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Togo: Selected Issues

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TOGO

Selected Issues

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Approved by African Department

April 8, 2009

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I. TOGO: EXPECTED IMPACT OF THE GLOBAL RECESSION[1]

Summary

1. **The current global recession is expected to have a significant impact on low-income countries (LICs), though with a lag relative to the impact in more advanced economies.** The direct financial channel is as yet relatively limited for most LICs and varies between countries depending on their degree of integration with international finance, but the direct impact of declining global demand for exports and falling commodity prices is already being felt, however, and will likely persist or even deepen. Oil and food importers could benefit from lower international prices, but many commodity exporters will be seriously affected, especially if their budget is financed in large proportion by taxes on those exports. The ultimate impact may be serious as declining real activity in the rest of the world feeds through the LICs, which are already socially, politically, and economically very vulnerable and have little scope to put in place offsetting measures compared to more developed countries.

2. **In the case of Togo, the impact of the global crisis, though evident, is expected to be moderate in 2009, given its low international financial integration and its already depressed exports.** This paper examines the main channels of transmission of the global financial crisis on Togo's economy and assesses its impact, focusing on 2009 and considering country-specific factors that may aggravate, mitigate or offset its effects. The decrease in global demand has already brought decreases in the prices of its main exports, phosphate and cotton, which already had problems. The increase in unemployment in Europe and the U.S. may also affect Togo through lower remittances, which have been a significant source of income (estimated at about 10 percent of GDP). Nonetheless, for 2009 increased public investment and a rebound in agricultural production may offset the impact of the crisis on trade and remittances.

3. **The main risk for Togo—which is just emerging from a protracted sociopolitical crisis and long-term economic mismanagement—is that the global crisis may postpone its much-needed economic recovery and poverty reduction.** After three years of major reforms the global recession may jeopardize economic revival. Given Togo's heavy reliance both on commodity exports and on official and private inflows (e.g., remittances), significant reductions in such flows could have economic and social consequences, putting at risk its still fragile political and social stability. Close monitoring and coordination with regional and donor partners will be critical at this stage so that the reforms bear fruit despite the problems in the global economy.

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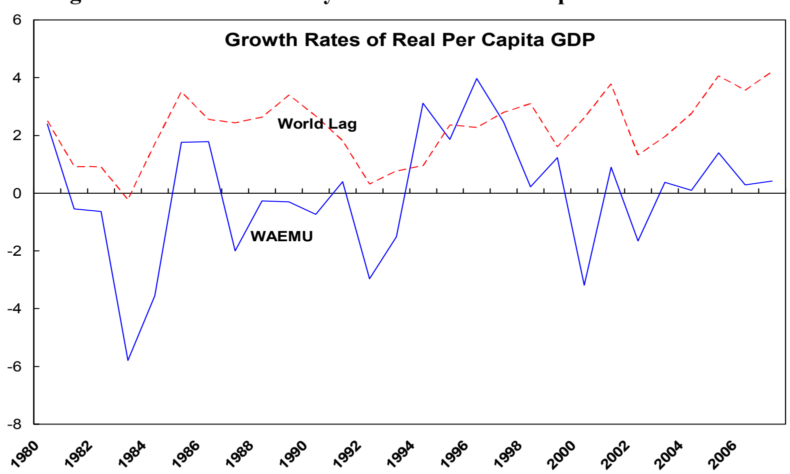
[1] Prepared by Lorraine Ocampos and Jihad Dagher.

A. Impact of Previous Crises on WAEMU and Togo

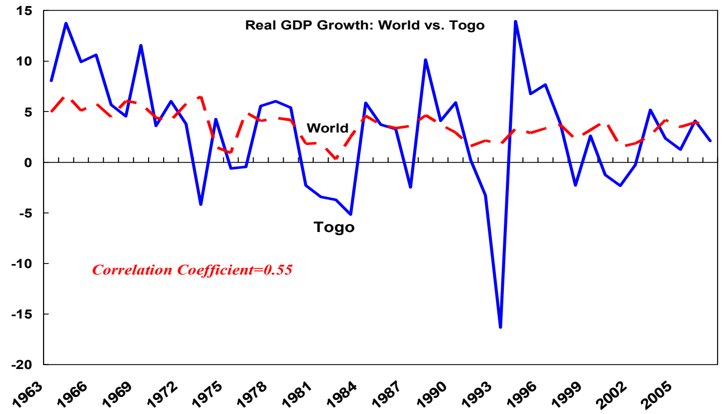
4. **The economies of the West African Economic and Monetary Union (WAEMU) have been affected by global conditions in the past.** Growth rates in the region show a significant correlation with world growth rates (Figure I.1). Rates of real per capita GDP growth in the WAEMU significantly declined in the early 1980s and 1990s during periods of global slowdown. Furthermore, the impact of earlier crises was usually more protracted and severe than in advanced economies, perhaps because of national economic and political factors in the region. Moreover, the growth correlation between WAEMU and the U.S. suggests that response to global economic conditions occurs with a lag of one year. However, the lag may have become shorter recently as the WAEMU has become more integrated into the world economy.

Figure I. 1. World Economy vs. WAEMU: Per Capita GDP Growth



5. **Togo's economic growth seems in general to track world growth not only with a lagged effect but also with higher volatility** (Figure I.2). However, this can be explained by domestic factors: a long-lasting sociopolitical crisis began in Togo early in the 1990s and only came to a close in 2007 with parliamentary elections. The withdrawal of donor support in the interim took a toll on Togo's economy, infrastructure, and institutions from which its economy has not yet fully recovered. Average annual economic growth since 1995 has been 2.2 percent, outpaced by population growth of about 3 percent. As a result, per capita GDP has declined by about 14 percent since 1995, with a consequent increase in poverty.

Figure I.2. World vs. Togo: Real GDP Growth
(Annual percentage change)



B. Expected Channels of Transmission to Togo

6. **The impact of the global crisis for Togo is expected to be moderate in 2009** (Table I.1). It may hit less through financial channels directly than through real channels, such as the protracted effect of declining global demand and prices of Togo's commodities. Limited cross-border linkages in banking systems and limited integration with international finance explain the former. Other real transmission channels might be driven by unexpectedly low foreign direct investments due to investors' lack of interest in engaging in such sectors as banking and phosphate, and lower remittances from abroad. Factors mitigating the crisis, such as a decline in food and oil importing prices, higher government spending, and favorable harvests may somewhat offset the impact (Box I.1).

Table I.1. Togo: Level of Sectoral Vulnerability to Global Recession - 2009

Financial Links	Global Demand	Trade Related Activities: Port + Transport	Remittances	FDI	Donor Support	Final Estimated Impact
Low / Moderate	High	Low / Moderate	High	High	Moderate	Moderate

Financial channels are limited

7. **Direct transmission to the financial system is expected to be low because Togo's banks and businesses have few links to global capital markets.** Banks are mostly state (50 percent of bank assets) or regionally owned (Figure I.3) The most active private regional bank, Ecobank, has its headquarters in Lomé. Publicly owned banks have been restructured and recently recapitalized with government securities, have remained under strict oversight

Box I.1. Factors Mitigating and Offsetting the Crisis for Togo

Little international exposure of the financial sector

Togo's financial system has little exposure to global financial markets; it is really limited to operations with correspondent banks. Its banks have not been exposed to complex financial instruments and operations; and the publicly owned banks are being restructured after the crisis in 1998. Microfinancial institutions, very locally oriented and very active among poor segments of the population, may also function as a shock absorber.

Public capital investment, financed mostly by foreign donors

Plans to boost public investments in 2009 will continue as projected. This is crucial to offset the negative impact of decreasing revenues from other sources, such as exports and remittances. Togo continues to be largely reliant on multilateral donors—the World Bank, the EU, and the AfDB—whose disbursements are more stable and which together have committed budget support of about 2 percent to help Togo meet its 2009 financing needs.

