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# **Togo:** Letter of Intent

April 1, 2009

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LETTER OF INTENT

Lomé

April 1, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Managing Director:

1. Further to my letter dated September 12th, 2008, I wish to take the opportunity of the second review of the program to report on the progress made in implementing this financial program supported by the Poverty Reduction and Growth Facility (PRGF) arrangement. In spite of the external shocks suffered during the first year of the program, we have remained committed to pursuing economic reforms with a view to consolidating the results of the actions undertaken over the last few years. We have made considerable progress, enabling us to meet our objectives under the reform program and fulfill our commitments. We would also like to explain our policy plans and commitments as the reform program shifts to a new phase in an uncertain global environment.

**Background**

2. Launched in 2006 as part of the government's strategy to overcome the prolonged social, political, and economic crisis, our economic recovery and poverty reduction program aims to restore macroeconomic stability, rationalize the public finances, and boost economic growth in order to raise living standards. Our major priority remains the implementation of our Interim Poverty Reduction Strategy Paper (I-PRSP) which underpins the program. The government's program, supported by the PRGF arrangement, has achieved significant results for the first two objectives despite difficulties beyond its control, such as the steep rise in world food and oil prices and the severe flooding that took place in August 2008.

3. Indeed, the program's framework contributed to mitigating the effects of these shocks on the public finances and to improving the macroeconomic situation. The government's financial situation has improved significantly. The program has also enabled us to normalize relations with our external creditors and to reach the HIPC decision point in November 2008, thus opening the way for significant debt relief and financial and technical support. Further action and continuing vigilance remain necessary in pursuing these objectives. The program is entering a phase that places greater emphasis on accelerating growth and reducing poverty.

Despite the efforts and sacrifices made in implementing the measures called for in the program, the results in terms of growth have been mixed as a result of the difficulties mentioned above. Moreover, the current global economic slowdown threatens to further delay the pickup in growth that was much expected by the population of Togo.

**Recent economic developments**

4. The Togolese economy and population were seriously affected by the global environment and the floods in 2008. The expected economic recovery did not materialize and the growth rate hovered around 1.1 percent, which is below the average for the last five years. This poor performance is mostly attributable to the damage caused by the floods and to the global hike in food and energy prices. In the wake of these shocks, inflation rose to a peak of 15.8 percent in August (year-on-year) before falling back to 8.4 percent at the end of the year with the reversal of global price rises. Reflecting the deterioration of the economy, household purchasing power has eroded.

5. The current account of the external balance of payments has worsened as a result of deteriorating terms of trade and the destruction caused by the floods. The current account deficit is projected at 6.6 percent of GDP in 2008, compared to 3.9 percent in 2007. The monetary situation has been characterized by an increase in foreign assets and slow growth in domestic credit due to stagnation in the economy. These developments have led to a slower expansion in the money supply, which rose by 16 percent.

**Implementation of the PRGF-supported program**

6. The strict implementation of the PRGF-supported program has provided a flexible and sound macroeconomic environment which has enabled Togo to deal with the impact of external shocks, while contributing to the achievement of the program's objectives. Despite the difficulties, public finances improved during the year and structural reforms have remained on track. All performance criteria and quantitative indicators for end-December 2008 have been met, with the exception of the indicative target for the minimum level of domestically-financed social and capital spending (see Table 1). Similarly, all structural benchmarks were achieved on time, except for a three-month delay in the case of one benchmark (Table 2).

7. The government's good financial performance is attributable to strong mobilization of domestic resources and solid control over recurrent expenditure. On the other hand, the rate of execution of capital expenditure has been low. Specifically, repairs to infrastructure damaged by the August floods were delayed by the country's limited absorptive capacity. Revenue collection was bolstered by the strengthening of the tax and customs administrations and the progressive computerization of customs operations. As a result, the PRGF-supported program ceilings for the primary fiscal balance and domestic financing were met by a comfortable margin. The primary balance stands at 0.4 percent of GDP and the government's net position with the banking system has improved. Greater fiscal discipline has prevented

the accumulation of payment arrears and the government has neither issued nor guaranteed any external debt on non-concessional terms.

