

**EXECUTIVE  
BOARD  
MEETING**

EBS/22/110  
Correction 1

December 19, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **Benin—First Reviews Under the Extended Fund Facility and the Extended Credit Facility Arrangements**

Board Action: The attached corrections to EBS/22/110 (12/5/22) have been provided by the staff:

**Evident Ambiguity** **Page 13**

**Typographical Errors** **Pages 14, 26, 46**

Questions: Mr. Lonkeng, AFR (ext. 38404)  
Ms. Daly, AFR (ext. 34032)  
Mr. Bennouna, AFR (ext. 37047)



• On the one hand, the winding down of one-offs mostly related to recent shocks (0.4 ppts of GDP) and a reduction in interest payments (0.3 ppt of GDP) will release space for continued spending to mitigate security-related risks (0.5 ppt of GDP increase over 2022). Continued support measures related to the war in Ukraine (113) and a reduction in grant financing (127) will lower total revenues compared with program approval, necessitating spending prioritization particularly non-priority capital expenditure and some reductions in transfers (beyond one-off reductions).

• On the other hand, and consistent with the authorities' commitment to a revenue-based consolidation under the program, the budget includes a tax package expected to cover the 0.5 ppt of GDP planned at program inception (115). The exceptional tax effort to fully make up for the shortfalls related to tax giveaways for subsidies in 2022 is not expected to be sustained in 2023 under the baseline. As such, while the tax target for end-December 2022 was maintained to lock-in the commendable tax effort to date, tax IT for 2023 in the program has been revised downward to allow

for a gradual phase out of subsidies-related tax giveaways in a challenging socio-economic environment, keeping the program's overall balance unchanged.

• Compared with program approval, the adjustment requires a reprioritization of spending (particularly in capital expenditure) to accommodate new spending pressures from prolonged war in Ukraine support, higher spending to improve state presence and effectiveness in communities under security threats, and lower grants. It also requires saving of 0.4 ppt of GDP in subsidy cost to offset spending increases related to public sector wage upgrade.

**Text Table 5. Benin: Fiscal Adjustment Between 2022 and 2023<sup>1</sup>**  
(percent of GDP)

<b>A. New Spending Pressures</b>	<b>0.9</b>
Security risk spending scale up	0.5
Wage bill increase	0.4
<b>B. Policy Measures</b>	<b>1.8</b>
Tax revenue measures	0.5
Reduction in one-off spending <sup>1</sup>	0.4
Spending reprioritization	0.9
o/w capital expenditure <sup>2</sup>	0.7
o/w transfers	0.1
<b>C. Other fiscal space creation</b>	<b>0.4</b>
Increase in grants <sup>3</sup>	0.1
Interest payment reduction	0.3
<b>D. Total Overall Adjustment ((B+C)-A)</b>	<b>1.3</b>
<b>Memo Item</b>	
Subsidy reform <sup>4</sup>	0.4

1/ Includes reductions in COVID-related spending and other temporary measures such as payment to the World Food Programme of accumulated cost related to the school feeding programme.

2/ Mostly reflects a reduction in non-security related capital expenditure.

3/ Includes EU budget support

4/ The associated savings would be reflected in lower tax expenditures or transfers.

Sources: Beninese authorities and IMF staff calculations and projections.

• Higher than anticipated security outlays or tax expenditures related to the war in Ukraine, including due to an increase in fuel subsidy costs (Annex III), represent important risks to the budget. Should these risks materialize, the authorities plan to implement additional revenue measures and further reduce non-priority spending. The well-established budgetary process which would require identifying such measures before the approval of such spending increases provides an important safeguard.

## 15. The 2023 tax package continues the gradual rationalization of tax expenditures from the 2022 budget.

- Tax expenditures amounted to 1.7 percent of GDP in 2021, above the WAEMU median at 1.5 percent. While Benin has recently made important progress on rolling back VAT exemptions (e.g., on water, electricity and imported rice), consolidating a strategy for streamlining tax expenditures—a structural benchmark for end-November 2022—remains a priority. The authorities' projections point to a decline in tax expenditures over the next years. They are finalizing internal analyses on the effect of removing certain exemptions to inform the tax expenditure rationalization strategy.
- New tax measures in the 2023 budget law (MEFP; Text Table 1) include the removal of tax exemptions for provision of certain services by public organizations, and for registering free of charges the transfer of buildings, and effectively applying the minimum tax on the sale of used vehicles. The authorities also expect to generate additional revenues from savings from the recovery of taxes and duties, the move to transactional values at customs, as well as from improved implementation of previous tax policy measures, including a stricter framing of investment incentives policies related to new businesses and the expansion of electronic VAT invoicing.