The effect of declining energy and food prices on inflation

The drop in oil and commodity prices in 2008 is benefiting oil and food importers like Togo by decreasing inflationary pressures, improving the terms of trade, and narrowing the current account deficit.

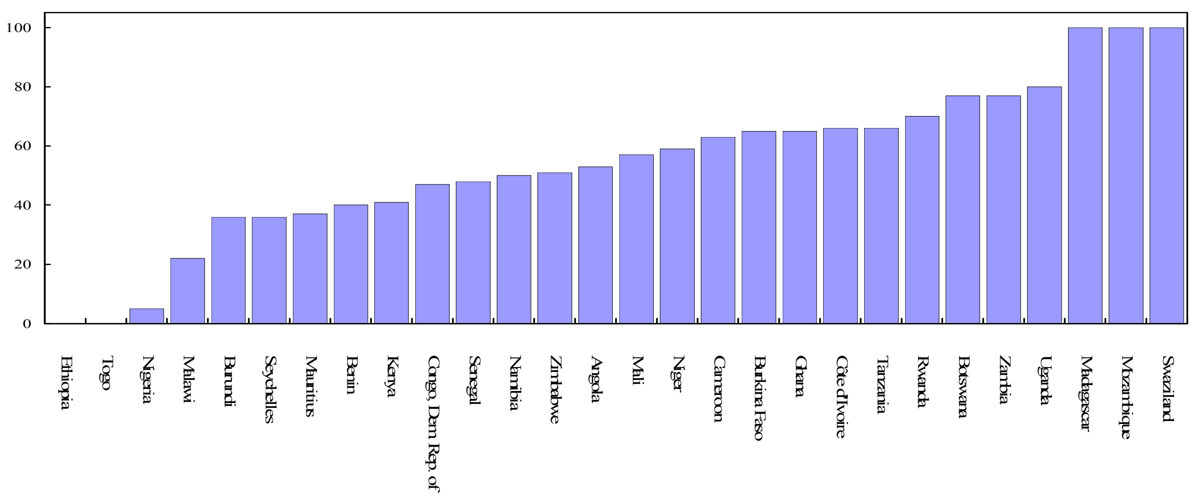
Food production as shock absorber and alternative supplier of exports

Production of food, currently largely for domestic consumption (25 percent of GDP), may not only be an important shock absorber but may also evolve into a dynamic export sector. In recent years, export of its production surpluses (e.g., corn) was not allowed for food security reasons. It is expected that the bans may be relaxed as soon as domestic stocks build up. Since low world inventories of major food crops are a reality, Togo should seize this opportunity to boost production of foods to serve regional markets.

of the regional banking authority, and are operating very conservatively. The risks of second-round effects of a slowdown in economic activity (such as an increase in nonperforming loans) are greatly reduced because the financial sector as a whole is not significantly exposed to private sector credit since financial intermediation is relatively low at 18 percent and large percentage of assets are in government securities, which minimizes the risk. Banks are therefore in a relatively healthy position to ride out adverse times.

8. **Nonetheless, the recent pick-up in household credit could reverse** if regionally owned private banks—the most active in this market—cut back lending for reasons unrelated to Togo. There is no evidence so far of disruptions in international trade finance or the interbank market; banks have noted, however, that requirements from correspondent banks have become stricter. Microfinance institutions that provide about 15 percent of total credits are also getting less funding from international institutions.

Figure I.3. Banking Assets Held by Foreign Banks with Majority Ownership, 2006

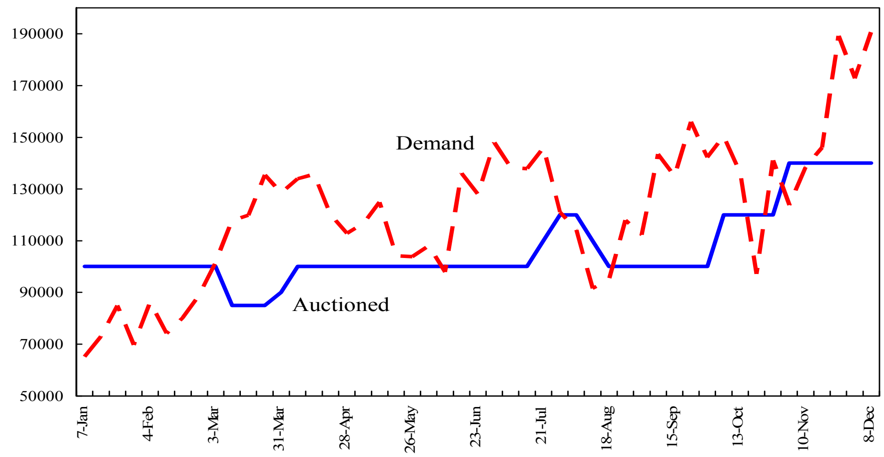


Source: World Bank's Global Development Finance, 2008

Note: A bank is considered fotimesreign owned if 50 percent or more of its shares in a given year are held directly by foreign nationals. Banks owned by nationals of the WAEMU region are not considered foreign.

9. **However, financial and monetary indicators need to be closely monitored since second-round effects cannot be ruled out.** A worse than expected economic decline could cause loan portfolios to deteriorate, and if the flow of funds to the region is drying up, some impact might be expected. Banks and authorities should be watching closely for signs of a credit crunch that might hurt the fragile economy. Liquidity injections by the BCEAO into the regional banking system increased in 2008, especially at the end of year (Figure I.4). This could indicate higher demand for liquidity in a region that has been characterized by excess liquidity in the recent past.

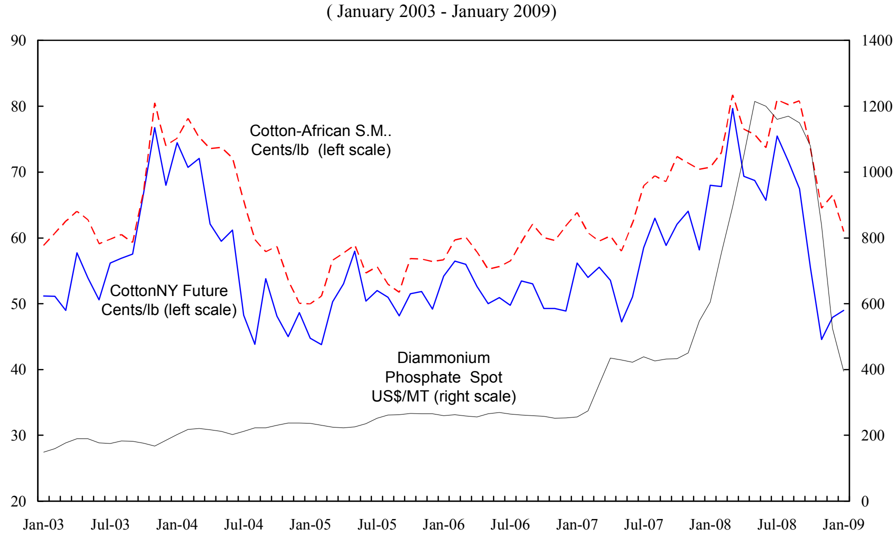
Figure I.4. Liquidity Injections by BCEAO in 2008
in millions of F CFA



Trade channels are highly vulnerable

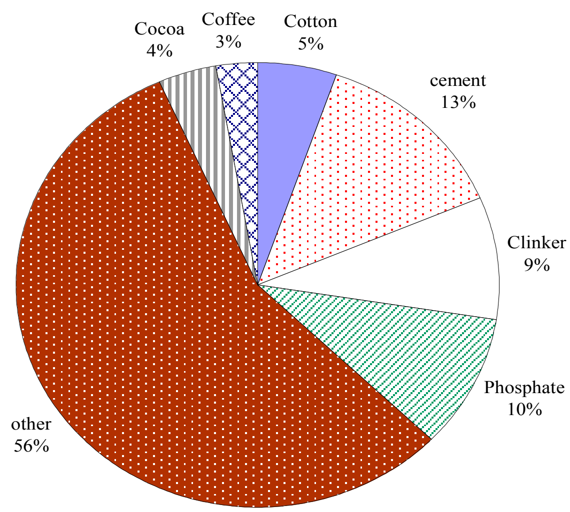
10. **The first and most visible impact of the crisis so far is a plunge in the prices of phosphate, cotton, and coffee** (Figure I.5). Lower global growth is pushing down demand for these traditional exports and therefore their prices. This may reduce even more their share in total exports, which declined from about 50 percent at the end of the 1990s to just 18 percent in 2008 (Figure I.6).

