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August 17, 1981

To: Members of the Executive Board
From: The Secretary
Subject: Benin - Staff Report for the 1981 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1981 Article IV consultation with Benin. A draft decision appears on page 18.

This subject will be brought to the agenda for discussion on a date to be announced.

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INTERNATIONAL MONETARY FUND

BENIN

Staff Report for the 1981 Article IV Consultation

Prepared by the Staff Representatives for the 1981 Consultation with Benin

Approved by J.B. Zulu and S. Kanesa-Thasan

August 17, 1981

I. Introduction

The 1981 Article IV consultation discussions with the People's Republic of Benin were held in Cotonou during the period June 3-16, 1981. The representatives of Benin included Mr. I. Amoussou, Minister of Finance, Mr. A. Baba Moussa, Minister of the Plan, Statistics and Economic Analysis, and Mr. G. Pognon, National Director of the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), as well as other senior officials concerned with economic and financial matters, including officials of the BCEAO headquarters in Dakar. The staff team consisted of Messrs. R.O. Carstens (head-AFR), R.A. Franks (AFR), A.G. Muirragui (BUR), Ms. U. Wilson (AFR), Mrs. N. Fahmy (IBRD), and Mrs. M.F. Dowsett (secretary-AFR).

Benin continues to avail itself of the transitional provisions of Article XIV. A summary of Benin's relations with the Fund and the World Bank is provided in Appendix I

II. Recent Economic Developments, Including Implementation
of the 1980 Financial Program

Benin is set apart from other West African coastal states by its favorable geographic location on several import transit routes and by its proximity to the large and expanding Nigerian market. Although there are sizable deposits of limestone and offshore oil, commercial exploitation is only now beginning. By mid- and late-1982 production of cement and petroleum, respectively, is likely to get under way, so that Benin will soon become a net exporter for both these products. Currently Benin's oil requirements are met fully by importation, as is a large proportion of its electricity consumption. The balance of payments is characterized by a substantial deficit on trade and services, financed by public and private transfers as well as public foreign borrowing. In recent years export proceeds were equivalent to about half of imports.

Although official national accounts data are not available since 1978, all evidence suggests that Benin's real per capita income has risen only

modestly in recent years, reflecting a deterioration in Benin's terms of trade, resulting from the rise in the prices of oil and manufactures. There has also been some decline in the volume of Benin's traditional exports--cotton and palm products--compared with the first half of the 1970s, so that pressures have continued on the overall balance of payments and Benin's external reserves. The outlook for 1981 is for a further deterioration in the underlying balance of payments position and an overall deficit of CFAF 3.1 billion (SDR 10 million), compared with a deficit of CFAF 0.4 billion in 1980.

The adverse developments with regard to both the domestic economy and external transactions are having serious consequences for the central government budget and the state enterprises, as well as for the monetary situation as a whole. The current budget, as approved for 1980, foresaw revenues and expenditures balanced at CFAF 33 billion, but revenue collection fell short of this objective by nearly a quarter. This was largely due to lagging revenues from income taxes, and expenditures were adjusted downward accordingly, particularly for personnel by postponing the payment of increments. The shortfall in receipts during the current year is likely to be considerably larger, reflecting partly the unduly high expectations with regard to the revenue contributions to be made by the state enterprise sector. Thus, actual current expenditures will have to be kept well below the budgeted CFAF 43 billion. Although the detailed financial accounts of state industrial and commercial enterprises are not always up to date, it appears that the financial position of some of the major ones has deteriorated sharply in recent years. This has resulted in a running down of the capital stock, but lately has also led to acute difficulties in meeting their payrolls. Moreover, the state farm sector is not achieving positive returns on capital invested, and agricultural production and exports have remained dependent on individual farmers using traditional methods. Nevertheless, overall economic performance might improve somewhat in the current year, reflecting continued growth in commerce, transportation, construction, and public works, the latter resulting from the high level of government investment expenditures, with work on the major projects under the plan proceeding with only minor delays.

With a good food crop harvest, domestic food prices have risen only modestly, while prices for imported goods continue to rise relatively fast. The increase in the GDP deflator was estimated at 12 per cent in 1980 and is expected to be slightly higher in 1981.

Given the difficult structural problems in the economy, and faced with a continued deterioration in the terms of trade, the Beninese authorities adopted a financial program for 1980, which was supported by a Trust Fund loan in the second period, in order to contain demand pressures and to limit the overall balance of payments deficit to CFAF 2.7 billion (SDR 10 million) while permitting an expanded development effort. The program called for a reduction in the ratio of the external current account deficit to GDP and continuation of the policy designed at least to balance current

budgetary transactions and to limit the overall deficit on central government financial transactions to a magnitude compatible with the overall balance of payments objective for Benin and for the West African Monetary Union as a whole. In support of this objective, the expansion of net domestic assets of the banking system was to be limited to 20 per cent during the program period, compared to 42 per cent in 1979 (Table 1). The growth of credit to the private sector (including state enterprises), which had risen substantially in the past, reflecting in particular the financial needs of the state enterprises, was to be limited to 10 per cent, compared to 27 per cent in 1979. Government recourse to the banking system was to be limited to CFAF 4.2 billion, implying a reduction of about half in the Government's net creditor position vis-à-vis the banking system. In the event, monetary data indicate reasonable success in the authorities' efforts to stabilize the economy. The Government's net creditor position even improved slightly rather than declined, as did the net foreign assets of the banking system. However, net domestic assets of the banking system rose by 36 per cent, or almost twice the rate projected, reflecting the strong credit demand from the agricultural and commercial sectors. Money supply rose by 41 per cent, compared to some 16 per cent projected in the program.

