PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

April 11, 2018
Report No.: 125612

Operation Name	BJ - Second Fiscal Reform and Growth DPF
Region	AFRICA
Country	Benin
Sector	Central government administration (30%); General energy sector (20%); General agriculture, fishing and forestry sector (20%); Primary Education (15%); Health (15%).
Operation ID	P166115 (DPF Loan) and P167278 (PBG)
Lending Instrument	Development Policy Lending and Policy Based Guarantee
Borrower(s)	Government of Benin
Implementing Agency	Ministry of Economy and Finance
Date PID Prepared	March 30, 2018
Estimated Date of Appraisal	July 11, 2018
Estimated Date of Board Approval	August 28, 2018
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

1. Benin is one of the world's least-developed countries, with an annual per capita income of approximately US$830 in 2017. Poverty remains widespread, with a poverty rate estimated at about 48 percent ($1.90 a day poverty line – 2011 PPP) in 2017. With an average per capita GDP growth rate of 1.3 percent (2005-2015) driven primarily by the services sector, poverty reduction has been limited, highlighting the need to ensure a broad-based and stronger growth. There are significant regional disparities in poverty rates and rural poverty rates are higher than those in urban areas. Fewer female-headed households fall below the national poverty line than male-headed households.

2. The country's economic performance has been hampered by low competitiveness and high informality. Following the temporary slowdown experienced in 2015, economy activity rebounded driven by the recovery of private consumption and supported by increased cotton production, strong activity at the Port of Cotonou, and rising telecommunications and transport sector activity. However, economic performance in Benin remains hampered by a weak business enabling environment. The high cost and unpredictable supply of electricity is a key constraint for private sector development. Agriculture's export is concentrated in the cotton sector, and agriculture suffers from supply chain deficiencies, including in the provision and distribution of inputs as well as on the marketing side. Approximately 90 percent of the labor force is engaged in the informal sector – agriculture, informal commerce and other services activities.

3. The first pillar of the Fiscal Reform and Growth series on fiscal consolidation is justified given the Government's effort to create fiscal space and improve the efficiency of public spending. In the run-up to 2016 Presidential elections, increases in the wage bill and out-of-budget expenses led to significant increases in public debt (up by almost 20 percent of GDP) and in the fiscal deficit (up from 2.1 percent of GDP in 2014 to 8 percent in 2015). The Government contained expenditures in 2016 to face the drop of tax revenues and managed to reduce the fiscal deficit from 8 percent of GDP in 2015 to 6 percent of GDP in 2016. In 2017, several measures were implemented to boost domestic revenues and reduce primary current spending and the fiscal deficit remained stable despite a surge in public investment spending. The DPO series supports the authorities' effort to create fiscal space by improving revenue collection and managing more efficiently public expenditure, with an emphasis on wages and transfers. In addition to the DPOs, the Government program is supported by an ECF program with the IMF approved by the IMF Board on April 7, 2017, providing macroeconomic and fiscal anchors that will support the implementation of the reforms. The first review of the Program, carried out in September 2017, confirmed that the authorities are committed to responsible fiscal management. This was also confirmed (at the staff level) by the preliminary results of the second review of the Program, which is currently under way.

4. The second pillar aims at promoting agricultural productivity and strengthening the power sector which is a Government's priority to create productive formal jobs and support inclusive growth. Agriculture employs over 50 percent of the population and is the economy's leading formal sector foreign exchange earner. The country has a large endowment of arable and fertile land and adequate water resources. However, Benin's comparative advantage in agriculture remains largely unexploited as the governance structure and relatively low food-safety standards had a negative impact on the sector's competitiveness. Also, the inconsistent supply of electricity is frequently noted as a leading constraint to private sector growth, particularly in the light manufacturing and agricultural processing sectors. Strengthening the financial viability of the power sector and promote private sector participation is essential to increase electricity production capacity in a sustainable way. Focusing on these important real sectors will help improve productivity, create higher paying jobs and livelihoods, and enhance the country's effort to reach the World Bank's twin goals of poverty reduction and shared prosperity.

5. The third pillar supports the Government's efforts to improve the delivery of social services, both in terms of equity and quality. Although Benin has recorded some progress in terms of access to education and health services over the past decade, significant variations persist depending on the income groups and locations. The reforms supported in this pillar will help addressing this issue. In addition, the recent SCD, and other studies, has identified that one major constraint in the delivery of better social services lies in the excessive concentration of responsibilities at the central level. The Government has launched a series of initiatives aimed at increasing the role of local government and communities and at improving the allocation of public resources across regions. The proposed operation will support these initiatives.