Figure I.5: Cotton and Phosphate Prices
(January 2003 - January 2009)



11. **The global downturn will particularly hit phosphate and cotton exports, which are in the midst of reforms, but so far there is no evidence that it is affecting cement exports, which now represent 20 percent of total exports.** Lower demand and lower prices for phosphate will make it even tougher to attract strategic investors, who are crucial to boosting production and exports, which are now at ¼ of potential. Phosphate production and exports increased in 2008 as international prices rose, which improved the financial position of the publicly owned company, but this could be interrupted. The cotton sector has not been able to recover from a protracted and failed restructuring, in particular of the state cotton company; declining output has reduced its share in total exports from 20 percent at the end of the 1990s to 5 percent in 2008.[2] The cement and clinker industry which produces for domestic and regional markets has been more dynamic. Higher prices have stimulated production and exports in recent years. One of the companies, a European consortium, is expecting to increase exports in 2009 because of demand in the region, where most of its exports go.

Figure I.6. Togo's Main Exports by Product, 2008



Source: IMF staff estimates
Note: The high level of others in total exports reflects trade data shortcomings. The authorities are, however, in a process of improving trade data quality.

12. **Togo's trading partners are relatively well diversified**: 35 percent with the region; 36 percent with Europe (of which France is the most important single trading partner); 20 percent with Asia (of which half with China); and 8 percent with the US (Figure I.7). Though about half of Togo's trade is with advanced economies severely affected by the crisis, other significant trading partners—such as the WAEMU region and China whose economies are still growing—may help limit the impact on Togo.

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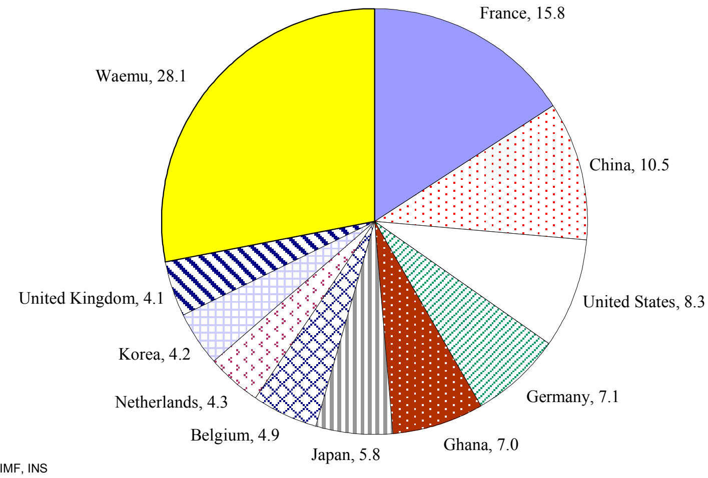
[2] The cotton sector in Togo collapsed when, after years of arrears to banks, SOTOCO, the state-owned ginning company, was unable to pay more than 250, 000 farmers for their 2004/2005 crop. The company has been audited, farmers paid in cash, and the debt of the company securitized by government bonds in 2008. Reforms are now underway.

Figure I.7. Togo's Main Trading Partners, 2008



Source: IMF, INS

Trade-related services: Port facilities and transportation should hold fairly steady

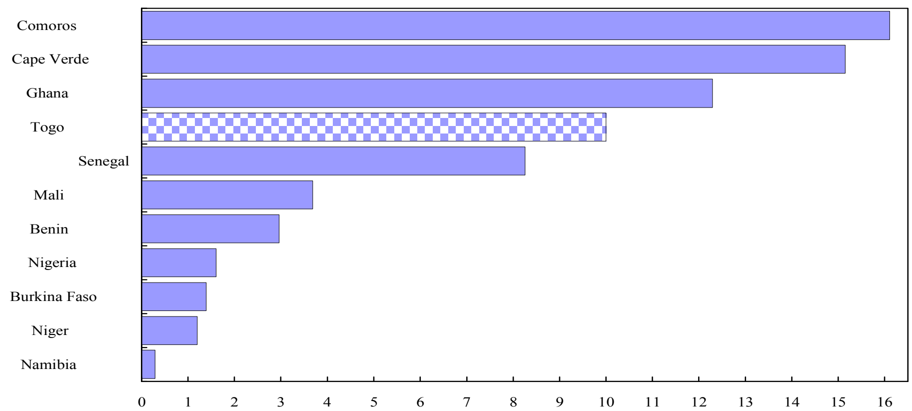
13. **Activity at the Port of Lomé, one of the most important deep-water ports in West Africa, is not expected to decline much in 2009.** The port and the related transport sector serve landlocked countries like Mali, Burkina Faso, and Niger (all WAEMU countries). The most important activity, transit and re-export of oil products, uses port facilities and the storage capacities of oil-importing companies in Togo. Since the port and transport sectors, which account for about 6 percent of GDP, are directly linked with economic activity in the region, any regional slowdown may have a negative impact on them. However, at the beginning of the year there was no evidence of a slowdown, perhaps because the WAEMU economies are estimated to increase growth on average by 3 percent in 2009, so no severe impact in this sector need be expected for the year as a whole.

Remittances are vulnerable to increasing unemployment in advanced economies

14. **Togo—one of Africa's top recipients of remittances, equivalent to about 10 percent of GDP—may be severely affected by a decline in those flows** (Figure I.8). So far remittances have not dropped much, but a decline of 10 to 15 percent might be expected for 2009. More than 30 percent of remittances come from Europe, mainly France, and about 20 percent from the U.S. Rising unemployment in host countries should inevitably affect immigrants. However, about 15 percent of remittances come from within the WAEMU, where economic activity is expected to slow, but not so much as in advanced economies. In

sum, a decline in remittances by 10 percent could lower GDP growth by about 1 percent, depending on the multiplier effect of remittances in domestic demand, especially internal trade and housing.[3]

Figure I.8. Remittances in Selected SSA Countries, 2008
(In percent of GDP)



Source: IMF, WEO October 2008

Lower than expected foreign investment may create an opportunity cost for higher growth

15. **Foreign direct investment, which is crucial to revitalize the banking and the phosphate sectors, is not likely to rebound soon.** As investors rebuild balance sheets, private capital flows dry up and new investment projects are likely to be slashed. Injection of fresh private capital into the banking and phosphate sectors is needed for concluding their restructuring process, which got underway in 2008. There is a high probability that the interest of investors may fade, jeopardizing structural reforms, postponing the expected boost in direct investment—now at 2.4 percent of GDP, and therefore flattening prospects for higher growth.