8. Significant progress has been made in implementing the structural reforms aimed at enhancing public financial management, repairing the damage to the financial sector caused by the prolonged social and political crisis, and creating the conditions for a return to financially viable and healthy banks and industries (see Table 2).

9. Significant progress has been made in public financial management reform:

- A strategy for clearing Togo's domestic arrears was adopted by the Council of Ministers in December 2008 (meeting a performance criterion) and a national commission to clear the country's domestic debt has been set up. The clearance of arrears will be carried out on the basis of the budget resources allocated for that purpose. The combined impact of implementing the strategy and the financial sector reform will strengthen the financial position of the enterprise sector and boost economic activity.

- With a view to limiting any distortions in economic incentives and broadening the tax base, we have included in the 2009 budget some important measures to reduce tax and customs exemptions in the Free Economic Zone, thus meeting a structural benchmark six months ahead of the program schedule. The General Tax Code is being updated to incorporate the amendments made in successive budget laws since 1998.

10. Continuing the process of bank restructuring is key to economic stability and to effective financial intermediation for raising growth potential:

- In November and December, the government initiated a financial restructuring process through the securitization of non-performing loans (NPLs) extended by banks to state-owned entities as well as those made by state-owned banks to the private sector. To that end, a Memorandum of Understanding was signed between the government of Togo and the banking pool (BTCI, UTB, BIA-TOGO, and ECOBANK-TOGO) for securitizing NPLs validated as at December 31, 2007 (thereby meeting a structural benchmark), with a 35 percent discount on government loans. The bonds amount to 7 percent of GDP and has enabled the three banks to meet the 8 percent minimum coverage requirement for the risk-to-equity ratio. The bonds will be eligible for refinancing by the Central Bank (BCEAO) and will be reimbursed over a period of seven years, after a one-year grace period.

- In addition, the government is exploring, in consultation with the World Bank, the possibility of creating a structure and mechanism to recover the banks' NPLs on behalf of the government.

11. We have made significant progress in reforming the state-owned enterprise sector to restore the conditions for sustainable operations:

- A strategic audit of the phosphate sector (structural benchmark) was launched with the World Bank support in January 2009, three months later than originally planned. This delay was due to the fact that only two firms responded to the initial call for expressions of interest, and a second call had to be issued. The final report could be available by the end of April 2009. The strategic audit will help determine the overall restructuring of the sector and facilitate the search for a strategic partner.

- In December 2008 the review of CEET's financial situation to establish the projected budget allocations was completed, and a performance-based contract between the government and CEET was signed (meeting a structural benchmark). The strategic and financial audit of CEET will begin in consultation with the World Bank.

- For the cotton sector, pursuant to the recommendations from the strategic audit, SOTOCO was liquidated, and a new cotton company was set up and will be rescaled to ensure its financial viability. In addition, the recommended establishment of a mechanism for indexing cottonseed producer prices to world prices has been endorsed by the cotton sector and will be operational during the 2009/10 crop season.

12. The measures taken by the government to alleviate economic hardship in 2008 remained consistent with program objectives. Despite rising prices for consumer goods, no controls were placed on their domestic levels or on international trade in such goods. However, in order to protect the most vulnerable segments of the society, the government sought to mitigate the price impact through targeted measures, including subsidies on seeds and fertilizers, swift payment of retirement pension arrears, and the sale of security stockpiles of foodstuffs in the most affected areas. The government intends to refrain from any interference with the prices of staple consumer goods. Lacking a social security system, the government intends to mitigate international price fluctuations by stressing programs to promote the domestic production and supply of consumer goods, especially staple foods. The government also took fiscal steps to raise household purchasing power by issuing lump-sum grants to civil servants for the last five months of 2008. That temporary step has been replaced in the 2009 budget by a cut in the personal income tax (IRPP). In addition, the Guaranteed Minimum Wage (SMIG, SMAG) was raised as of August 1, 2008. We have also reduced the corporate tax rate by seven percentage points, and the maximum rate is 33 percent as of January 2009.