The overall balance of payments, as measured by the change in the central bank's net foreign assets, showed a deficit of only CFAF 0.4 billion, compared to a projected deficit of CFAF 2.7 billion (SDR 10 million). This was due to better-than-expected output in the agricultural sector during the 1979/80 crop year, with larger exports of palm products and other agricultural products and lower imports of foodstuffs, as well as higher-than-anticipated inflows of foreign grants and loans.

Despite enlarged inflows of resources from abroad Benin's external debt level and profile remain manageable. As at end-December 1980 the total external public and publicly guaranteed debt outstanding amounted to US\$262 million, and the bulk of this was in the maturities range of 12 years and above. Debt service payments during 1980 totaled US\$6.9 million, equivalent to about 2 per cent of exports of goods and nonfactor services. Gross official reserves declined from SDR 16.8 million at end-1977 to SDR 6.4 million at the end of December 1980, when they were equivalent to barely one week of projected 1981 imports.

III. Report on the Discussions

1. Production prospects and development policies

Notwithstanding the problems encountered during 1980 in both the agricultural and the industrial sectors, as well as a continued downward trend in the terms of trade, prospects for a broadening of the economic base and sustained, though modest, economic growth remain favorable. Assuming normal weather conditions for the remainder of 1981, output of food crops, in particular maize and cassava, is likely to expand. With regard to cash

Table 1. Benin: Execution of the 1980 Financial Program

	Projection, objective, or target	Outturn	Projection, objective, or target	Outturn
	(In billions of CFA francs)		(In per cent)	
<u>Monetary survey 1/</u>				
Changes in:				
Net foreign assets	-2.7	0.7
Of which: BCEAO	(-2.7)	(-0.4)	(...)	(...)
Domestic credit (net)	10.5	18.7	20.2	35.9
Claims on Government (net)	(4.2)	(-2.1)	(...)	(...)
Credit to the private sector	(6.3)	(20.8)	(10.3)	(34.7)
Money supply	7.3	19.0	16.1	40.6
			(Percentage increase over preceding year)	
<u>Public finance 2/</u>				
Revenue and grants	35.85	34.12	25.9	19.8
Expenditure and net lending	49.45	42.50	53.9	32.1
Of which: current expenditures	(31.10)	(24.24)	(50.7)	(20.9)
capital expenditures	(15.70)	(16.18)	(151.6)	(129.5)
Central government deficit	-13.60	-8.38	271.6	125.9
External financing	8.30	7.55	196.4	170.6
<u>Balance of payments</u>				
Exports, f.o.b.	47.0	51.0	16.6	17.8
Imports, c.i.f.	-89.0	-91.7	19.3	21.0
Trade deficit	-42.0	-40.7	22.4	25.2
Services (net)	-6.3	-11.3	-5.8	18.9
Transfers (net)	22.1	27.3	24.9	30.6
Current deficit	-26.2	-24.7	12.5	17.1
Nonmonetary capital	23.0	19.2	28.5	57.2
Overall deficit	-2.7	-0.4

Sources: BCEAO; Direction du Trésor et de la Comptabilité Publique; Debt Amortization Fund (CAA); National Investment Fund (FNI); and staff calculations.

1/ Old series. government sector narrowly defined.

crops, output of cotton could double if the special input problems experienced in the 1980/81 season are not repeated. Output of palm oil and kernels is expected to show further improvement as it continues its gradual recovery from the 1977 drought. Following the completion of new production units, this should lead to increasing output of agro-industries, although the new maize mill might experience temporary shortages of inputs given the attractiveness of the Nigerian market to growers. Other industrial activity, however, is not likely to expand, as no major new units will start operations, while many established ones are experiencing operational and financial problems. Construction will continue its upward trend, mainly due to the execution of a number of large projects, namely a cement clinker plant, a sugar complex, the extension of the Cotonou harbor, and facilities for offshore oil exploitation and exploration. With commerce and other services also expanding, reflecting Benin's importance as a gateway to the subregion, real GDP growth could reach 5 per cent in 1981, compared with 4 per cent in 1980.

In discussing economic prospects, the Beninese representatives said that the lessons learned in planning and plan execution from careful evaluation of the results achieved under the first three-year plan, 1978-80, would be put to good use in elaborating the next plan, which was likely to cover the period 1983-85. They felt that such a cautious timing was justified insofar as it allowed for devising and putting in place a more appropriate institutional framework for dealing in a coordinated way with matters of detailed implementation of the strategy laid out for the current decade in a document recently presented to the UN-sponsored conference on least developed countries. They believed that the preliminary reaction of potential aid donors had been rather encouraging. This was important, as foreign financing had been put at about 75 per cent of the total investment of CFAF 959 billion (Table 2). Projections for the ten-year period were based on an assumed 7 per cent average annual rate of real growth, which implied a doubling of GDP by the end of the decade. While the authorities considered this the minimum required to assure an acceptable level of well being for a rapidly growing population, it was of course only a working hypothesis and as such probably on the high side, given that in recent years average growth had barely exceeded half that rate.