Aid flows: Budget and project aid is not expected to decrease in 2009

16. **In 2009 the global slowdown is not likely to affect donors' commitments to Togo, but a protracted and deeper crisis would certainly jeopardize future flows**. Togo already receives less international support than most neighboring countries at its income levels because of the economic and political crisis that lasted for more than a decade (Figure I.9). Reengagement with donors started a few years ago and since aid has been low—even by regional standards—a cut is not expected. In the case of Togo, the major part of aid for the next year or two is expected to come from multilateral agencies which have been more stable sources. It is likely, however, that the desired four-fold increase in aid, from an average of

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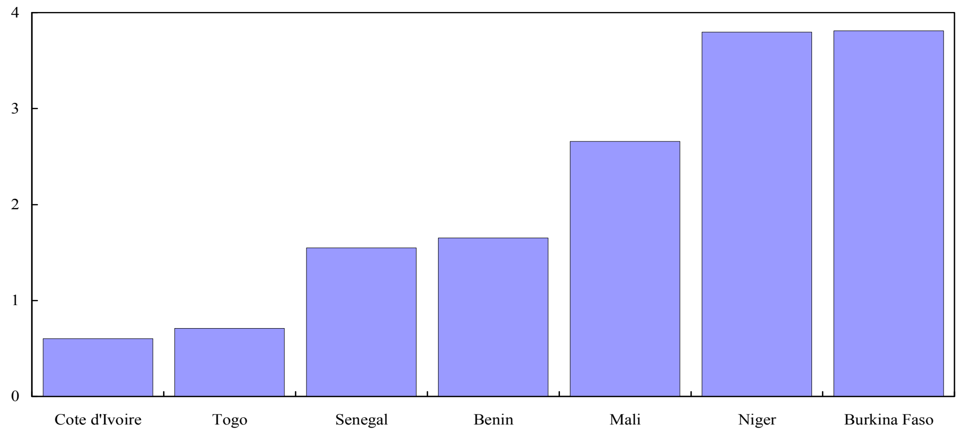
[3] It is assumed that only ¾ of remittances are spent and a multiplier of 1.2.

less than 1 percent of GDP between 2000 and 2008 to at least 4 percent, may not materialize in the medium term, particularly if the global recession worsens or persists.

Figure I.9. Project grants received (in percent of GDP)
(2000 - 2008 average)



Source: Fund staff estimates.

C. Quantitative Estimates of Spillovers

Projected Growth for 2009

17. **Based on estimates of the impact of the various transmission channels, Togo's growth rate for 2009 is now projected at about 1.7 percent, a slight increase from 2008's lackluster growth but about 1.5 percent lower than previously projected.** The growth projection for 2009 is based on Togo's macro framework that reflects provisional estimates of real growth by sector (Table I.2). The two main transmission channels, the fall in global demand and remittances, together could decrease foreign exchange inflows by about 1.5 percent of GDP. Because this would depress local demand, it would have a significant impact on the nonexport sector. However, the anticipated increase in public investment of about 2 percent of GDP financed by the government and foreign donors would offset that fall in demand.

18. **A planned significant increase in government spending in 2009, largely financed by an increase in donor project support, would be the main factor mitigating the decline in revenues.** Donors' project support projected at 2.8 percent of GDP in 2009 (1 percent more than in 2008) will be crucial for Togo's economic revival and for poverty reduction. The government is also expected to increase its financing of public investment projects by 1 percent of GDP, of which about 0.5 percent consists of a shift of capital spending from 2008 to 2009.

19. **As a result, growth in 2009 will be mainly driven by the nonexport sector, particularly by an increase in public investment and to a lesser extent by an increase in agriculture production for domestic consumption.** The export sector is expected to contract due to the decline in global demand and prices, which will inevitably push planned production down. For the nonexport sector, the estimates are mainly based on the two offsetting effects of higher government spending and lower remittances and export revenues. Construction, an important source of growth in 2009, is expected to benefit more from the former effect than from the latter. Overall the nonexport sector is expected to grow at about 2 percent.

Table I.2. Togo: Forecast for GDP by Sector in 2009

Impacting (-) and Mitigating (+) Factors	Sectors	Percentage Change	Percent of GDP in 2008	Contribution to GDP Growth
	Export sector	**-0.6**	**9.0** [1]	**- 0.05**
	Primary			
Global demand (-)	Cotton	-5.0	0.8	-0.04
	Secondary:			
Global demand (-)	Phosphates	-3.0	2.0	-0.06
Global demand (-)	Cement and clinker	-1.0	1.7	-0.02
Global (-) / regional demand (+)	Other	0.0	4.5	0.00
	Non-export sector	**1.9**	**91.0**	**1.73**
	Primary			
Subsistence agriculture (+)	Domestic	1.0	35.0	0.35
	Secondary			
Public investment (+) / Remittances (-)	Construction	20.0	3.2	0.64
Public investment (+) / Remittances (-)	Other	-0.1	10.0	-0.1
	Tertiary			
Regional demand (+) / Global demand (-)	Transportation	1.0	6.0	0.06
Remittances (-) / Public investment (+)	Other	1.8	36.0	0.60
	Gross Domestic Product	**1.7**	**100.0**	**1.7**

[1] Only the part of exports for which data on international prices are available was considered. Total domestic exports amount, otherwise, to about 19 percent of GDP.

Correlations with Main Trading Partners

20. **Togo's growth rate is significantly correlated with the growth rates of France and the WAEMU**, making them the most important external drivers of Togolese growth (Table I.3). A simple regression of Togo's growth between 1972 and 2008 on growth rates in

the WAEMU and France shows positive and statistically significant coefficients (Table I.3) [4]. Nigeria's economy, which affects Benin heavily, does not seem to have a major impact on Togo.

Table I.3. Togo: Growth Rate Correlations

Correlation	WAEMU	France	NGA	USA
Togo	0.39	0.37	0.03	0.23

21. **Based on WEO growth projections for France and the WAEMU—setting aside country-specific factors, such as the expected fiscal expansion that will boost domestic demand—the regression predicts a growth rate of 0 percent for Togo in 2009 (Table I.4).** This suggests that, due to the global financial crisis, external factors are not likely to contribute to positive growth in Togo in 2009. This result is similar to the one obtained in Section I, which predicts that export sector growth would be close to zero. Moreover, as also observed in Table I.2, the nonexport sector will be the sole driver of economic growth in 2009.

Table I.4. Togo: Regression Results for Links to France and WAEMU Growth

Dependent Variable: TGO

Method: Least Squares

	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.04	0.02	-2.39	0.02
WAEMU	0.82	0.29	2.79	0.01
FRA	1.49	0.56	2.65	0.01
R-squared	*0.30*	**F-Stat**	*0.00242*	

	TGO	FRA	WAEMU
ADF test	-5.77***	-3.76***	-4.35***

D. Possible Policy Responses

22. **The general challenge for the authorities is to assess the scope for countercyclical policies.** The impact of the crisis should be in particular focused on the more vulnerable

[4] Adding other external conditions (growth rates in other OECD countries, world commodity prices, and terms of trade) as exogenous variables to this regression does not significantly improve the adjusted R-squared.

segments of the population. Because the options will be limited by the financing available, adequate donor financing will be crucial for continuing investment in basic services and infrastructure. The expected 1.7 percent growth for 2009 depends heavily on public investment. Two factors are crucial to growing the economy: (i) continued donor confidence on the government's program and capacity to implement reforms, so as to shore up donor support; and (ii) strengthening expenditure management to avoid the types of delays in capital investment that occurred in 2008.

23. **The authorities should keep their medium-term goals in mind.** They should continue working to stabilize the economy as they undertake to achieve broader development goals, such as continuing with structural reforms to improve competitiveness, increase sustainable growth, and reduce poverty. In particular, efforts to restructure the financial, phosphate, and cotton sectors should be pursued even if strategic investors are not identified.

24. **The main sectoral policy challenges are in the fiscal and financial sectors.** By rationalizing tax incentives and strengthening revenue administration, Togo can mobilize additional resources and create fiscal space to preserve priority spending in poverty-reducing areas. Spending capacity and efficiency should continue to increase, especially efforts to reduce unproductive expenditure. The government should accelerate providers' arrears as well as current payments. The financial sector should be closely monitored so that vulnerabilities can be identified quickly.

25. **The authorities should also regularly and closely monitor real activity.** In cooperation with their development partners, they should track a few monthly indicators, such as remittances, trade activity, port activity, and phosphate and cement production and exports.

26. **At a regional level, WAEMU institutions should consider measures to boost regional productivity and support activity.** First, any deterioration in competitiveness would need to be addressed through structural reforms. For instance, boosting productivity through better regional infrastructure and basic services, such as electricity, must remain a priority of regional developing agencies. Second, the BCEAO should continue to support management of regional bank liquidity through regular, well-calibrated monetary operations. Depending on the monetary policy stance in the Euro area and conditions of the subregion's economies, the BCEAO could usefully strengthen its liquidity support by expanding its direct liquidity injections.