13. Retail fuel prices did not keep pace with rising world oil prices. A price adjustment mechanism was in place between the government and the oil companies in order to keep prices at the pump stable. By comparing the import price with the benchmark price range (changes exceeding plus or minus 5 percent), surpluses or shortfalls are calculated vis-à-vis the oil companies' operating margin, which is set at 35 CFA francs per liter. Generally

speaking, at a time of rising world oil prices, the oil companies suffer a shortfall, while in the case of falling prices they realize a surplus. The mechanism of surpluses or shortfalls allows pump prices to be kept unchanged, but requires compensation between the government and the oil companies. Faced with rising inflation, and in order to avoid social unrest, the government had kept retail fuel prices at their November 2006 level. As a result, the accumulated shortfall to the oil distributors due to this mechanism has increased considerably. The government commissioned an audit of the sector, which calculated that the net shortfalls incurred by fuel importers totaled 1.5 percent of GDP. Despite the recent turnaround in global oil prices, the government has decided to keep the retail price above world levels. The resulting surpluses will be used to clear the deficit to the oil companies within 20 months, in consultation with the companies. The government intends to review the mechanism for setting the pump prices for oil products in order to avoid creating a contingent liability for the government.

**Macroeconomic outlook**

14. Togo's growth in 2009 will be sluggish owing to the global economic slowdown. Economic growth is projected at 1.7 percent. The crisis is expected to lead to a reduction in migrants' remittances, a decline in the demand for transit and warehousing services, and a drop in phosphate, cement, and clinker exports. We are seeing the early signs of the crisis through the fall in the value of our exports (cotton, phosphate, and clinker). We are closely monitoring trends in development assistance and private transfers for possible declines. This unfavorable development will be offset by an improvement in the terms of trade, renewed confidence following the government's reform measures, and a substantial boost in public capital spending. In addition, the recent easing of externally induced inflationary pressures, especially on fuel and food prices, should help bring the inflation rate below the 3 percent threshold set in the WAEMU pact on convergence, stability, growth, and solidarity. A significant improvement in the terms of trade will contribute to reducing the current account deficit to about 6.1 percent of GDP, despite the sharp rise in capital spending.

**Implementation of the PRGF-supported program in 2009**

15. In spite of these risks and difficulties, the government is determined to continue and even accelerate its planned reforms under the PRGF-supported program in order to lay the foundation for strong and sustained growth. We would also like to register our concern about the vulnerability of our economy to external shocks and describe the actions we intend to take to alleviate their adverse economic impact.

16. The fiscal policy objective for 2009 is to preserve our achievements in macroeconomic stabilization, improve the absorptive capacity of the economy, and support economic recovery. In that context, government revenues are projected to be comparable to last year at 16.9 percent of GDP, as a result of continued fiscal reforms, mainly the broadening of the tax base (including in the Free Economic Zone) and administrative

capacity building. However, the global crisis remains a downside risk to revenue projections. In view of this, the government will continue to monitor growth and revenue trends closely.

17. Expenditures are projected at 22.2 percent of GDP, i.e., up by 2.5 percentage points from 2008. Despite the additional cost of loan securitization, recurrent expenditure will be contained. The level and share of social expenditures will increase substantially and the food production support program will continue. Investment spending financed both domestically and externally will be boosted by one percentage point of GDP each. Part of this increase will come from a supplementary budget (*collectif budgétaire*) that we plan to enact in the second quarter to increase spending authority by the amount of the remaining emergency spending from 2008, which will be used exclusively for funding priority infrastructure projects. As a result, the primary fiscal balance should remain at a level equivalent to −0.6 percent of GDP. We also plan an increase from 0.5 to 1.0 percent of GDP in the amount of arrears to be settled in cash. In addition, we have approached our development partners to explore the possibility of additional budget support to increase this amount. The deficit will be financed by budget support expected from our partners, including the European Union (EU), the World Bank, the African Development Bank, France, China, and other bilateral partners. In order to accelerate the implementation of emergency repairs to infrastructure and of the clearance of domestic arrears, we plan to issue in the first half of the year a six-month T-bill for about 1.3 percent of GDP.

18. The reforms envisioned in our program for the rest of 2009 aim to safeguard macroeconomic stability, strengthen public finances and—increasingly—build the foundation for stronger growth, and we are determined to implement and in some cases strengthen them (Table 3).

