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REPORT AND RECOMMENDATIONS

OF THE PRESIDENT OF THE

INTERNATIONAL DEVELOPMENT ASSOCIATION

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED SUPPLEMENTAL CREDIT

FOR THE PUBLIC EXPENDITURE REFORM ADJUSTMENT CREDIT

IN THE AMOUNT OF SDR 7.6 MILLION

(US$10.0 MILLION EQUIVALENT)

TO

THE REPUBLIC OF BENIN

September 30, 2002

Poverty Reduction and Economic Management 3
Africa Region

CURRENCY EQUIVALENTS

Currency Unit = CFA Franc
US$1 = CFAF 666.352

GOVERNMENT FISCAL YEAR

January 1 - December 31

ACRONYMS AND ABBREVIATIONS

CAS	Country Assistance Strategy
CSPR	Centrale de Sécurisation des Paiements et du Recouvrement
DANIDA	Danish International Development Agency
GDP	Gross Domestic Product
IDA	International Development Association
IMF	International Monetary Fund
PERAC	Public Expenditure Reform Adjustment Credit
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
SONAPRA	Société Nationale pour la Promotion Agricole

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MEMORANDUM AND RECOMMENDATIONS OF THE PRESIDENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION TO THE EXECUTIVE DIRECTORS ON A PROPOSED SUPPLEMENTAL CREDIT TO THE REPUBLIC OF BENIN FOR THE PUBLIC EXPENDITURE REFORM ADJUSTMENT CREDIT IN THE AMOUNT OF SDR 7.6 MILLION (US$10.0 MILLION EQUIVALENT)

A. Introduction

1. I submit for your approval a proposed supplemental credit of SDR 7.6 million (US$10.0 million equivalent) to the Republic of Benin on standard IDA terms, with a maturity of 40 years, to be added to the Public Expenditure Reform Adjustment Credit (PERAC), Cr. 3479-BEN. The proposed supplemental credit would assist in meeting Benin's increased financing requirements caused by an unanticipated decline in the international price of cotton. If approved, the proposed supplemental credit would be released upon effectiveness; no additional conditions are being proposed for its release.

2. The absence of additional financing through the proposed supplemental credit would jeopardize the Government's ability to keep the macroeconomic and public expenditure reform program on track and to deliver basic social services. The proposed supplemental credit is fully consistent with the Bank's Interim Country Assistance Strategy (IDA/R2000-242) for Benin, which was discussed by the Executive Directors on January 23, 2001. The interim CAS envisaged the possibility of providing exceptional quick-disbursing assistance in case of an acute negative shock in the cotton sector.

B. Original Credit

3. The SDR 7.8 million (US$10.0 equivalent) PERAC was approved on March 22, 2001 and became effective on August 30, 2001, following the Government's fulfillment of effectiveness conditions, and the National Assembly's approval of the Credit Agreement. It is expected to close on March 31, 2003.

4. The PERAC is intended to: (i) increase the allocation of government expenditures on economic and social development and poverty alleviation; (ii) improve governance by providing a more explicit system of budget preparation and execution that links budget allocations to program objectives and sector strategies; (iii) increase the efficiency and incidence of public expenditures; and (iv) assure fiduciary transparency and accountability consistent with the international standards. The PERAC is a Structural Adjustment Credit associated with the Government's overall budgetary reform program. It supports Government's efforts to implement a set of institutional reforms and capacity building essential to reach these objectives. These include the following: (i) reform of the budget preparation system through the use of performance budgeting; (ii) strengthening administrative/institutional capacity for more efficient and timely budget execution; (iii) establishing a fiduciary framework; and (iv) greater use of

monitoring and evaluation techniques to better evaluate and report on the outcomes of public expenditures.

C. Supplemental Credit

5. Benin has been facing an unanticipated decline in the international price of cotton since early 2001. While international cotton prices fell by 15.6 percent in 2001, this and the global economic slowdown had a limited impact on Benin in that year as cotton exports were completed by mid-2001 and a significant part was sold on forward markets at a higher price. Also, the negative shock was partially compensated for by the strengthening of the US$ exchange rate by some 4.6 percent. However the decline in the world price of cotton and a higher than initially-projected decline in Nigerian economic growth are expected to have a much higher negative impact in 2002. Benin's real GDP growth rate is expected to be lower than projected by about one percentage point (5.3 percent instead of 6 percent) and the current account deficit to increase to 8.3 percent of GDP.