27. **The international community should consider how best to support fragile economies through the global financial crisis**. Particularly worthy of support are those, like Togo, that have demonstrated a firm commitment to policy reforms and are beginning to recover from years of mismanagement and declining economic growth.

II. Principles Underpinning the Design and Implementation of a Debt Management Strategy in Togo[1]

Summary

1. **This note comes in response to authorities' request for support in defining a set of broad principles to guide the design and implementation of Togo's debt strategy, particularly the resumption of domestic debt issuance.** While these principles are not new in the field, their clear application in the case of Togo can be an important contribution to help the authorities design a coherent framework to manage public debt. The note includes (and differentiates between) best practice for issuing and managing both T-bills and longer term government bonds.

2. **Togo is currently undertaking a reform of its debt management framework to improve both the borrowing strategy and its execution.** Hence a committee was created to formulate a debt strategy while the Directorate of Public Debt (DPD) is being reformed to ensure the implementation of the strategy. Reforms are still at an early stage and there are significant challenges ahead. Weaknesses still exist both in terms of the formulation of a coherent explicit strategy and its practical implementation. Moreover, integrated domestic and external debt recording and the implementation of a legal framework will need to be addressed for the reforms to be successful.

3. **The case for strengthening debt management reflects also the engagement of the authorities with the IMF, and their commitment under the PRGF arrangement to seek highly concessional financing to avoid debt distress**. In the near-term, the authorities can rely on a resumption of short-term borrowing on the regional market through issuance of T-bills as an instrument to manage the treasury's cash needs and support the objectives stated in the debt management strategy. Issuing short-term instruments would also meet the target to foster the development of the regional capital market, particularly debt secondary and interbank markets. In the medium-term, the regional debt market could become a source of additional medium-term development financing.

4. **Moreover, important operations aimed at restructuring ailing banks and clear domestic arrears are underway, entailing the exchange of a government securities (around 9 percent of GDP in 2009/10) with under-capitalized banks for nonperforming loan and with enterprises or clearing domestic arrears**. These securities will have to be managed by the DPD. Finally, and barring an even sharper decline in the global economy, Togo is set to resume larger scale and more regular external borrowing, particularly after

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[1] Prepared by Jihad Dagher and Samuele Rosa.

reaching completion point, to finance its investment plans. Against this background, all borrowing decisions, foreign and domestic, as well as short and long term maturity, will have to be subordinated to debt sustainability considerations underpinned by a sound strategy. To ensure this, a continuous monitoring of the regional demand for T-bills and government bond is necessary, in particular following the increased uncertainty brought by the global financial crisis.

5. **Against this background, the note advocates for the need to swiftly improve the collection and updating of debt data, including domestic debt data on state owned enterprises, and to increase staffing and IT support accordingly.** Within the next twelve months, an explicit debt strategy should be defined and communicated, with debt sustainability analysis made an obligatory part of the borrowing policy discussion.

A. Developing Access to the Regional Public Debt Market

6. **Togo is planning to improve its cash management through issuing T-bills in the WAEMU regional market on a regular basis.** The authorities are also focused on preparing to meet their longer term financing needs through issuing medium-term bonds on the regional market, although such issuances are not planned at the moment. It is therefore important that the regional debt market[2] be well developed and that the cooperation between market participants and sovereign issuers is sound. Moreover, the DPD will ensure debt service on the securities issued in the context of the 2009 bank restructuring and domestic arrears clearance operations. Although the latter operation does not involve the actual floating of securities on the market, it will require enhanced ability to monitor and ensure debt service.

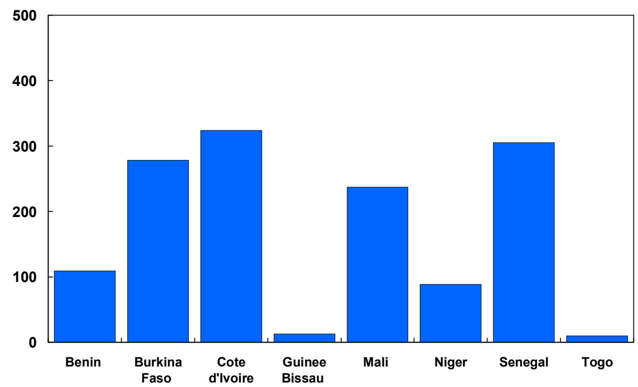
7. **Development of a regional debt market could entail significant benefits to Togo and the West African Economic and Monetary Union (WAEMU) in general.** First, a liquid regional debt market improves the government's ability to issue its securities and reduce borrowing costs. Second, the existence of a well developed public debt market is critical to the development of a regional capital market, as it establishes a reference yield curve for different maturities and risk profiles, thereby facilitating the creation of a wider range of financial instruments to increase the scope of the region market. Third, by deepening the capital markets in the region, a liquid regional debt market can improve the role of monetary policy and enhance its effectiveness, thereby increasing macroeconomic management capacity.

8. **While developing a deep and liquid debt regional market remains a long term goal for the region, substantial progress has been made in the recent years.** As central

[2] In this note, domestic debt includes T-bills and government bonds, as well as direct loans, issued in local currency.

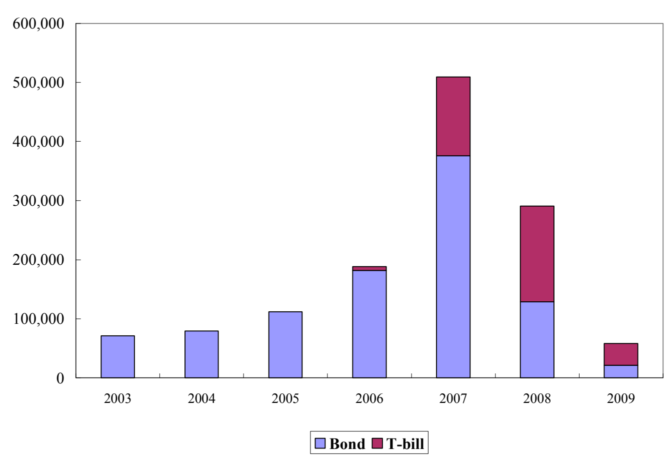
bank financing of the budget was gradually phased out in the early 2000s, national treasuries in the region have resorted to issuing treasury bills (T-bills) and bonds (T-bonds). Sovereign bonds, normally linked to long term investment plans, have first emerged as securities of choice, while T-bills have been issued starting from the second part of the last decade, reaching CFAF 162 billion in 2008. The overall volume of issuance have been relatively concentrated in few countries. Burkina Faso, Cote d'Ivoire, and Senegal have auctioned T-bills through the BCEAO on a regular basis while Benin and Togo, for example, had their first issue of T-bills in 2006 and 2008, respectively. The total volume of T-bills issued on the regional market between 2000 and 2008 is shown in Figures II.1 and II.2.

Figure II.1. WAEMU: T-bills Issuance, 2003-09
(Millions of FCFA)



Source: BCEAO

Figure II.2 WAEMU: T-bills and Bond Issuance, 2000-08
(Billions of FCFA)



9. **While governments in the region have increasingly sought to address their cash and financing needs in the WAEMU debt market, it remains shallow by international comparison, on both the primary and, in particular, on the secondary market.** For example, T-bills are issued only twice a year for most countries. More than 50 percent of total T-bills and bond issuance (both in value and occurrences) take place between July and August. The framework establishing regular communications between the issuers and market participants is weak. As for the activity on the secondary market, it is still minimal as banks have so far been keeping the securities on their balance sheets to maturity. This may partly be explained by the relatively low volume of outstanding securities as well as lack of bankable opportunities. The volume of public debt financed by T-bills and bonds on average accounts for less than 10 percent of the financing needs of governments in the WAEMU region. The recent experience of securities issued by the government of Benin to repay its debt to civil servants shows some activity in the secondary market as a large part of the initial placement of CFAF 25 billion in T-bonds (0.7 percent of GDP) has been rediscounted by commercial banks. Likewise, Togolese government securities provided to local banks against nonperforming loans, have been actively sold at a discount over the counter to other regional banks to obtain liquidity.