19. Key fiscal reforms will be focused on the following points:

- Before the end of June 2009, the government will make operational the new Treasury structure consistent with WAEMU directives (structural performance criterion). In July 2008, a start was made to reorganizing the Directorate General of Treasury and Public Accounting, with the adoption of legislation creating three main central offices and regional offices of the Treasury, and appointments to the relevant positions were made in December. This new structure will strengthen the Treasury's capacity to effect better controls and provide more reliable information on revenues, expenditures, and government cash management as well as avoid the accumulation of payment arrears. The Treasury will complete the validation of entry items in the Treasury balance sheet, and will start producing monthly treasury balances with a lag of one month, as of April.

- The government will start implementing the strategy to clear domestic arrears by the amount provided in the budget and the supplementary budget, and securitize the arrears to suppliers validated by the KPMG audit by December 2009 (structural benchmark).

- In order to preserve public debt sustainability, the government will ensure that its financing needs are met through grants or highly concessional loans and are committed to maintaining sustainable levels of debt. In this regard, a National Public Debt Committee has been set up to develop, coordinate, and monitor the national policy for the assumption and management of public debt (contributing thereby to achieving a structural benchmark).

- A plan of action has been launched to strengthen the capacity for quick and effective project implementation in the short run, with a view to enhancing aid absorptive capacity for implementation of the Emergency Program especially to repair flood damage. We will ensure that these measures will be accompanied by reforms to strengthen the cash management so as to ensure that resources are available.

- In addition, public expenditure control will be enhanced by further reform of government procurement, for which a new law will be passed in June 2009. This reform is essential for guaranteeing the efficiency of public investment outlays.

- Steps have been taken to complete the remaining structural reforms for June 2009, including the enactment of the new law on the Court of Auditors, the appointment of judges to this body, the preparation of the 2007 management accounts and the *Loi de règlement* (budget reconciliation law) for 2007. These actions will also move Togo toward the HIPC completion point.

20. Further bank restructuring will enable Togo's economy to improve quickly the financial intermediation needed to support economic activity:

- The initial call for proposals for strategic investors in the four major state-owned banks will be completed before the end of the year, as planned (structural benchmark). With support from the World Bank, the government intends to engage the services of one or more investment banks for that purpose. In cooperation with the supervisory authorities, the government will maintain close oversight of banks' management through to the end of the process.

- By December, the government will set up a structure and mechanism for managing NPLs that have been exchanged against government bonds (revised structural benchmark). Given the complexity of this operation, which benefits from technical assistance from the World Bank, the timetable has been extended by four months. The mechanism will allow the government to recover some of the cost of recapitalizing the banks and reduce the large stock of cross-debts, which will help revitalize credit channels.

21. Maintaining sound public finances and reviving growth will require reforms to state-owned enterprises so as to restore their financial health, guard against future losses, and promote gains in production and productivity:

- The government intends to assist the new cotton company to obtain the credit necessary to complete its operations in its first year, but that assistance will remain consistent with the current fiscal framework.

- The government will prepare a development strategy for the phosphate sector based on the strategic audit, no later than September 2009 (structural benchmark), as planned. The final report could be available by the end of April 2009. The strategic audit will help shape the overall restructuring of the sector and facilitate the search for a strategic partner.

22. In order to address external shocks and ensure economic recovery, we will need the continued support of the development partners who agreed in Brussels in September 2008 to mobilize resources in the context of the resumption of international cooperation and in accordance with the principles of the Paris Declaration and the Accra Agenda for Action. Beyond the resources required for the clearance of arrears and debt servicing, Togo needs immediate new resources (in the form of grants or concessional loans) to finance the investments that are essential to improve economic infrastructure, deliver social services, reduce poverty, and more generally, to achieve the MDGs. We welcome our partners' decision to increase the level of aid and to ensure maximum flexibility in their procedures. For its part, Togo is determined to meet its floating completion point triggers under the HIPC initiative as early as possible in 2010.