6. The Government has taken appropriate measures to offset the adverse effects of the external shock, but additional external assistance will be required to keep the macroeconomic and public expenditure reform program on track and protect social spending. The external non-project financing requirements are now estimated at US$29.5 million (see Table 1 below). Several donors, including the IMF, are expected to provide funds to meet the financing requirements.

7. ***The reform program is on track.*** Despite slower progress on the structural reform agenda, significant progress was registered in the two critical areas of cotton sector and budget management reform. The Government of Benin has taken strong measures to liberalize the cotton sector and encourage private sector investment in ginning activities. Private operators currently control 50 percent of the installed ginning capacity and preparations are underway to privatize the Government owned ginning plants. Following the elimination of the monopsony of the cotton parastatal (SONAPRA) in primary marketing in June 2000, an autonomous agency (CSPR - *Centrale de Sécurisation des Paiements et du Recouvrement*) was established by the private sector to oversee seed cotton marketing and facilitate input credit recovery by commercial banks. The CSPR operates as a clearing house through which the payment of seed-cotton by ginners to producers and the repayment of input credit by producers to distributors are coordinated.

8. A major budget management reform program supported by the PERAC was launched with the 2001 budget and significant progress has been made in improving public expenditure management, in particular: (i) a Medium-Term Expenditure Framework covering 2002-04 and consistent with the Poverty Reduction Strategy under preparation has been finalized; (ii) performance-based budgeting is driving the preparation of annual budgets for key ministries covering about 70 percent of total Government spending; (iii) a performance based budget cycle has been completed with an external performance audit conducted by the Chamber of Accounts; (iv) a new comprehensive budget implementation system is in effect since January 2001 and has been computerized; and (v) accounts for 1998 have been audited and approved by the National Assembly in 2002. Similarly, the final accounts for 1999, together with the opinion by the Chamber of Accounts, were presented to the National Assembly at end-2001. The 2000 accounts

are being audited by the Chamber of Accounts. The budget execution rate rose to 94 percent and payment lags decreased from 30 to 23 days in 2001.

9. ***The macroeconomic program supported by a PRGF arrangement is on track.*** Benin's macroeconomic performance is broadly satisfactory. The Government's macroeconomic objectives for 2002, supported by the Fund's current PRGF program, include: (i) a real GDP growth of 5.3 percent; (ii) containing inflation to 3.3 percent; and (iii) containing the external current account deficit to 8.3 percent. With the sharp fall in the world price of cotton, and the related increase in the Government subsidy to producers, the overall deficit of the Government will rise to 5.2 percent of GDP (from 4.2 percent originally programmed).

10. Consistent with the Fund-supported program, the Government has taken strong measures to respond to the external shock and mitigate its negative impact on growth and cotton producers' incomes. In effect, as the price shock occurred after the negotiation of price between private sector operators and during the first year of the cotton sector reform process supported by IDA through Credit 3598-BEN, the Government agreed to subsidize the cotton producer price. An agreement was reached at end-2001 by cotton sector actors to maintain the producer price at CFAF 200 per kilogram while reducing the price paid by ginners to CFAF 165 per kilo. The gap would be financed by a Government subsidy estimated at US$24.7 million (based on a production projected at 400,000 tons), or 1 percent of GDP.

11. The 2002 subsidy is a one-time intervention designed to help producers cope with the price shock. The Government has taken two decisive measures to limit the risk and the scope of Government subsidies for the next and future crop years. First, in the context of the ongoing cotton sector liberalization, the cotton parastatal SONAPRA has withdrawn from primary marketing of seed cotton. For the next season, the producer price of cotton will be determined according to a pricing mechanism which links the domestic prices to export prices and which establishes norms (based on lower cost ginners) for determining costs in the sector. The new pricing mechanism is under discussion between the ginning companies and the producers. Second, the Government has reached an agreement with ginners to: (i) undertake by December 2002 through an independent firm and under conditions acceptable to IDA, a financial audit of the export operations of ginning companies participating in the primary marketing of cotton this year; and (ii) recover at least 75 percent of the surplus revenue of each ginning company that would result from an increase in the world market price for cotton, as measured by the Cotlook Index A, above 42.7 US Cents/lb, and as determined by the above audit.