10. **Further developing the regional debt market remains a key target, supported by the BCEAO and the WAEMU commission**. These institutions are engaged in a number of initiatives aimed at facilitating the primary and secondary markets for sovereign securities, including preannouncing planned issuance ahead of time, setting up revenue earmarking mechanism, enlarging the list of securities that can be used for repo or reverse repo operations with the BCEAO, and supporting sound fiscal policies. In the longer term, these initiatives aim at implementing the Basel II prudential principles, including increasing the use of rating schemes for private borrowers. Other initiatives cover the harmonization of the accounting for income statements and balance sheets. WAEMU governments are also engaged in parallel initiatives to improve the business environment, which can improve the quality of both the sovereign and private issuers, such as streamlining the issuance and transfer of land titles, and real and commercial estate property rights.

11. **Despite the still relatively limited debt market, Togo's access to the domestic and regional market has increased over the past three years, and is set to increase further in light of important bank restructuring and domestic arrear clearance operations.** (See Tables II.1 and II.2).

Table II.1: Togo – Issuance of Bonds and T-bills

	2004	2005	2006	2007	2008	2009	2010
	Issuance of bonds and t-bills (percent of GDP)						
Securities/loans	1.9	0.0	5.3	1.7	1.4	8.7	0.7
Government bond [1]	0.0	0.0	3.1	1.7	0.0	0.0	0.0
Arrears clearance bonds	0.0	0.0	0.0	0.0	0.0	1.4	0.0
Bank restructuring bonds	0.0	0.0	0.0	0.0	0.0	6.6	0.0
Other bonds / L-T loans	1.9	0.0	2.2	0.0	0.0	0.0	0.0
T-bills (outstanding amount)	0.0	0.0	0.0	0.0	1.4	0.7	0.7

Source: Togolese authorities, and staff estimates and calculations.

[1] Issued in the WAEMU regional market, with the support of the BCEAO. Include provisions to earmarking revenues at the BCEAO to secure debt service. Issued at 6.5% and 6% interest rate in 2006 and 2007, respectively.

Table II.2: Togo – Stock of Arrears and Securities

	2006	2007	2008	2009	2010
	(In percent of GDP)				
Stock					
Arrears	22.7	20.7	11.3	8.9	8.2
Commercial debt (to suppliers)	4.8	4.5	3.9	2.0	1.7
Financial debt (to banks and social security funds)	16.1	15.3	7.2	6.8	6.3
Social debt (civil service wages)	0.5	0.2	0.0	0.0	0.0
Securities	5.9	6.8	11.9	11.0	8.5
2006 issue [1]	3.1	3.0	2.1	1.4	0.7
2007 issue [2]	0.0	1.7	1.6	1.5	1.3
Arrears clearance bonds [3]	0.0	0.0	0.0	1.4	1.2
Bank restructuring bonds [4]	0.0	0.0	6.8	5.9	5.1
Other bonds / loans [5]	2.7	2.1	1.4	0.8	0.3
Total	28.6	27.5	23.2	19.9	16.7
***Memo item:* arrears to private suppliers not yet validated**	2.2	2.2	2.0	1.9	1.9

Source: Togolese authorities, and staff estimates and calculations.

[1,2] Includes bonds issues to finance long-term investment plans. Debt service is ensured through earmarking revenues at the BCEAO.

[3] Covers the clerance of verified domestic arrears to private suppliers for high transactions. Smaller transactions to be cleared in cash (CFAF 12.6 bn, including budget support from France).

[4] Includes the securitization of nonperforming loans of public banks, and those of private banks towards state owned enterprises

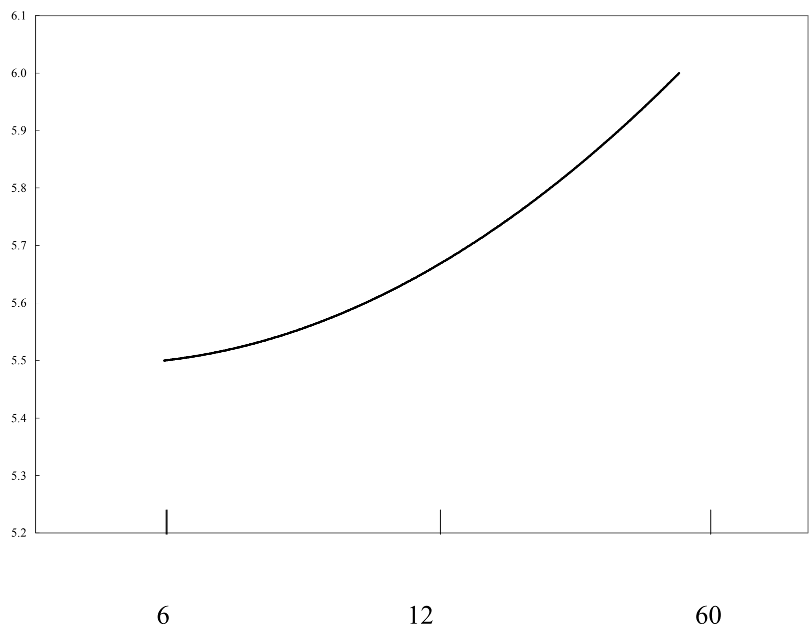
[5] Includes the assumption of nonperforming loans, mainly to SOTOCO and the phosphate company.

12. **The sound management of government debt plays an essential role in the development of the regional debt market.** Government securities receive better ratings when they are well managed within a transparent and well-framed medium- to long-term debt strategy. Since public debt is typically the largest and most complex financial set of instruments in the market, slippages in sovereign debt management can create significant

disruptions to capital markets and endanger the stability of the regional financial system. There can also be a substantial benefit in terms of lower rates required by the market, particularly assuming sound macroeconomic policies and benign international liquidity conditions, as shown in 2006/08, including in the WAEMU (see Figure II.3) Conversely, market conditions can reverse very abruptly, with a spike particularly in long-term interest rates required by the market to compensate the perceived risks. Finally, once a debt management strategy reaches a point of issuing a mix of maturity, it will need to decide on the optimal mix of maturities, balancing the trade-offs between borrowing costs and rollover concerns.

Figure II.3: Illustrative Yield Curve for Selected WAEMU Countries[3]

Average for all issuers (2006/08)- by original maturities in months



B. Debt Management in Togo

13. **Prior to the reforms initiated in 2008, Togo's debt management have suffered from many fundamental weaknesses.** The legal framework of debt management lacked important implementation decrees and was not always respected. The main unit responsible for debt management, the DDP (*Direction de la Dette Publique*), a part of the Treasury Department, did not have an explicit debt management strategy. Cut off from donors' support due to a long-lasting sociopolitical crisis, Togo ran arrears with the principal multilateral and

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[3] This figure is provided for illustrative purposes and does not represent an actual yield curve since high frequency data for multiple maturities are not available.