**16. The authorities [recently announced] public sector wage increases effective from 2023, after protracted negotiations.** While they maintained the 5 percent across-the-board salary increase that was anticipated at program approval, they granted higher top-up benefits for low-wage earners to compensate for purchasing power erosion. The total impact of additional measures is estimated to about 0.32 ppt GDP (Text Table 6). While these adjustments are not expected to drive Benin's wage bill above the regional average (around 6 percent of GDP) over the medium term, they would imply a deviation of the wage-to-tax-revenue ratio from the WAEMU target of 35 percent in the near term. However, given the authorities' commitment to ensuring that public compensation remains equitable and sustainable (grounded on robust technical analysis), the program's macroeconomic framework still assumes a return to the 35 percent target from 2025. Considering the relatively low wage bill in Benin across a set of benchmark indicators (Text Figures 4a–4b) after several years of wage containment, the program accommodates the planned wage increase, which the authorities committed to finance through additional permanent measures starting in 2023 (¶14).

**Text Table 6. Benin: Deviations from Original Wage Bill, 2023**

	CFAP billions	Percent of GDP
Top-up for low-wage earners	29.1	0.25
Extended pay for "aspiring" teachers from 9 to 12 months	9.4	0.08
Other (incl. authorities refined projections for notch progressions and lower base effect from 2022)	-1.5	-0.01
<b>Total wage bill increase</b>	<b>37</b>	<b>0.32</b>

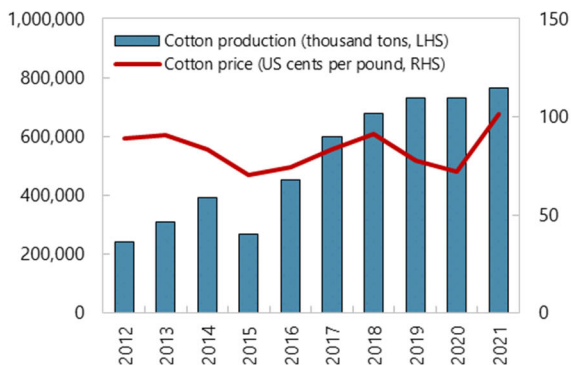
Sources: Beninese authorities and IMF staff calculations.

Note: Numbers relate to central government (military and civil servants). "Aspiring" teachers (*Aspirants au Métier d'Enseignant - AME*) refer to individuals who are part of a list of suitable candidates to teach in primary and secondary schools, after passing a qualification test.

**Figure 3. Benin: Real and External Sector Developments, 2012–21**

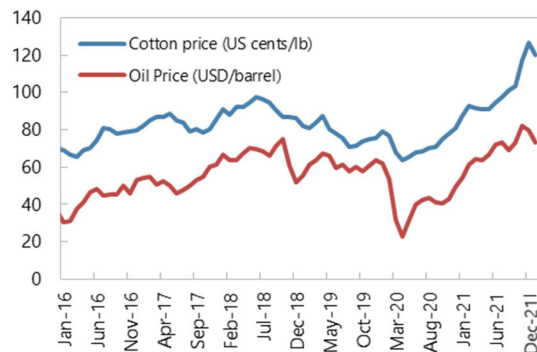
Although cotton production plateaued after nearly tripling in volume since 2015 ...

**Cotton Production and Price**



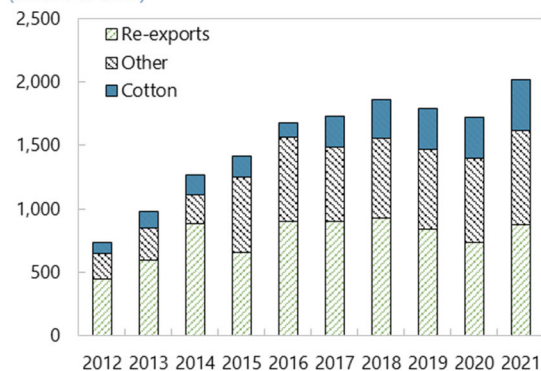
... the international price of cotton continued to rise to its highest levels in years ...

**International Cotton and Oil Prices**  
(US cents per pound)



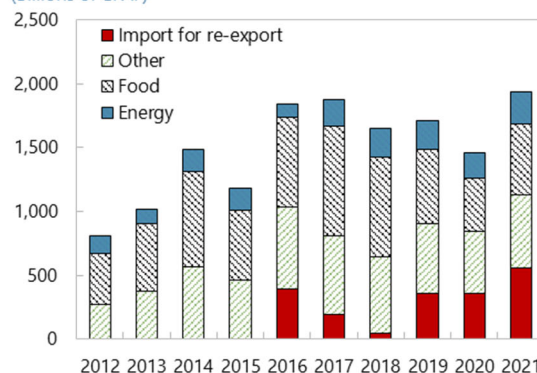
... contributing to significantly higher cotton export receipts in 2021.