The basic orientation of development policies to be followed during the two interim years, covered by annual investment programs, and during the second plan period will follow essentially established lines. However, given the need to improve the attractiveness of the rural sectors in the context of the authorities' renewed efforts to foster more balanced regional development, no new large-scale enclave type projects are likely to be undertaken during the next few years. This increased emphasis on broadly based indigenous development is aimed particularly at improving productivity in the agricultural sector, with a view to consolidating self-sufficiency in food, with a surplus for export, while continuing to stimulate traditional export crops. Policy with regard to the secondary sector will be directed at creating industries based on the processing of

Table 2. Benin: Growth Targets and Financing Needs, 1981-90

	1981-85	1986-90	1981-90
<u>(Average annual growth rate in per cent)</u>			
<u>Growth targets</u>			
Real GDP (at factor cost)	6.5	7.3	6.9
Primary sector	4.0	4.5	4.2
Secondary sector	13.3	14.5	13.9
Tertiary sector	6.9	6.9	6.9
<u>(In billions of CFA francs: 1980 prices)</u>			
<u>Financing needs</u>			
Total (cumulative)	421.9	536.9	958.8
Domestic resources	77.5	155.9	233.4
External assistance	344.4	381.0	725.4
<u>(In per cent)</u>			
External assistance/Total financing	81.6	71.0	75.6
External assistance/GDP	26.1	20.4	22.7

Source: Ministère du Plan, de la Statistique et de l'Analyse Economique, Programme National de Développement Economique et Social pour la Décennie 1980-1990.

local raw materials, but increasingly also on production of intermediate goods for the domestic market as inputs or for export markets. Regarding the tertiary sector, development of an integrated network of infrastructure to serve the needs of trade and balance regional and sectoral development is the main priority. At the same time, exploitation in an orderly way of the country's regional trading potential would imply a properly conducted import-export trade to neighboring countries. All policies, the Beninese representatives said, were geared to achieve increasingly self-sustained growth. Thus, the share of domestic savings in financing investments should rise gradually from 16 per cent in 1981 to 21 per cent in 1985 and 35 per cent by the end of the decade.

To stimulate productivity and along with it to achieve growth in rural sector incomes, the authorities intend to maintain a remunerative structure of product and input prices, even if in some cases this might entail a deviation from the policy of charging the full economic cost for inputs, including rates of interest that reflect the scarcity of capital. To this end, the fertilizer distribution and subsidy schemes for cotton will be continued, while the intensified efforts of the banking system to service the rural areas should help meet the credit needs of farmers as well as mobilize their savings. The Beninese representatives said that, given the unsatisfactory experience so far with state farms and collectivization, more careful preparatory studies would have to be made in the future. This, in combination with improved extension services to spread modern methods of cultivation and the use of higher yielding varieties more rapidly, should ensure that in the future there would be a decline in the share of agricultural output produced by individual farmers using traditional methods. To ease the recurring problem of ensuring the timely and adequate provision of fertilizers, it is envisaged that a fertilizer plant will be established, even though it would be dependent on imported raw materials. Generally, however, in the area of industrial policy, while retaining the major enterprises in public hands, intensified efforts will be made to encourage local entrepreneurs and smaller-scale enterprises upstream and downstream of domestic agricultural production. The Government has lately also paid increasing attention to the implications of growing regional integration, in particular with regard to the Economic Community of West African States (ECOWAS), and is examining measures to make Beninese industry more competitive within the region and, if necessary, to adapt the existing structure of incentives to the needs of diversification and sustained growth in a changing economic environment.

In establishing priorities and developing new ideas for the immediate future, the Government is greatly handicapped by the dearth of reliable statistics. Investment performance under the previous plan has yet to be analyzed in any depth, and changes in economic trends typically are discovered only with considerable delays. Basic information on the real economy is frequently out of date or inaccurate and thus not readily usable by policy makers. Information on external transactions, including public and publicly-guaranteed debt, is inadequate, and reliable consolidated financial statistics

have not been available since the mid-70s, as neither the Treasury nor banking accounts have been properly closed and audited since then, while detailed financial data on the state enterprise sector are difficult to obtain.

The Beninese representatives concurred that this last problem in particular was a cause for concern to the authorities at this juncture, as the deficient management and the resulting adverse financial situation of a number of state enterprises would be difficult to tackle without more precise information on both their physical and financial operations. They placed great hope in the work of the new Ministry for the Inspection of Public and Semipublic Enterprises, which was set up about a year ago to control the activities of state enterprises and give appropriate advice and recommendations. The Minister also chairs the newly formed Commission Nationale de Bilan, which has the specific task of reviewing the financial situation of each state enterprise. The commission has completed its first comprehensive report, which is currently being updated and elaborated, a process which might last until the end of the year. However, given the urgency of the situation, the Government has already replaced the managements of several important state enterprises, abolished the monopoly for the importation and distribution of pharmaceutical products, and imposed new salary guidelines. In addition, the banks have been asked to tighten control over credit to state enterprises, and the Treasury has increased its efforts to settle its claims against them, thus compelling reorganization where required.

Regarding energy, the Beninese representatives noted that the country's strong reliance on imports was likely to be much reduced within little more than a year and that by 1983 Benin was likely to be a net exporter. Since 1973 Benin has been importing electricity from Ghana's Akosombo Dam, so that imports of oil products have been relatively low, amounting in recent years to only about 5 per cent of total import payments. However, as costs of importation of energy rose, Benin has been obliged to upgrade its generating capacity as well as re-examine the hydroelectric potential of its own rivers. A joint project with Togo on the Mono river is under active consideration. The major breakthrough, however, will come from the offshore oil field currently being developed with help from Norway. Trial operations might start in October 1982, although full production, currently foreseen at 10,000 barrels of crude oil a day or 500,000 tons per year, would not be reached before 1983. With domestic consumption of around 150,000 tons, Benin would nevertheless export all of its crude oil and continue to import petroleum products, as it lacks a refinery and, given current cost structures, would not proceed to implement its refinery project in the near future. With regard to further exploration, the Beninese representatives indicated that the IBRD and the UN were involved, and that it was hoped to launch a call for bids for concessions by the end of next year.