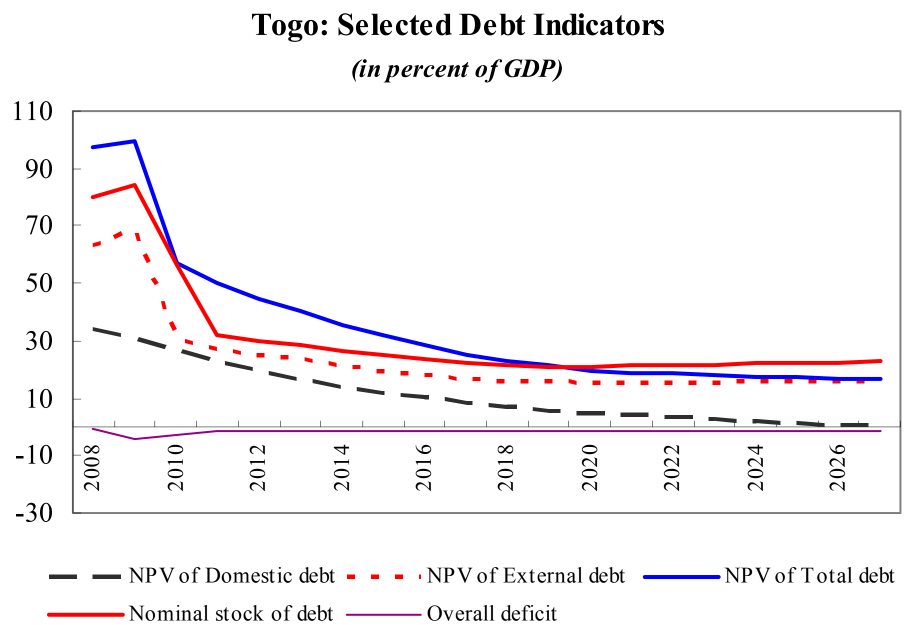
bilateral creditors (excluding the IMF). Debt service, together with other budget spending, was selectively paid based on the decision of a committee in charge of prioritizing cash payment in light of the limited budget resources, effectively reducing the role of the DDP. In this context of limited operations, accurate debt data recording was one of its main weaknesses, even though it was nominally still responsible for monitoring debt and debt service debt. The problem was aggravated by the practice of fact that often line ministers could negotiate and sign loans without the involvement of the DDP. Despite some initiative to clarify the institutional framework, the DDP still does not have full command over the resources needed to ensure debt service. Moreover, the staff of the DDP are not adequately trained in the analytical requirements of debt sustainability studies and the more advanced debt management operations.

14. **Obliged to operate under tight financing and cut from donor support, Togo debt management strategy lacked a coherent framework as budget financing needed to rely mostly on domestic resources**. Because of this resource constraints, the budget execution tended to accumulate large surpluses during the first part of the year to create a cushion for the rest of the fiscal year, effectively squeezing the time frame and overall envelop for capital spending, which typically need to be initiated in due time to ensure that resources are committed and the private agents can start deliver. Moreover, essential transfers and subsidies, including to nongovernmental entities engaged in priority social policies, where postponed towards the end of the fiscal year to create a cushion in case of revenue shortfalls.

15. **Under IMF program, budget execution has improved remarkably and important reforms in the Treasury department have been designed to strengthen cash and debt management**. However actual implementation is lagging behind. In particular, 2009 saw the creation of a new committee responsible for formulating a debt strategy within the ministry of finance (CNDP). The CNDP has been entrusted a number of important tasks, which yet need to be backed by concrete measures and resources to make the operational. Beyond the formulation of the strategy, these tasks include: (i) ensuring the implementation of the strategy, (ii) undertaking Debt Sustainability Analysis (DSA), (iii) communicating to the public the strategy and its outcomes, and (iv) improve the coordination of debt managers with the fiscal and monetary authorities. The CNDP, who is in the process of elaborating specifics on these tasks, is also expected to put forth a specific ceiling on debt borrowing based on assessing overall public debt developments against key macroeconomic indicators, such as the GPD level and growth, total revenues, and exports. A suitable tool to integrate these key elements in a unified analytical framework, considered by the CNDP, is the Debt Sustainability Template (DSA), developed by Fund-Bank staff. Staff recently included in the DSA estimates of the domestic debt service, showing that under the baseline scenario the totality of external and domestic public debt would reach sustainable levels (see Figure II.4). However, the DSA also shows that debt sustainability dynamics in Togo are particularly

sensitive to the concessionality of loans, the share of grants in overall external financing, and a decline in the long term growth.[4]

Figure II.4.: Togo – Selected Debt Indicators



16. **However the creation of the CNDP alone is not likely to solve the problems related to the implementation of the strategy, to be entrusted with the DPD.** In particular, the current legal framework still poses little limitation to the ability of spending ministries to initiate negotiations or sign protocols on new loans without associating in these discussions DPD.[5] Furthermore the DPD, still the unit responsible for implementing the debt strategy, has not seen a significant increase in either its technical or human capacity to make a significant and lasting improvement in debt recording to avoid future slippages that were seen in the past.

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[4] Togo: *Enhanced Initiative for Heavily Indebted Poor Countries* — Decision Point Document - Country Report No. 08/370.

[5] In the current system, only the Minister of Finance can actually sign borrowing agreements with third parties. However, the practice is that other line ministers can initiate discussions and sign technical memorandum of understanding without associating the DPD. When the government finally approves the loan through the signature of the Minister of Finance, the DPD normally has not provided an evaluation regarding the debt sustainability implication of the new loan.

17. **Progress in debt management is also hindered by cash management problems at the Treasury Department.** There are significant accounting weaknesses at the treasury department making it not only hard to forecast future short term needs but also to properly account for current liabilities. Particularly in the past, the fiscal framework was loaded by numerous contingent liabilities, particularly from state owned enterprises, not properly accounted for, which resulted in episodes of sudden increase in debt as the underlying contingent liability materialized, normally triggered by these companies experiencing unsustainable operating losses. Moreover, while revenues are transferred regularly at the Treasury account BCEAO, the practice of earmarking spending in subaccounts effectively introduce an element of rigidity contrary to minimal standards underpinning sound cash management.

18. **Despite the past and current challenges, Togo has reached a fairly comfortable level of macroeconomic stability under Fund-supported programs, resulting in renewed market appetite for government papers.** Togo issued Treasury bills for the first time in September 2008 and plans to issue on a regular basis going forward. This issuance of CFAF 10 billion, coordinated with the BCEAO, was intended to help familiarize the Treasury with the procedures and market participants. The T-bill issuance is seen as a tool to help manage cash needs, while medium-term financing need should be met with government bonds. Furthermore given the risks[6] involved in short term borrowing and in light of the treasury's cash needs it is advisable to keep outstanding short term T-bills around a 1 percent of GDP;[7] this threshold represent a practical reference that can help the authorities assess how much their short-term borrowing policies may undermine debt sustainability. While issuing short term instruments can minimize borrowing cost, particularly as the financial market is becoming more risk adverse with respect to longer term instruments, T-bills expose the authorities to considerable rollover risk, due to the need to meet the refinancing need on a frequent basis. For this reason, staff have advised the authorities to balance the perceived lower borrowing cost with the higher rollover risk and make sure that long term liabilities are not financed with short term instruments.

19. **To maintain Togo's access to the regional financial market debt, debt sustainability must be made a priority in its borrowing strategy.** The last DSA for Togo was prepared in 2007 and assessed Togo as being in debt distress. Going forward, significant improvement in overall debt indicators is projected, due to continued improvements in the macroeconomic policy framework, the large arrears clearance operation of 2007, and the

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[6] See Box II.1 in Annex for a discussion about the risks.

[7] This reference limit is commensurate with the expected domestic primary surplus and corresponds to the domestic debt service under program, with the goal of maintaining a balance between overall domestic resources and spending, without running arrears.

HIPC Initiative interim debt relief. The total financing under the HIPC initiative (arrear clearance and debt cancellation) will be about 74 percent of the GDP.

20. **Following the PRGF program, the authorities in Togo have not engaged in nonconcessional borrowing**. This decision underscores strong political commitment, particularly since it has implied refraining from financing on nonconcessional terms key sectors and public enterprises. As the global environment will likely reduce the prospect for financing at concessional terms, it is hoped that Togo's policy stance should be followed by reaching completion point in relatively short time.

21. **Due to the global financial crisis and the rise in uncertainty in the region, tapping the regional debt market is likely to be significantly more difficult in 2009 and 2010.** Indication of a liquidity tightening in regional commercial banks have reduced the appetite for government debt in the second half of 2008. A clear signal of this was the undersubscription of a placement of Senegalese T-bills in June 2008. Going forward, the liquidity tightening is likely to intensify. Placing large amounts of T-bills and bonds on the regional market could put upward pressure on interest rates and lead to further partially subscribed issuances. Market participants, particularly banks, are increasingly showing a preference for short term maturity instruments.