**Composition of Exports**  
(Billions of CFAF)



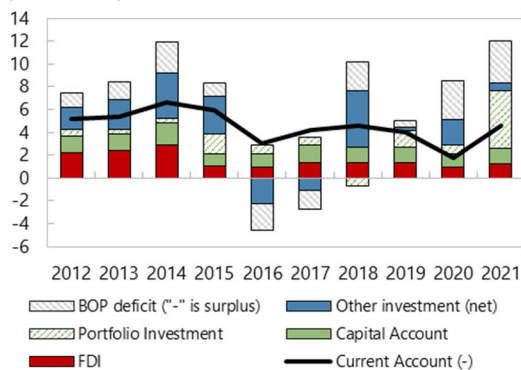
Imports have increased in 2021, partly reflecting high food and energy prices ...

**Composition of Imports**  
(Billions of CFAF)



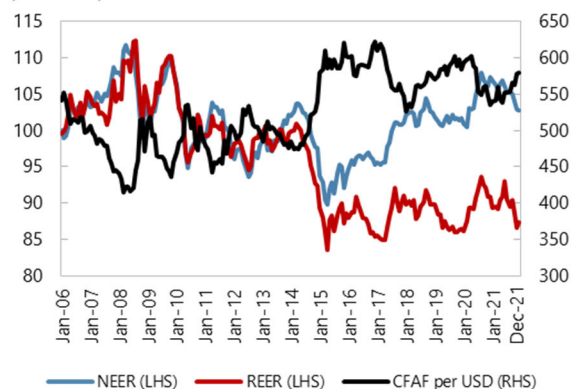
... and widening the current account deficit in 2021 compared to 2020, when supply chain disruptions reduced imports.

**Financing Sources**  
(Percent GDP)



The CFA franc depreciated against the US dollar in 2021, while the effective exchange rate appreciated.

**Exchange Rates**  
(2010=100)



Sources: Beninese authorities and IMF staff calculations.

purchasing power of poor households because of the weight of the subsidized product in their budgets, including indirect effects such as transportation costs. In addition, in order to reduce resistance to the reform, depoliticize fuel pricing, and build public support, a communication campaign should be conducted in advance. It should clearly state the rationale for the reform, emphasizing the cost of subsidies to the government budget and their crowding out effect, notably on priority social spending. The public should also be re-assured about the appropriate use of the savings that will be generated from the reform, including the increase in social spending. In addition, part of the savings generated by the reform should be channeled into social safety nets, including targeted measures to compensate for the loss of purchasing power of the most vulnerable.

### **Authorities' Views**

**9. While the authorities are committed to phasing-out fuel subsidies over the medium term, they flagged important structural and conjunctural constraints that may slow the process.** First, they noted that further diesel price adjustment—after the cumulative hikes of 40 percent in 2022—would alter the price differential vis-à-vis Nigeria, which could incentivize smuggling of diesel (illicit traffic of fuel as so far been limited to gasoline), leading to significant petroleum revenue losses. Second, they argued that Benin's fuel market is fully liberalized, with no intervention of the State in the purchase of fuel products, compared to peers which either have a local refinery or rely on imports of refined fuel products by the State, often benefiting from discount in strategically timed bulk purchases. Third, the authorities argued that diesel is mostly used in agriculture (diesel-powered tractors) and in transport (dominant in transit-dependent economies like Benin); a removal of fuel subsidies would therefore negatively affect economic activity, increase consumer prices, including for foodstuffs, which may exacerbate food insecurity risks. Last, but not least, they underscored that the challenging economic environment, including uncertainty over the near-term path of international oil prices, makes it difficult to pre-commit with precision to further pump price adjustment *ex-ante* (after the already large hikes in 2022).

**10. Against this background, the authorities see revenue mobilization as an alternative for offsetting fuel subsidies in the near-term.** Already, they are expected to raise an additional 0.7 ppt of GDP in tax revenues in 2022 to offset tax giveaways related to subsidies (of which 0.3 ppt of GDP for fuel subsidies offset). This is on top of the tax package amounting 0.5 ppt of GDP in the original 2022 budget. Staff emphasized that it would be critical to gradually phase out fuel subsidies over time and compensate the vulnerable in the adjustment process.