12. ***External Financing Requirements.*** Of the estimated external financing requirements of US$29.5 million for 2002, the European Union, DANIDA, and IMF will cover about US$19.5 million leading to a residual financing gap of about US$10.0 million. The proposed supplemental credit (US$10.0 million equivalent) would cover this gap.

13. ***The proposed supplemental financing would enhance the impact of the original credit.*** Without the supplemental financing, the Government would need to reduce expenditure, compromising progress in increasing spending on economic and social development, as well as in poverty alleviation and the country's ability to deliver basic social services. In particular, the supplemental financing would contribute to maintaining the increase in allocations to education

and health services which rose to 6.2 percent of GDP in 2001 from 4.8 percent in 1999 and 2000. In addition, since cotton is a major source of income in rural areas where poverty is widespread, protecting cotton producers' incomes would contribute to poverty alleviation efforts, an ultimate objective of the PERAC. The subsidy will be provided directly to all cotton farmers, contributing directly to their income and indirectly to the living standards of an estimated 25 percent of the population who live on cotton in rural areas.

14. In line with the interim CAS for Benin, discussed by the Board on January 23, 2001, the Bank envisages a PRSC covering 2003-05. However the preparation of this credit has been hampered by slower than anticipated progress in preparing a PRSP. In light of the urgency of covering residual financing gap in 2002, a supplemental credit to the PERAC is the most suitable instrument for IDA's contribution.

15. The 2002 cotton price subsidy is being disbursed to cotton producers through the CSPR mechanism and linked to the payment of seed cotton by ginning companies. Government will not make any payments related to this subsidy through any other channels. The frequency of individual tranches of disbursement has been agreed upon between the Government and CSPR's management and is based on the schedule of payment for seed-cotton by ginning companies. Subsidy payments will be audited as part of the annual audit of CSPR accounts under the Cotton Sector Reform Project (Credit 3598-BEN). The reform program supported by the PERAC is supervised by an Inter-ministerial Committee chaired by the Minister of Finance. Coordination and monitoring will be managed by the Technical Secretariat for Structural Adjustment Programs.

16. The proposed Supplemental Credit would be disbursed in one installment upon Credit effectiveness. Apart from the standard effectiveness conditions, there are no specific conditions attached to the credit.

17. ***Recommendation.*** I am satisfied that the proposed Supplemental Credit complies with Articles of Agreement of the Association, and recommend that Executive Directors approve it.

James D. Wolfensohn
President

By: Shengman Zhang

Washington, D.C.
September 30, 2002

Table 1. Benin: External Financing Requirements and Sources, 2000-02

(In millions of US $ unless otherwise indicated)

	2000	2001	2002
I. Current account (excl. official tranfers)	**-222.5**	**-242.9**	**-276.0**
Exports, f.o.b.	188.5	210.3	206.7
Imports, f.o.b.	-446.5	-466.6	-479.4
Net services and incomes, f.o.b.	-48.9	-68.2	-71.3
Private transfers	84.4	81.6	68.0
II. Capital and financial accounts	**210.7**	**227.8**	**159.8**
Scheduled amortization	-32.4	-24.0	-25.5
IMF repayments	-12.6	-14.2	-14.3
Other capital (net) 1/	255.7	266.0	199.6
III. Debt relief obtained	**29.0**	**21.5**	**27.3**
IV. Change in official reserves (increase -)	**-81.8**	**-154.1**	**-9.6**
V. Change in arrears (decrease -)	**-21.1**	**0.0**	**0.0**
VI. External Financing requirements	**-85.7**	**-147.7**	**-98.5**
VII. Expected disbursements	**85.7**	**147.7**	**98.5**
a. Project financing (loans)	74.3	80.5	69.0
b. Program financing	2.4	57.1	19.3
Grants	2.4	29.5	9.3
Concessional loans	0.0	27.6	10.0
of which IDA	*0.0*	*10.0*	*10.0*
c. IMF	9.0	10.1	10.2
VIII. Financing gap	**0.0**	**0.0**	**0.0**
Total Program financing requirements incl. IMF (b+c)	11.4	67.2	29.5
Memorandum items			
Cotton exports	152.2	159.1	150.4
Cotton international price *(US cents per pound)*	59.0	47.2	39.8
Producer price *(CFAF/Kg)*	185	200	200
US$/CFAF exchange rate *(average)*	712.0	728.8	728.8

Source : Beninese authorities and staff estimates and projections.

1/ Include errors and omissions, official project grants and private capital inflows

IMAGING

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