23. Work on preparing the full Poverty Reduction Strategy Paper is far advanced. At the heart of the process is the government's will and commitment to a participatory approach involving all segments of society. This participatory approach has allowed all the stakeholders from the public and private sectors to take ownership of the PRSP process. Thematic studies have been conducted with input from civil society organizations through consultations that led to the production of a preliminary draft of the F-PRSP. Regional consultations on this draft have been held and the document will be sent to the National Assembly for consideration before submission for national validation and adoption by the Council of Ministers, no later than April 30, 2009.

24. Progress under our PRGF-supported program will be monitored against the revised end-June PC and end-December 2009 quantitative PCs understandings on which have been reached with the mission. We would like for the fourth review under the arrangement to be completed by the end of April, 2010.

25. To support our policies and in view of the remarkable progress achieved in implementing the PRGF-supported program, we are requesting the completion of the second

review. We also request disbursement of the third loan, including the augmentation approved by the IMF Board during the first PRGF review.

26. The government is convinced that the measures and policies set out in this Letter of Intent are sufficient to achieve the program's objectives. It stands ready to take any additional steps needed to achieve them. The government will consult with the IMF, at its own initiative or at that of the Managing Director, in advance of any additional measure or revisions to the policies set out in this Letter of Intent.

27. The government authorizes the IMF to publish its staff report and the Letter of Intent related to the discussions on the second review of the program.

Sincerely yours,

/s/

Adji Otèth Ayassor
Minister of Economy and Finance

Table 1. Togo: Quantitative Performance Criterion and Indicative Targets
June 30, 2008 - December 31, 2009

| | 2008 | | | | 2009 | |
|---|---|---|---|---|---|---|
| | June | | Dec. | | June | Dec. |
| | Prog. [1] | Act. | Prog. [2] | Act. | Prog. | |
| | (Billion CFA francs, cumulative from end of preceding year) | | | | | |
| Performance criteria (for end-June, end-December 2008, and end-June 2009; indicative targets otherwise) | | | | | | |
| Domestic primary fiscal balance (floor) | -4.5 | 28.3 | -7.6 | 5.6 | -10.7 | -7.8 |
| Nonaccumulation of external arrears [3] | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net domestic financing (ceiling) | -3.1 | -31.5 | -7.5 | -12.6 | 10.0 | 4.0 |
| Central government contracting or guaranteeing of nonconcessional external debt (ceiling) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Indicative Targets | | | | | | |
| Total revenue (floor) | 103.6 | 109.6 | 209.8 | 220.7 | 108.0 | 225.7 |
| Domestic payments arrears, changes in stock (ceiling) | 0.0 | -3.1 | -3.1 | 0.0 | 0.0 | 0.0 |
| Domestically financed social and capital spending (floor) | 48.9 | 34.7 | 99.7 | 82.8 | 50.3 | 120.7 |
| Projected program financing | … | 16.4 | 32.3 | 32.3 | 24.1 | 37.4 |

[1] Letter of Intent dated March 28, 2008.
[2] Letter of Intent dated September 12, 2008.
[3] Continuous performance criterion.