22. **In the short term, capacity constraints and lack of reliable data remain a serious problem in Togo.** The DPD has only 8 staff, of which 4 in the management position, tasked with actively managing a stock of debt which is in the range of 8-10 percent of the GDP. The IT support is also very poor, with limited access to modern databases and certain loan contracts not being updated regularly. Data coverage on domestic debt is still weak, particularly regarding the t-bills, securitization of the bank restructuring and domestic arrears clearance operations, and state-owned enterprises. Going forward (but not beyond 12 months), it will be critical that DPD defines and announces an explicit debt strategy, and that its opinion on all government decisions affecting the debt level be sought before these decisions are taken (see Table II.3).

Table II.3: Togo – Measures to Improve the Debt Management

Short term (next 6 months)	Improve the collection and updates of debt data, including domestic debt data on state owned enterprises.
	Increase staffing and IT support.
Medium term (next 6/12 months)	Define and communicate an explicitly debt strategy.
	Make the debt sustainability analysis an obligatory part of the policy discussion whether or not borrow.

C. Policy Considerations

- **The reforms currently undertaken by the authorities in Togo will help strengthen the debt management framework.** However, these reforms are at an initial stage, and 2009 will be an important testing phase to consolidate the institutional framework and the internal procedure leading to a sound debt management**.**

- **Defining a clear debt strategy.** The first priority is for the CNDP to set up a consistent set of objectives, targets, and instruments guiding debt management. The objectives should clearly distinguish between the need to support borrowing needs, minimize costs, and help develop the financial market. The objectives in using each instrument (including amounts and maturities) should be clear. For example, T-bills issuance should be a tool to manage cash flows and short term borrowing needs. The strategy should be made public and form the terms of reference for the DPD.

- **Strengthening the institutional framework**.

    - It will be vital to revise the set of rules governing how the different actors in the public sectors contribute to define the debt profile of Togo. First, the Debt Directorate should be given clear mandate to define debt guidelines consistent with the debt strategy, collect and update data on actual and contingent debt, be associated in discussions potentially leading to increased debt at an early stage, and have command over the budget resources allocated to ensure debt service.

    - It will also be important to support to the efforts at the regional level to develop the institutional and market framework for debt issuance.

- **Highlight pro-growth policies.** Debt dynamics should be assessed against key economic aggregate, particularly the level and growth rate of the GDP. Therefore, it is essential that debt decision be complemented and supported by pro-growth policies, and that the use of the resources borrowed in the market underpin these policies.

- **Increase capacity**. Togo's current debt management capacity is low even for regional standards. The knowledge base of the DPD needs also to be revamped, to fully familiarize with the concepts used in the of-the-art debt management, particularly to better include rollover and currency risks, as well to encompass off-balance sheet contingent liabilities and full assessment on a net present value. Continued financial and technical support by the development partners will be critical to ensure that these gaps are filled.

ANNEX

Developing a Strategy for Debt Management

1. **The principal components of sound debt management (DM) are**: (i) clear debt management objectives, (ii) an effective institutional framework and proper coordination with monetary and fiscal policy; and (iii) a prudent and transparent strategy to manage the risks and achieve the stated objectives.

I. Objectives of DM

2. **In most countries, the objectives of debt managers are stated in terms of expected cost and risk of issuing different forms of debt**. The objective is often to ensure that the government financing needs and its payment obligations are met at the lowest possible cost over the medium and long run, consistent with an acceptable degree of risk. Sometimes, the development of domestic debt markets is also stated as an explicit objective. It is very important that these objectives be clearly stated and communicated as transparency plays a key role in reducing the cost and increasing the predictability of public debt.

II. The Framework of DM

Institutional framework of DM

3. **A clear legal framework should be in place to clarify the authority to borrow and issue debt, and to invest government assets**. As stated in the *Guidelines for Public Debt Management*[8] for an effective governance structure, the organizational framework for debt management should be well specified and ensure that mandates and roles are well articulated. Countries sometimes differ on the institutional arrangements for locating the sovereign debt management functions across one or more agencies. However the key element is to ensure a well specified organizational framework and that there is sufficient coordination and sharing of information.

Coordination with the monetary and fiscal authorities.

4. **Given the interdependencies between their different policy instruments, debt managers, fiscal policy advisors, and central bankers should share an understanding of the objectives of debt management**. Lowering the risk premia, for example, on medium and long term government bonds can only be achieved with prudent debt management, fiscal, and

[8] "Guidelines for Public Debt Management", IMF and World Bank Publication, 2000. [http://www.imf.org/external/np/mae/pdebt/2000/eng/index.htm].

monetary policies. The interaction between debt and liquidity management is essential to avoid large swings in commercial banks' liquidity.

DM Strategy

5. **A full debt management strategy needs to encompass the following elements**:

(i) **Debt sustainability analysis** (DSA): The capacity to conduct regular DSAs is an important element in the elaboration of a debt strategy as it involves debt and debt service projections as well as projections of key macroeconomic variables. Debt managers should monitor the sustainability of the stock of debt and discuss the risks with the fiscal authorities.

(ii) **Identifying risks**: One of the important tasks of a debt manager is to identify and manage the trade-offs between expected cost and risks in the government portfolio. There are many risks involved with sovereign borrowing due to the size and the complexity of the government debt portfolio. Box 1 lists some of the risks that could be important for LIC and emerging economies. To assess the importance of these risks the debt manager can conduct stress tests of the debt portfolio to evaluate the impact of potential economic and financial shocks.

(iii) **Choices facing debt managers:** A debt management strategy also consists of choosing between different forms of debt (T-bills, Bonds, Loans), issuance techniques (auction, syndication, underwriting) and frequency of issuance. Typically, in most developed markets, the government borrows on a regular basis tapping the market on a constant frequency. Often, T-bills are issued on a weekly basis and sold in an auction, while bonds are auctioned on a less frequent basis (varies from monthly to quarterly basis). However what works for the more advanced economies is not necessarily what is best for low-income countries (LICs). In terms of the maturity, most LIC usually face a very steep yield curve that makes it prohibitory expensive to borrow long-term. That is why debt managers in LIC should aim toward minimizing this cost by trying to improve the rating of government debt through a better and more transparent management. Meanwhile, issuing shorter term bonds and T-bills could be optimal for these countries, even if it exposes them to larger rollover risks. As for the issuance technique, auctions have become predominant in both developed and developing countries as they have proved to be more cost effective and more transparent than other methods. The timetable for auctions, on the other hand, is a function of debt management decision and desire to promote a secondary market. Having a regular issuance calendar has the advantage of improving transparency on the market and benefiting the development of a secondary market. However, too frequent auctions may lead to small auctions volumes and less meaningful price information which would not necessarily spur the development of secondary markets.

Box II.1: Risks Encountered in Sovereign Debt Management

Risk	**Description**
Market risk	Refers to the risks associated with changes in market prices, such as interest rates, exchange rates, and commodity prices, on the cost of the government's debt servicing.
Rollover risk	The risk that debt will have to be rolled over at an unusually high cost or, in extreme cases, cannot be rolled over at all.
Liquidity risk	Refers to more than one risk. For DM units in LIC countries it mostly refers to a situation in which the volume of liquid assets can diminish quickly in the face of unanticipated cash flow obligations or a possible difficulty in raising cash through borrowing in a short period of time.
Credit risk	The risk of nonperformance by borrowers on loans and other financial assets or by a counterparty on financial contracts.
Settlement risk	Refers to the potential loss that the government could suffer as a result of failure to settle by the counterparty.
Operational risk	This includes a range of different types of risks, including transaction errors in the various stages of executing and recording transactions; inadequacies or failures in internal controls or in systems and services; reputation risk; legal risk; security breaches; or natural disasters that affect business activity.