II. Proposed Objective(s)

5. The overarching goal of the proposed FRGC series is to boost real economic growth, reduce poverty and increase opportunities for the poorest in the population. The program development objectives of this FRGC series are to: a) support macroeconomic stability by strengthening fiscal management; b) promote economic growth by increasing the productivity and competitiveness of the agricultural sector and strengthening the power sector's financial viability and production capacity; and c) improve social service delivery.

III. Preliminary Description

6. The first pillar of the DPO series will focus on supporting macroeconomic stability by strengthening fiscal management. Not only is adequacy of the macroeconomic and fiscal framework a prerequisite for sustainable economic growth but budgetary and debt sustainability is necessary to the delivery of effective public services that maximize the impact of available revenues on beneficiaries, including the poorest segments of the populations. In addition, increasing fiscal space will help relax fiscal constraints to accommodate the financing of needed infrastructure projects.

7. The second pillar will seek to promote economic growth by increasing the productivity of the agricultural sector and strengthening the power sector's financial viability and production capacity. This series focuses on measures aimed at increasing the productivity of the agricultural sector by supporting a policy, regulatory, and institutional framework that strengthens agriculture value chains and enhances diversification, promotes higher quality standards for agricultural products and supports greater access to credit in the primary sector. Moreover, the measures supported by the operation strengthen the financial viability of the power sector that is necessary to attract private sector participation and, thus, increase electricity production capacity, including in renewables, and access to electricity in a sustainable way.

8. The third pillar contributes to addressing the key constraints to a more sustainable, efficient and equitable allocation of resources to build and maintain the human capital of Beninese adults and children. The measures supported under this pillar address two main issues: (i) the geographically uneven deployment of qualified primary teachers and health workers, and (ii) the limited and unpredictable resources allocated by the central government to communities to finance non-salary inputs and investments necessary to maintain quality service delivery. In particular, the proposed pillar supports the Government's efforts to deploy teachers and health workers to underserved communities and ensure that local governments receive a sufficient and regular flow of funds to meet priority social sector needs, particularly those for the poorest members of communities served.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

9. The FRG series is expected to have a positive impact on poverty reduction through different channels. This impact has been strengthened by the inclusion of the third pillar on human capital development that could have both a direct and indirect influence on the level and distribution of poverty.

10. Prior Actions 1 to 3 support measures to create fiscal space and are expected to facilitate the delivery of essential public services and to contribute to a macroeconomic environment conducive to economic growth and private sector employment creation. A stable and predictable macroeconomic environment is necessary to limit uncertainty, to attract and sustain both domestic and foreign investment, to grow the formal economy and to generate increasingly productive employment opportunities. Furthermore, the creation of fiscal space allows for an increased allocation of fiscal resources to the delivery of essential social services, a direct contribution to poverty reduction and improved quality of life. Increased fiscal space also allows for implementation of the Government's public investment plans, which is conducive to the crowding-in of increased levels of private investment. As noted, the failure of growth to lead to poverty reduction in Benin largely reflects the highly informal nature of the economy and the lack of high productivity, high wage and secure employment opportunities. Fiscal and debt sustainability, and the macroeconomic certainty it engenders, along with better infrastructure and improved delivery of essential services will encourage and foster economic growth that is more formal in nature and thus more effective in reducing poverty.

11. Prior Action 2 provides a potential exception, as the recommendations of the tax expenditure analysis have not been finalized yet and could entail removing exemptions that benefit the poor. Eighteen percent of taxes expenditure on VAT are related to basic foods; removing these exemptions could possibly have negative distributional impact on the poor. However, this scenario is unlikely given that tax exemptions on basic foods are regulated by a regional policy. In case some recommendations of the tax expenditure analysis suggest removing exemptions that potentially benefit the poor, a distributional impact analysis will be carried out to inform the Poverty and Social Impact Assessment (PSIA).

12. Prior action 4, 5, and 6 focus on increasing agricultural productivity and competitiveness and contribute to the Government's poverty reduction goals. In 2015, 60 percent of the rural population lived below the US$1.90 per day poverty line. As the rural population share is greater than the urban share, 65 percent of the poor reside in rural areas. As noted previously, limited agricultural growth (around 3.5 percent per year, which is approximately the rate of population growth in the country) has contributed to overall growth, but the impact on poverty reduction has been limited. Diversifying production into more valuable crops, and raising productivity should boost incomes among those involved in agriculture.