2. Prices and incomes policies

With regard to consumer prices, the Government continued to follow a policy of ensuring a sufficient supply of basic foodstuffs and certain other

essential products at relatively stable, uniform, and low prices, while maintaining sufficient incentives for agricultural production. To this end some prices are controlled, and subsidies are used to keep down prices of rice, sugar, and palm oil. In general, however, prices are market determined, and the authorities have limited their interventions to specific cases, realizing that, in an open economy like that of Benin with a very active trading community, possibilities to act successfully were strictly circumscribed. Thus, emphasis is being placed on maintaining orderly conditions in the commercial sector and on regulating markups and profit margins. In addition, special efforts are being made to improve storage and transport facilities for maize and other food crops, with a view to smoothing price fluctuations in the internal market between regions and over time.

With regard to border trade and all its attendant repercussions, such as temporary shortages of goods in Benin and erratic price movements, the Beninese representatives reiterated that problems were continuing. However, the coincidence of an easing of import restrictions in Nigeria with the depreciation of the CFA franc had resulted in a reduction of the discount for Nigerian naira in the parallel market. At the same time, there was not only considerable circulation of naira in Benin but CFA francs were also increasingly used for commercial transactions in Nigeria, which was possibly one of the reasons for the sharp increase in Benin's recorded money supply in 1980 (see below). The main problem, at this juncture, thus related mostly to spillovers of temporary market disturbances from across the border into Benin.

In early 1980, following a protracted period of falling real incomes in the urban areas while incomes in rural areas had been rising, the Government adopted a number of measures aimed at raising real incomes of wage earners. These included raising the minimum wage rates in the private sector by 15 per cent and public sector salaries by 11 per cent across the board. In addition, public sector promotions, which had been blocked periodically in the past, were fully unblocked in January, following the unblocking of a housing allowance in the previous year.

In discussing these measures the Beninese representatives stated that the increases accorded by no means fully compensated civil servants and others with contractual incomes for past price increases. They emphasized that this reflected the Government's basic approach of wage restraint for urban areas in order to slow the rural exodus and to link increases in wages and salaries as much as possible to actual increments in production and productivity. While this policy has been reasonably successful, in that it has kept Beninese goods and services competitive in foreign and domestic markets, it has also entailed a growing discrepancy between domestic wage levels and those prevailing in neighboring countries. This has apparently caused skilled persons to emigrate and thus contributed to Benin's manpower problems. The authorities hope to ease the domestic manpower constraint for skilled personnel by providing increased opportunities for appropriate training and education.

2. Fiscal policies and prospects

Commenting on the prospects for 1981, the Beninese representatives said the Government's financial operations would be a major instrument in preventing increased imbalances in the economy and, in particular, in containing the deterioration in the external position. To this end, the 1981 budget projects revenue equal to current expenditure of CFAF 43 billion. This represents a doubling over the level of revenue and expenditure recorded in 1980.

The Beninese representatives concurred that the revenue estimates for 1981 as a whole may be over-optimistic, although some new tax measures were introduced in the budget, including an increase in the profit and turnover tax rates. They expected that current budgetary revenue would amount to just above CFAF 30 billion, even after an intensification of the collection effort in regard to state enterprises, but they expressed hopes that other sources of revenue would become available to enable the expenditure target to be met. The budgeted level of current expenditure was considered the minimum necessary to support the expanded development effort and to permit a more competitive salary structure in the public service. However, the authorities emphasized that their established policy of at least balancing the current budget would take precedence over this expenditure target if extraordinary revenue did not materialize in the course of the year. They believed that their existing budgetary control procedures would enable them to limit expenditures to the level of revenues, as had been the case in 1980, when the net creditor position vis-à-vis the banking system had even improved somewhat.

Another major feature of fiscal operations in 1981 will be a substantial increase in net foreign borrowing, while there will be only a marginal reduction in net government deposits with the banking system of CFAF 1.2 billion to finance expected total investment expenditure and net lending of CFAF 57 billion, equivalent to 22 per cent of GDP. Consolidated central government transactions for the year 1981 are thus expected to show a deficit of CFAF 36 billion, equivalent to 10 per cent of GDP. This sharp increase reflects an unusual bunching of investments in 1981, due in part to delays incurred in getting projects included in the 1978-80 plan under way because of fiscal and administrative bottlenecks. It also reflects the implementation of several large projects, which are expected to have a beneficial impact on output and the balance of payments in the medium term. Concerning budgetary policies for future years, the authorities emphasized their intention to continue to strive at least to balance their current transactions and to limit the overall deficit to a reasonable magnitude that would be compatible with the overall balance of payments objectives for Benin and for the West African Monetary Union as a whole.

In discussing the Government's policy with regard to investment expenditure in the period immediately ahead, the Beninese representatives confirmed that the authorities had become increasingly aware of the interaction between

current and investment expenditure as more and more resources were allocated to increasingly complex projects requiring a high degree of precision in preparation, coordination, and control. Continuing efforts were being made to strengthen administrative procedures and structures. In this connection, in February 1980 a government order was issued establishing a Caisse Centrale de Financement, which would absorb the functions of the Treasury, the Caisse Autonome d'Amortissement (CAA), the Fonds National d'Investissement (FNI), the Directorate of Monetary and Banking Affairs in the Ministry of Finance, and the Directorate of Technical Cooperation in the Ministry of Planning. The new institution, which is scheduled to begin operations in the latter part of 1981 or early 1982, would be responsible for the management of all of the Central Government's financial resources, including foreign borrowing and grants. In this way the authorities hope to improve the allocation and efficient use of public resources, hitherto handicapped by a complex system of earmarking of accounts. The Beninese representatives also expected that the new institution would make an important contribution to improving the flow of data on government financial operations and on Benin's external debt transactions. Coordination between the Ministry of Planning and the Ministry of Finance in implementing the interim tranches of the development program would also benefit from the new structure.