**Table 2. Structural Conditionality for 2008**

| Measures | Date | Macroeconomic rationale | Status |
|---|---|---|---|
| **Fiscal governance**<br>Implement a new framework for monthly monitoring of budget execution and report data for April-June 2008 based on a new template. | Benchmark August 2008 | To provide policymakers with a tool for making timely and informed spending decisions as they seek to achieve the budget objectives and mitigate the risk of fiscal slippages | Done: July 2008. |
| Create a General Inspectorate of Finance under the responsibility of the Minister of Finance. | Performance criterion August 2008 | To strengthen fiscal governance by introducing oversight, control, and transparency for all units handling public resources | Done. Decree adopted on July 23. The Inspector General was appointed on August 29. |
| Adopt a new strategy and time table for clearing domestic arrears. | Performance criterion December 2008 | To restore supplier confidence, facilitate the return to regular spending procedures, and allow a gradual reduction in the government's large stock of domestic arrears | Done. Strategy approved on December 9 2008. |
| **Financial sector** | | | |
| Change management and oversight of BTCI based on terms of reference prepared in consultation with the WAEMU Banking Commission. | Prior action for PRGF approval | To prevent further erosion of BTCI's capital and liquidity, to restore confidence in Togo's largest bank, and in the financial sector more broadly. | Done: February 2008. |
| Adopt an action plan for introducing regular Treasury bill auctions in 2009. | Benchmark December 2008 | To develop the domestic securities market, promote financial sector development, improve Treasury management, and avoid new budgetary arrears. | Done. The Treasury has agreed with the BCEAO on a framework for issuing T-bills on a regular basis in 2009, following one initial issue this year. |
| **Public enterprises** | | | |
| Initiate an audit of the phosphate sector, based on competitive selection of an audit company, in consultation with the World Bank. | Benchmark October 2008 | To prepare the restructuring of Togo's traditionally largest export sector (currently operating at only one-third of capacity), including by providing options for attracting a strategic investor. | Done late. After a delay due to the fact that only two firms responded to the initial call for expressions of interest, a second call was issued. The audit firm was selected and the work is underway. |
| Prepare a review of the finances of the national electricity company (CEET) in consultation with the World Bank | Benchmark December 2008 | To provide the information necessary for preparing energy sector reforms and deciding on 2009 budget allocations, as rising oil prices and regionwide electricity shortages have dampened economic growth and led to increasing demands for budget support to the energy sector | Done. The preliminary report was submitted to the authorities and the World Bank in December 2008. The final report was concluded on February 12, 2009 and submitted to the World Bank. |

**Table 3. Structural Conditionality for 2009**

| Measures | Date | Macroeconomic rationale | Status |
|---|---|---|---|
| **Fiscal governance** | | | |
| Reduce tax and customs exemptions and strengthen tax and customs control, including enterprises licensed in the Free Economic Zone. | Benchmark June 2009 | To limit leakage of tax-exempt goods into the domestic economy, which distorts economic incentives and reduces fiscal revenues | Done. Tax exemptions have been reduced in the 2009 budget law. Customs and tax authorities have the power to conduct inspections in the Free Economic Zone. |
| Make operational a new Treasury structure based on WAEMU directives. | Performance criterion June 2009 | To create a functioning Treasury that has adequate control and information on revenues, spending, and cash management to ensure timely payments, avoid arrears, and provide for real-time consistent budget execution data | On track. The Treasury reorganization began in 2008, based on World Bank and IMF advice. |
| Start implementing the domestic arrears clearance strategy by securitizing validated arrears to suppliers and setting up a mechanism for monitoring domestic debt (see paragraph 19). | Benchmark December 2009 | To move toward a sustainable debt position and prevent new arrears as Togo regularizes its large stock of domestic arrears, starts servicing long-term regional bonds, and initiates short-term Treasury bill auctions | On track. The overall strategy adopted in November 2008, based on IMF advice, and the National Debt Management Council were instituted in January 2009. |
| **Financial sector** | | | |
| Initiate restructuring of BTCI, including by raising its capital through issuance of government securities. | Benchmark March 2009 | To support the financial rehabilitation of Togo's largest bank, prepare it for privatization, and set the conditions for sound financial sector development | Done. Remarkable progress has been made in preparing the exchange of BTCI's NPLs against government securities as part of a broader multi-bank scheme |
| Set up a structure and mechanism for managing the NPLs that have been exchanged against government securities in the bank restructuring process. | Benchmark December 2009 (revised from August) | To recover part of the budgetary cost of securitizing NPLs and reduce the large stock of state-owned enterprise arrears and cross-debts | On track. Given the complexity of the operation, for which the IMF and World Bank are providing technical assistance, the timetable has been extended by four months. |
| Initiate the process of identifying strategic investors for state-owned banks. | Benchmark December 2009 | To reduce risks to macroeconomic stability caused by Togo's large loss-making state-owned banks and support expansion of financial intermediation | On track. The World Bank is supporting government efforts in this area. |
| **Public enterprises** | | | |
| Phosphate sector: Prepare a development strategy based on the results of the strategic audit. | Benchmark September 2009 | To promote transparency in the restructuring of the phosphate sector, which could generate additional exports of up to 10 percent of GDP at current world prices | On track. The World Bank is supporting government efforts in this area. The strategic audit is underway. |