13. Prior actions supported in the power sector pillar promote reliable access to electricity and a more cost-effective electricity provision and should have a direct and positive impact on the poor. As discussed above, only 29 percent of Benin's households have access to electricity, and due to the significant disparities between urban and rural areas, only 6 percent of the rural population has access to electricity. The measures supported under this series will support the financial viability of the power sector which is a necessary condition to attract private investments, increase power production, improve power transmission and distribution, and ultimately improve access to electricity in Benin. Increased access to electricity is strongly correlated with improved education and health outcomes and associated increases in human capital and earning potential. Furthermore, access to electricity liberates non-paid family time demands, particularly for women and girls, and further increases quality of life and opportunities for investment in human capital, including in girls and women. Increased and more reliable access at affordable prices should also have a significant impact on firm creation, firm growth and resultant employment opportunities, particularly in the higher productivity formal sector.

14. A full-fledged PSIA has been carried out to assess the potential impact of electricity pricing reforms in Benin. The PSIA concluded that improving the financial situation of the SBEE and thus reducing the gap between SBEE's service unit cost and revenues per kWh are prerequisites for the expansion of SBEE operations throughout the country and greater access for poor households to electricity. The PSIA study also concluded that the current social policy of subsidizing the tariff for the poor is not effective and suggested some possible options to strengthen the policy including adopting a tariff policy based on usage and eliminating fixed costs for small customers.

15. Prior action 9 provides measures to improve education service delivery is expected to have indirect positive effects on poverty reduction. Schools quality play a determinant role in education outcomes. The 2017 SCD concluded that low human capital contributes to income inequality, undermines long term economic growth and the prospects of the poor to realize shared prosperity. Improving school quality (through the pupil to teacher ratio) is likely to improve learning outcomes and increases grade attainment. As education outcomes improve for the poor, their will have better job opportunities that offer higher earnings and security.

16. Prior action 10 supports the improvement of health services in rural areas through the recruitment of new health workers. Providing affordable health care service to the poor remains a challenge in Benin particularly in the rural areas. Addressing health care needs of the poor requires a multidimensional strategy integrating availability of health services, their quality, geographic and financial accessibility. While the provision of new health workers will improve availability of health services in rural areas, we do not expect this measure alone to improve significantly health outcomes for the poor.

17. Prior action 11 aims at strengthening social safety net programs through the promotion cash transfer which is expected to have substantial positive impact on poverty reduction in the short term. There is a body of evidence around the world that well-designed cash transfers program substantially improves lives of the poor including higher levels of asset holdings, consumption, food security, employment, income and saving. However recent studies show the impacts of conditional or unconditional cash transfers on living standard are transitory and fade away in the long run.

Environment Aspects

13. The policies supported by the proposed DPF are not likely to have negative impacts on the country's natural assets. All the actions supported throughout the first operation are policy-oriented; they do not support environmentally impactful investments or involve policy actions with significant environmental consequences. The measures supporting domestic resource mobilization and efficient management of public expenditure pose no risk to the environment. Measures designed to strengthen economic competitiveness are also largely environmentally neutral.

14. Strengthening the financial viability of the power sector will support increased access to electricity and is expected to have a positive environmental impact. Households in Benin, particularly rural households, are highly dependent on biomass for their daily energy requirements. The reform program supported under the energy sector is likely to have positive environmental impacts and would help in the reduction of greenhouse gases occasioned by the predominance of fuel biomass (fuelwood, charcoal and plant wastes). Strengthening the financial viability of the power sector is likely to produce climate change mitigation co-benefit, since strengthening the financial viability of the sector is likely to promote the development of new energy efficient production capacities. In the agricultural sector, measures intended to diversify agriculture away from a reliance on cotton could have a potentially positive environmental effect as agriculture becomes less mono-culture based and increasingly diversified.

15. Over the last 20 years, the Government has made significant strides in mainstreaming environmental sustainability in projects. EIA is a legal requirement and it is widely applied to all developmental projects. Environmental assessment is a necessary condition to obtain the approval to implement any development project. It has been set up in the Law N° 98-30 relating to the environmental framework and in the Decree N° 2001-235 relating to the environmental assessment procedures. The national environmental protection agency (ABE) has the capacity to implement, monitor, and report on mitigating measures and/or environmental and social management plans; and have been working in direct collaborations with the environmental and social specialists of the Bank funded projects.

V. Tentative financing

Source:		($m.)
BORROWER/RECIPIENT		0.00
International Development Association (IDA)		60.00
Borrower/Recipient		
IBRD		
Others (specify)		
	Total	60.00

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