4. Monetary policy and balance of payments prospects

Since the general reforms in 1975, annual monetary and credit targets for the West African Monetary Union as a whole and individually for each member country have been established. These targets are determined in light of overall growth and balance of payments prospects for each of the member countries and of objectives regarding the level of international reserves for the union as a whole. In the face of continued pressures on prices and the balance of payments, the Beninese authorities established monetary and credit targets for 1980 to be compatible with a 12-month financial program ended in December 1980, in support of which they received a Trust Fund loan in the second period. As indicated above, the program was to some extent successfully implemented.

Concerning monetary policy in 1980, the Beninese representatives indicated that the end-1980 targets set for net foreign assets, domestic credit, and broad money had been revised in the course of the year, because economic developments had been considerably less favorable than had been anticipated when the targets were originally formulated. This was in line with BCEAO policy to revise end-year targets if the situation deteriorated and corrective measures were required. The discussions on monetary developments and projections were made particularly difficult by some statistical inconsistencies in the data on money supply and credit to the Government due to a change in the definition of those items as of October 1979. After making the necessary adjustments, estimates for 1980 and 1981 were prepared, consistent with actual and expected developments in the various sectors, as discussed above.

In 1981, assuming a slight further decline in the velocity of circulation, broad money is estimated to rise by 11 per cent (Table 3). The net foreign assets of the Central Bank are expected to decline by CFAF 3.1 billion and those of the deposit money banks by CFAF 1.2 billion. Regarding credit to the Government, the Beninese representatives indicated that the ceiling on central bank lending to the Government for 1981 as a whole was CFAF 6.4 billion (gross), about half of which was still available. However, the Beninese representatives expressed the hope that net recourse by the Government to the banking system in 1981 would be lower than the CFAF 1.2 billion now projected. Regarding credit to the private sector, since January 1980 the BCEAO had set monthly maximum rates of credit expansion (excluding crop credit) for commercial banks. While the demand for credit had increased dramatically in 1980 relative to 1979, reflecting an increase in economic activity in the private sector, it is expected to be relatively more modest in 1981, and the monthly maximum rates were not currently constraining the banks' lending activities. The control over the use of preferential credit had been tightened, to prevent crop credit, in particular, from being diverted into speculative real estate and commercial investments.

all, credit to the private sector was expected to grow by around 13 per cent in 1981, and net domestic assets by 17 per cent. The Beninese representatives considered that these were clear indications of the authorities' intentions to adjust the economy by moderating credit expansion to the changing internal and external conditions. Although they felt that the attainment of the targets was feasible, they emphasized that, in making decisions in the course of the year, the country's need for economic growth was considered to be paramount. The authorities would thus not rigidly adhere to a credit target if it implied strangling a vital sector of the economy. Concerning expected monetary developments and policies in 1982, the authorities felt that they were not in a position to give any firm indications, given the volatile situation in the international commodities and financial markets at this time.

Due to Benin's membership in the West African Monetary Union, which maintains a fixed exchange rate between the CFA franc and the French franc and a common interest rate structure, changes in the exchange rate or in interest rates cannot be implemented unilaterally by Benin. As far as interest rates were concerned, increases in rates in France had exerted considerable pressure on the Monetary Union since 1979, in particular in those countries with active financial markets. Consequently, in April 1980 the Monetary Union decided to increase all lending rates by 2 1/2 points and all term deposit rates by 2 points. Rates on larger deposits remained freely negotiable. The preferential discount rate moved from 5.5 to 8.0 per cent, while the basic discount rate became 10.5 per cent and the maximum bank lending rate 15.5 per cent. The Beninese representatives felt that it was still too early to assess in depth the impact of this measure, but it appeared that there had been net inward capital flows in response from other countries in the region. The increase also had some positive impact on time deposits. Credit demand had initially been reduced somewhat following the increase but was not substantially affected, as witnessed by

Table 3. Benin: Factors Affecting Money Supply, 1976-81

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u> Proj.
<u>(Annual changes in billions of CFA francs)</u>						
Net foreign assets	-0.85	-0.04	-2.72	-7.11	0.72	-4.33
Net domestic assets <u>1/</u>	-2.03	4.42	6.80	15.31	18.68	11.95
Net claims on Government	-2.56	-2.11	-2.83	2.48	-2.13	1.20
Net claims on private sector	0.54	6.53	9.62	12.83	20.81	10.75
Of which: financed by central bank	(-0.17)	(1.63)	(2.02)	(3.66)	(7.75)	(3.25)
SDR counterpart	-0.05	-0.09	0.02	-0.44	-0.42	-0.38
Money and quasi-money	-1.23	4.29	4.10	7.76	18.99	7.24
<u>(Annual changes in per cent)</u>						
Net domestic assets <u>1/</u>	-7.4	17.3	22.7	41.7	35.9	16.9
Net claims on private sector	1.8	21.1	25.6	27.2	34.7	13.3
Money and quasi-money	-3.9	14.0	11.7	19.9	40.6	11.0

Sources: BCEAO, IMF, and MONEYCALC.

1/ Domestic credit net of on-lending of long-term foreign borrowing and other items (net).

the exceptionally large credit expansion during 1980 as a whole. With the surge in interest rates abroad in 1981, the question arose whether further upward adjustments in the interest rate structure would be required, given the unrestricted flow of funds within the franc zone at fixed exchange rates. The Beninese representatives stated that the question of interest rates was under constant review, although they did not believe Benin's circumstances required any major increase. They felt that the rise in money market rates from 11 per cent to about 15 per cent by May 25, 1981 should suffice to inhibit outward short-term capital investments and that temporarily negative real interest rates represented no impediment to a proper allocation of resources.

