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**Benin:** Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

October 29, 2006

The following item is a Letter of Intent of the government of Benin, which describes the policies that Benin intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Benin, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

## Benin: Letter of Intent

Republic of Benin  
Ministry of Development, Economy,  
And Finance

Cotonou, October 29, 2006

The Minister

To:

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

Dear Sir:

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

The missed performance criteria pertain to the program requirements that the authorities not accumulate domestic payments arrears and neither contract nor guarantee nonconcessional debt. At end-June 30, 2006, domestic payments arrears accumulated in FY 2005 stood at about CFAF 33 billion (1.3 percent of 2006 GDP). With technical assistance from the World Bank, the government is carrying out a comprehensive evaluation of these arrears. The audit report, which is expected to be completed by December 2006, will include an arrears clearance plan. During the same period, the government guaranteed CFAF 17.4 billion (US\$ 31.3 million) in nonconcessional borrowing by Benin Télécoms, the state-owned telephone company. Also, the government did not meet the program's quantitative benchmarks for domestic revenue mobilization and the wage bill for the first review test date of September 30, 2005.

The government has taken the necessary steps to address existing weaknesses in the areas of missed performance criteria and to ensure that relevant targets and commitments are fully observed in the future. In particular, the government has enhanced Treasury cash-flow monitoring by establishing a cash-flow committee headed by the Minister of Finance. The

corrective measures taken to ramp up budget tracking should prevent accumulation of new domestic payments arrears. Furthermore, the government reaffirms herewith its commitment to no longer contract or guarantee nonconcessional loans in the future. In light of the remedial actions undertaken, the government requests waivers of nonobservance of the missed performance criteria; it also requests that the first PRGF review be completed and related PRGF resources disbursed.

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

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

Truly yours,

/s/

Pascal I. Koupaki

## Attachment I

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

#### I. INTRODUCTION

1. **Since the adoption of its medium-term economic program supported by the International Monetary Fund under the Poverty Reduction and Growth Facility (PRGF), the government has taken measures to consolidate progress made under previous programs and to lay the foundations for a new, second-generation, reform agenda.** The reform efforts aim to consolidate fiscal sustainability and improve the institutional environment, strengthen the country's socioeconomic infrastructure, and promote exports and economic diversification. They should enhance economic competitiveness, give new impetus to growth, and accelerate progress toward the Millennium Development Goals.
2. **The PRGF-supported program provides a framework for preserving macroeconomic stability and creating conditions for greater involvement of the private sector in the economy.** In this context, the government is pushing resolutely ahead with its fiscal consolidation program, and promoting modernization of public utilities by privatizing the state-owned enterprises operating in this sector. In agriculture and transport, reforms are focused for the most part on government disengagement from the cotton sector, and on modernization of the autonomous Port of Cotonou.
3. **This memorandum reviews progress made since the adoption of the program supported by the PRGF arrangement** and presents the policies and measures that the government proposes to implement in the last quarter of 2006 and in 2007 to achieve its objectives under the program.

#### II. ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

##### Recent economic developments and outlook for end-2006

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

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

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

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

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

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

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

**9. Determined action is being taken to meet the main fiscal targets for FY 2006.**

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

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

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

## Program implementation

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

### III. ECONOMIC AND FINANCIAL POLICIES FOR 2007

#### A. Macroeconomic Framework

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

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

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

*alia*, with resources from the Millennium Challenge Account. The financial support expected from that source is US\$307 million over five years.<sup>2</sup>

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

## **B. Fiscal Policy**

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

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

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<sup>2</sup> The agreements for access to these resources were signed in Washington, D.C. (USA) in February 2006.

<sup>3</sup> An FAD technical assistance mission visited Cotonou during October 10-23, 2006.

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



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

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

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

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

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

### C. Money and Credit

**22. Monetary policy will be conducted by the BCEAO at the regional level.**

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

### D. Balance of Payments and External debt

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

### E. Structural Policies

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

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

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

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

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

#### **F. Poverty Reduction Strategy Paper (PRSP)**

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

#### **IV. PROGRAM MONITORING**

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

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

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

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

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

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

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

1/ The targets and performance criteria are cumulative as from end-December of previous year.

2/ The ceiling on domestic financing will be adjusted pro tanto if the amount of disbursed budgetary assistance falls short of the program forecast up to a limit of CFA francs 10 and 18 billions at end-September and end-December 2006, respectively.

3/ If external budgetary assistance exceeds the amount projected in excess of more than CFAF 3 billion, the ceiling will be adjusted downward by the excess disbursement beyond CFAF 3 billion, unless it is used to absorb domestic arrears.

