA+ + system to 12 additional regional customs posts is now expected to be completed by August 2010; and 2) the adoption of an informatization blueprint for the tax department (DGID) after its audit to operationalize the taxpayer identification number is now expected to be completed by September 2010. These implementation delays are not expected to have a significant impact on revenue collection in 2010. Progress toward the implementation of the one-stop window (*guichet unique*) at customs and the Port of Cotonou is expected to be completed by end-June 2010, following the recent Cabinet of Ministers' decision to implement a management

information system for port operators. The timetable for the implementation of this system will be sent to Fund staff before the end of 2009. Separately, the authorities also confirmed that the new strategy for addressing the deficit of the National Pensions Fund of Benin (FNRB) has been finalized; a copy of the strategy has been provided to Fund staff.

11. The authorities and Fund staff will continue their discussions in the next few months and have agreed to negotiate an economic and financial program in March 2010 that could be supported by an IMF arrangement.

Attachment—Letter from Economy and Finance Minister Daouda dated December 1, 2009
(Translated from the French Original)

Cotonou, Benin
Date: December 1, 2009

Antoinette Sayeh
Director of African Department
International Monetary Fund
Washington, DC

Subject: Mission of Benin delegation to the IMF, November 23-24, 2009

Dear Ms. Sayeh,

I would like to thank you for the arrangements made by your staff to facilitate discussions with the delegation that I led on November 23-24, 2009 in Washington. These discussions helped both parties reach an agreement on fiscal policy stance in 2010.

With respect to 2010, the government of Benin is committed to prudent fiscal management aimed at putting public finances on a viable path for maintaining microeconomic stability and debt sustainability. It was agreed upon with IMF staff to base 2010 budget execution on prudent forecasts of revenue and financing. Total revenue is projected at CFAF 686.7 billion, and financing (including grants) at CFAF 163.8 billion. Out of total financing, 35 billion is estimated in the form of concessional budget support (grants or loans with a grant element of at least 35 percent). An additional CFAF 50 billion in financing is needed, the sources of which have not yet been identified and which the government expects to mobilize during the course of the year in the form of additional concessional budgetary support from it technical and financial partners.

Based on these estimates, the government is committed to not exceeding the ceiling of CFAF 883.2 billion in expenditure execution, including approximately 50 billion in expenditure carried forward from fiscal year 2009. In addition, the government is committed to paying, within this ceiling, any outstanding amounts payable that may be accumulated in 2009. However, expenditure may be higher if revenue or additional concessional financing (beyond the 50 billion financing requirement mentioned above) are mobilized.

This prudent management will help avoid a new accumulation of outstanding payables as well as credit carryovers to the following fiscal year. The basic primary deficit is thus projected at CFAF 12.4 billion (0.4 percent of GDP), and the overall cash-basis deficit (excluding grants) at CFAF 213.9 billion (6.5 percent of GDP), an improvement over the results expected for 2009.

In support of this fiscal program, the government is also committed to accelerating the implementation of structural reforms aimed at improving fiscal management, enhancing revenue mobilization, increasing the competitiveness of the economy, and encouraging private investment. These reforms will include (but will not be limited to): (i) expanding the ASYCUDA++ information technology system by 12 additional stations at regional directorates by end-August 2010; (ii) adopting a master computerization plan for the Directorate General of Taxes and Property (DGID) after it is audited, aimed at making the Single Taxpayer Identification Number (IFU) operational by end-September 2010; and (iii) implementing the one-stop facility for the customs office and port of Cotonou by end-June 2010, based on a timetable that will be forwarded to IMF staff by end-2009.

In this connection, it would be helpful if the IMF could send an assessment letter to our technical and financial partners at the earliest possible date, to reassure them concerning the efforts made by Benin to consolidate public finances and pursue structural reforms. The government authorizes the IMF to publish this letter along with the assessment letter.

Sincerely yours,

/s/

Idriss L. Daouda