In recent years analysis of monetary and credit developments in Benin has been greatly hampered by the lack of reliable data on the operations of the deposit money banks. The problem centers on the Banque Commerciale du Bénin (BCB), which was established in 1975 to take over the operations of three foreign commercial banks with widely differing accounting systems. With the assistance of the previous shareholders as consultants, and new computer equipment, appreciable progress is currently being made in the field of data processing, and the Beninese representatives indicated their expectation that the BCB would begin the next financial year, October 1, 1981, with a clear balance sheet. Consequently, by the end of the year the Central Bank should be in a position to revise its estimates of the deposit money bank data for the 1976-81 period and make them fully consistent with the fiscal data.

The Beninese representatives stated that their two objectives with regard to the balance of payments for 1981 were to limit the overall deficit to SDR 10 million (CFAF 3.1 billion) and the deficit on current account to SDR 135 million, equivalent to about 16 per cent of projected GDP. This was to be financed through increasing disbursements on foreign borrowing, partly on commercial terms, by both the Central Government and the public enterprises. The Beninese representatives indicated that the rising trend of their current account deficit was a matter of concern. The rise in 1981 would be due to a further widening of the trade deficit, as merchandise imports would rise more rapidly than merchandise exports. The terms of trade were expected to decline by 6 per cent. Under the assumption of some leveling off in re-export trade to Nigeria, but of stable world market conditions and some increase in output for Benin's main exports, foodstuffs and oil palm products, an increase of 6 per cent is projected for total export receipts in CFA francs. Imports are expected to grow by 17 per cent in terms of CFA francs, reflecting increased imports of capital goods and petroleum products, partly offset by the expected reduced need for imports of staple foods; the trade deficit is expected to rise by SDR 22 million to SDR 170 million, equivalent to 20 per cent of GDP. Reduced receipts from transit trade with neighboring countries will result in a rise in the deficit on invisibles, so that the deficit on goods and services will increase by 16 per cent to SDR 219 million. Official transfer flows are projected to decline somewhat, while private transfers will rise in

terms of CFA francs, due to increasing remittances of Beninese workers abroad, although declining in terms of SDRs. The deficit on current account is thus projected to be much larger than in 1980, although, thanks to an increase in capital inflows, the overall balance of payments deficit is likely to remain modest.

With the ratio of debt servicing to the export of goods and nonfactor services rising from 2 per cent in 1980 to about 9 per cent in 1981 in regard to debt solely contracted and/or guaranteed by Benin, the authorities intend to monitor carefully the further increase in debt servicing in future years. To maintain debt service at a manageable level, they will seek to obtain funds chiefly on favorable terms. Recently some large loans jointly guaranteed by Benin and Nigeria, have been contracted on commercial terms to finance major industrial investments. Over the four-year period ending in 1985 servicing of these debts, relying essentially on adequate project cash flows, could raise the debt service ratio to around 30 per cent.

5. Exchange and trade policies

Benin's exchange system is similar to that of other countries that maintain an operations account with the French Treasury, and is free of restrictions on payments and transfers for current international transactions.

The CFA franc continues to be pegged to the French franc at the rate of CFAF 50 = F 1. The effective value of the CFA franc, as measured by an import-weighted exchange rate index, has remained virtually stable between the end of 1978 and the end of 1980, but declined somewhat in the first half of 1981. The authorities noted that the exchange rate was set on a Union-wide basis, and they referred to the assurances provided by the French Government concerning the convertibility of the CFA franc. Although the common exchange rate might not, at any one time, be the most suitable for each member country, they emphasized that well-coordinated action in this area was crucial. The recent sharp movements in the exchange rates of the major currencies had a negative impact on certain sectors of the economy, which proved difficult to counteract. Overall, Benin continues to consider that its exchange rate system is appropriate to its needs.

IV. Staff Appraisal

In recent years Benin has continued to experience a modest, though broadly based, economic expansion combined with a relatively low rate of inflation, but a weakening in the underlying external payments position. This was partly a result of the deterioration in Benin's external terms of trade. In addition, the volume of Benin's traditional output of cash crops and exports has been lower than in the first half of the 1970s and the volume of imports has risen sharply. The decline in traditional exports has not been sufficiently compensated for by the increased exports of food products to neighboring countries. These pressures have continued to increase on the overall balance of payments and Benin's external reserves.

The financial position of the Government and the state enterprises, has weakened with serious consequences for the monetary situation as a whole. The 1980 budgetary targets were not reached, as revenues, particularly from income taxes, were lagging, and the shortfall in 1981 is likely to be even larger. Although detailed financial accounts are available only for a limited number of state enterprises, it appears that the financial position of some major enterprises has deteriorated. This has resulted in a running down of the capital stock and in acute difficulties in meeting payrolls. Moreover, as most of the state farm sector is not achieving positive returns on capital invested, agricultural production remains dependent on individual farmers using traditional methods. This situation, if allowed to continue, is likely to hinder the Government's plans to secure noticeable improvement in living standards, particularly in rural areas, as resources needed to finance investments will increasingly have to be diverted to support unproductive state enterprises and to finance imports of basic foodstuffs for the urban centers, thus increasing pressures on the balance of payments.

The Government's policy of wage restraint has been successful insofar as it kept costs down in both the public and private sectors. This has not only made it possible to maintain budgetary equilibrium but has also been instrumental in maintaining the international competitiveness of Beninese exports, including services. In the case of Benin, this is of particular importance, as its membership in a monetary union sets a framework for interest and exchange rate policies. To counteract manpower problems in the public sector resulting from emigration to higher-wage countries, improved education seems an appropriate response in the medium term; however, the judicious increase in wages accorded in 1980 may prove of even greater significance for retaining certain scarce skills at this time. Given that a shortage of experienced cadres is one of the main constraints in the attainment of the development targets, a continued review of income policies may be called for in the future.