4/ This performance criterion is monitored on a continuous basis.

5/ Informal targets agreed with staff.

6/ To be set at time of second PRGF review.

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

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

1/ The targets and performance criteria are cumulative as from end-December of previous year.

2/ The ceiling on domestic financing will be adjusted pro tanto if the amount of disbursed budgetary assistance falls short of the program forecast up to a limit of CFA francs 10 and 18 billions at end-September and end-December 2006, respectively.

3/ If external budgetary assistance exceeds the amount projected in excess of more than CFAF 3 billion, the ceiling will be adjusted downward by the excess disbursement beyond CFAF 3 billion, unless it is used to absorb domestic arrears.

4/ This performance criterion is monitored on a continuous basis.

5/ Informal targets agreed with staff.

6/ To be set at time of second PRGF review.

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

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

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

**Attachment II****Technical Memorandum of Understanding**

October 29, 2006

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

**I. DEFINITIONS**

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

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

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



the arrangement, excluding those payments that cover the operation, repair, or maintenance of the property. Under this definition of debt set out above, arrears, penalties, and judicially awarded damages arising from failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

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

## II. QUANTITATIVE PERFORMANCE CRITERIA

### A. Ceiling on Net Domestic Financing of the Government

#### Definition

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

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

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

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

### **Performance criteria and indicators**

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

### **Reporting requirement**

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

## **B. Narrow Primary Fiscal Balance**

### **Definition**

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

### **Performance criterion**

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

### **Reporting requirement**

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

### **C. Accumulation of New Domestic Payments Arrears on Government Obligations**

#### **Definition**

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

#### **Performance criterion**

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

### **Reporting requirement**

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

### **D. Nonaccumulation of External Public Payments Arrears**

#### **Definition**

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

#### **Performance criterion**

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

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

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

**Definition**

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

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

**Performance criterion**

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

**Reporting requirement**

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

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

**Definition**

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

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

**Performance criterion**

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

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

### **III. QUANTITATIVE INDICATORS**

#### **A. Floor on Government's Revenues**

##### **Definition**

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

##### **Indicative targets**

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

##### **Reporting requirement**

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

#### **B. Ceiling on the Wage Bill**

##### **Definition**

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

##### **Indicative targets**

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

##### **Reporting requirement**

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

#### **IV. PRIOR ACTIONS FOR CIRCULATION OF THE REQUEST FOR THE COMPLETION OF THE FIRST REVIEW**

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

- Approval of disengagement strategies for Benin Telecoms SA, the cotton parastatal (SONAPRA), and for the electric power company (SBEE);
- Selection of an audit firm to assess outstanding domestic arrears and develop arrears settlement plan;
- Formal reaffirmation of government commitment to neither contract nor guarantee nonconcessional loans.

#### **V. STRUCTURAL PERFORMANCE CRITERION**

33. The following actions are set performance criteria

- Start up the centralized clearing and invoicing management center of the Port of Cotonou
- Effective start of the consolidated electronic billing at the centralized clearing and invoicing management center of the Port of Cotonou
- Establishment of a privately controlled ginning company to purchase and operate the ginning plants of SONAPRA

#### **VI. STRUCTURAL BENCHMARKS**

34. The government will complete the following actions:

- Transmittal to the Fund of the proposed program to develop and expand the activity of the Port of Cotonou;
- Transmittal to Fund staff of the report of government's debt vis-à-vis civil servants resulting from the past wage freeze and the accompanying plan to settle those obligations;
- Transmittal to the Audit Chamber of the relevant accounts of the 2005 budget; transmittal to the National Assembly of the settlement laws for the 2003 and 2004 budgets;

## **VII. OTHER DATA REQUIREMENTS FOR PROGRAM MONITORING**

### **C. Public Finance**

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

### **D. Monetary Sector**

36. The government will provide to the Fund the following data on a monthly basis within eight weeks of the end of the month:
- the consolidated balance sheets of deposit money banks, and the individual bank balance sheet, as needed;
  - the monetary survey;
  - lending and deposit rates;
- the standard bank supervision indicators for banks, as well as those for nonbank financial institutions and for individual institutions, as needed.

### **E. External Sector**

37. The government will provide to the Fund the following data within 12 weeks of the end of each quarter:
- Export and import price and volume data;
  - Other balance of payments data, including data on services, private transfers, official transfers, and capital account transactions.

### **F. Real Sector**

38. The government will provide to the Fund:

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

### **G. Structural Reforms and Other Data Requirements**

39. The government will provide to the Fund:

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