For the period immediately ahead, these problems would be best addressed by concentrating available resources in those areas where Benin has the greatest comparative advantage, the agricultural and commercial sectors. Given the already tight budgetary situation, it is necessary that

the full economic cost be charged for inputs in directing resources to these sectors, including rates of interest that reflect the scarcity of capital. Measures of agricultural rehabilitation like the improved provision of extension services, better marketing and storage, and improved supplies of necessary inputs, e.g., for cotton, take time to put into place let alone obtain positive results in the form of increased output or improved productivity. However, certain macroeconomic policy measures can be considered and implemented more rapidly. With regard to fiscal policy, there is an urgent need to reduce the difference between the budgeted amounts and the actuals, so as to put the budgeting process on a more realistic basis and thus avoid severe ad hoc expenditure curbs in the course of the fiscal year. Policy toward state enterprises should aim at eliminating their operating deficits and at ensuring that provision is made for normal capital replacement, without relying on subsidies provided through the Government or indirectly through the banking system. In the short term this would effectively mean reviewing output pricing policy. In the medium term, it is of utmost importance to adopt policies designed to improve efficiency in the organization and management of state enterprises. Public enterprises should present regularly, and, where possible, on a monthly basis, comprehensive and accurate reports about their operations, including exact information about production of goods and services, and financial flows.

More generally, there is an urgent need to improve the statistical services, with a view to making possible more detailed economic analysis and the assessment of the ramifications of alternative macroeconomic policies as well as the incidence on the economy as a whole of the large investment projects.

The staff concurs with the authorities that for the time being the objective of credit policy must be to ensure that the rate of overall credit expansion is reduced in comparison to 1980, so as to support the twin aims of restraining inflation and reducing pressures on the balance of payments. These objectives are closely related to the policies pursued to encourage resource mobilization through the banking system, a precondition of promoting growth of production and incomes under conditions of reasonable internal and external equilibrium. Such policies involve in particular the encouragement of voluntary domestic savings, in particular, through an appropriate interest rate policy. For this reason, it is important that financial policies be fashioned in such a way as to ensure that positive real rates of interest are also available to the small savers. Given the current rate of inflation of above 10 per cent, the question arises whether the increases in interest rates effected in April 1980 were adequate.

Following several years of an intensified investment effort, the debt service ratio has begun to rise significantly. Though there is no reason for concern at this time, developments in this area need to be monitored closely.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision in concluding the 1981 Article XIV consultation with Benin, in the light of the 1981 Article IV consultation with Benin conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).
2. The Fund notes with satisfaction that Benin continues to maintain an exchange system which is free of restrictions on payments and transfers for current international transactions.

I. Fund Relations with Benin
(As of July 31, 1981)

Date of membership:	July 10, 1963
Quota:	SDR 24 million
Fund holdings of local currency:	SDR 21.98 million, or 91.61 per cent of quota
Holdings of SDRs:	SDR 2.88 million, or 30.63 per cent of net cumulative allocation of SDR 9.40 million
Trust Fund loan disbursements: (first and second period)	SDR 12.70 million
Direct distribution of profits from gold sales (July 1, 1976- July 31, 1980)	US\$2.09 million
Gold distribution	11,123.669 fine ounces
Last Article IV consultation and Trust Fund mission	March 19-April 1 1980; Executive Board discussion and approval of Trust Fund loan July 18, 1980 (EBM/80/106)

The Executive Board took the following decision:

1. The Fund takes this decision in concluding the 1980 Article XIV consultation with Benin, in the light of the 1980 Article IV consultation with Benin conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Benin continues to maintain an exchange system which is free of restrictions on payments and transfers for current international transactions.

II. World Bank Relations with Benin

To date, the World Bank Group has extended 14 credits to Benin, as well as 2 supplementary credits, totaling US\$121.1 million. Five of the credits were for agriculture (27 per cent of total lending), seven for highway construction and maintenance (48 per cent), and one each for rural education, port expansion, small-scale enterprises development, and water supply and sewage in Cotonou.

The most recent economic report on Benin by the World Bank was issued on May 31, 1979 (No 2079-BEN), based on a mission in September-October 1977. No further economic missions are scheduled until at least 1982.

A staff member of the Bank participated in the Fund's mission to assist the authorities to review and to update Benin's external public debt data.

BENIN--Basic DataArea, population, and GDP per capita

Area	112,622 square kilometers
Population: Total (1980)	3,424,000
Growth rate	2.7 per cent
GDP per capita (1980)	SDR 239

<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u> Est.	<u>1981</u> Proj.
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(In per cent of GDP)

Gross domestic product 1/
(in current prices)

Primary sector	40.0	39.6	43.5	43.0	42.9	42.8
Secondary sector	10.6	10.0	9.5	9.4	9.0	8.9
Tertiary sector	39.5	39.9	37.6	38.2	37.7	37.9
Consumption	101.3	100.4	101.7	99.9	98.1	100.3
Investment	19.9	19.6	20.7	21.7	24.8	25.0
Resource gap	21.2	20.0	22.4	21.6	22.9	25.3
Gross domestic savings	-1.3	-0.4	-1.7	0.1	1.9	-0.3
Total (in billions of CFA francs)	134.31	151.20	168.56	193.33	224.92	265.41
Annual growth rate (in per cent)						
Nominal	19.1	12.6	11.5	14.7	16.3	18.0
Real	4.3	3.8	5.6	4.3	4.1	4.7

(Annual change in per cent)

Prices

Implicit GDP deflator	14.2	8.5	5.6	10.0	11.7	12.7
High-income consumer price index	8.3	9.8	6.9	10.2	10.9	...
Export prices (in CFA francs)	16.7	10.5	7.4	7.7	8.0	15.0
Import prices (in CFA francs)	10.8	12.3	3.4	10.4	15.2	22.2
Terms of trade	5.3	-1.6	3.9	-2.5	-6.3	-5.9

(In billions of CFA francs)

Central government finance 2/

Revenue	22.86	25.04	26.39	28.64	32.83	39.34
Grants	12.75	14.10	10.70	18.00	18.00	16.50
Current expenditure	17.05	19.39	19.22	22.15	26.29	34.57
Transfers	0.06	2.34	0.38	0.23	0.25	0.30
Investment expenditure	14.49	17.48	15.31	26.26	29.16	31.77
Net lending	3.75	6.27	3.59	8.42	10.22	25.36
Overall surplus/deficit (-)	0.26	-6.34	-1.41	-10.42	-15.09	-36.16
External financing	6.13	7.59	6.14	9.63	14.71	34.52
Banking system financing	-2.56	-2.11	-2.83	2.48	-2.13	1.20
Other domestic financing	-3.83	0.86	-1.90	-1.69	2.51	0.44

BENIN--Basic Data (continued)

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u> Est.	<u>1981</u> Proj.
(In per cent of GDP)						
<u>Central government finance 2/</u> (cont'd)						
Revenue	17.0	16.6	15.7	14.8	14.6	14.8
Current expenditure	12.7	12.8	11.4	11.5	11.7	13.0
Investment expenditure and net lending	13.6	15.7	11.2	17.9	17.5	21.5
Overall surplus/deficit (-)	0.2	-4.2	-0.8	-5.4	-6.7	-9.6
(In millions of U.S. dollars)						
<u>Public external debt 3/</u>						
Disbursed and outstanding (end of period)	111.32	144.12	172.93	194.29	261.74	...
In per cent of GDP	(20.6)	(22.4)	(21.4)	(20.2)	(26.3)	(...)
Disbursements	29.91	33.26	36.82	46.26	83.89	...
Repayments of principal	3.36	3.03	3.64	2.52	4.44	...
Interest payments	0.94	0.87	2.19	2.09	2.44	...
Debt service ratio 4/	2.8	2.1	2.9	1.7	2.2	
(In billions of CFA francs; end of period)						
<u>Money and credit</u>						
Net foreign assets	6.33	6.29	3.57	-3.54	-2.82	-7.15
Net domestic assets 5/	25.50	29.91	36.71	52.02	70.70	82.65
Net claims on Government	-5.51	-7.63	-10.45	-7.97	-10.10	-8.90
Net claims on private sector	31.01	37.54	47.16	59.99	80.80	91.55
Of which: financed by central bank	(7.69)	(9.33)	(11.34)	(15.00)	(22.75)	(26.00)
Money and quasi-money	30.63	34.92	39.02	46.77	65.76	73.00
In per cent of GDP	(22.8)	(23.1)	(23.1)	(24.2)	(29.2)	(27.5)
(In millions of SDRs)						
<u>Balance of payments</u>						
Exports (f.o.b.)	101.48	134.23	120.36	157.55	185.45	170.99
Imports (f.o.b.)	-180.85	-206.40	-227.26	-275.81	-333.44	-340.71
Trade balance	-79.37	-72.17	-106.90	-118.26	-147.99	-169.72
Services (net)	-24.00	-33.75	-27.61	-34.56	-41.09	-49.71
Transfers (net)	63.25	71.37	66.55	76.05	99.27	84.86
Current account balance	-40.12	-34.55	-67.96	-76.77	-89.81	-134.57
Nonmonetary capital (net)	37.40	34.55	34.23	44.43	69.82	119.26
Of which: government	(21.93)	(22.42)	(12.71)	(20.89)	(23.27)	(109.24)
public enterprises	(1.12)	(3.49)	(8.42)	(12.99)	(30.55)	
Monetary capital	-8.70	-12.41	4.42	8.00	2.91	3.80
Errors and omissions	16.49	11.82	12.04	12.71	13.97	--
SDR allocations	--	--	--	1.66	1.66	1.66
Overall surplus/deficit (-)	5.07	-0.59	-17.27	-9.97	-1.45	-9.88

BENIN--Basic Data (concluded)

	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u> Est.	<u>1981</u> Proj.
	<u>(In per cent of GDP)</u>					
<u>Balance of payments (cont'd)</u>						
Exports (f.o.b.)	20.9	25.5	20.2	22.4	22.7	20.4
Imports (f.o.b.)	-37.2	-39.2	-38.1	-39.2	-40.8	-40.5
Current account balance	-8.2	-6.6	-11.4	-10.9	-11.0	-16.0
Overall surplus/deficit (-)	1.0	-0.1	-2.9	-1.4	-0.2	-1.2
	<u>(In millions of SDRs; end of period)</u>					
<u>Official foreign reserves</u>						
Gross reserves	16. ^c	16.8	11.9	10.8	6.4	10.3 ^{6/}
Net reserves	15.7	15.3	-1.9	-12.3	-12.6	...
	<u>(CFA francs per SDR)</u>					
<u>Exchange rates</u>						
End of period	288.70	285.76	272.28	264.78	287.99	304.55 ^{6/}
Period average	275.91	286.82	282.50	274.83	275.01	315.81

^{1/} Official national accounts data are not available since 1978.

^{2/} Including expenditures directly financed from foreign aid.

^{3/} As reported to the IBRD Debt Reporting System, including Trust Fund.

^{4/} Debt service related to exports of goods and nonfactor services.

^{5/} Domestic credit net of on-lending of long-term foreign borrowing and of other items (net).

^{6/} As at end of March 1981.