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Enabling poor rural people  
to overcome poverty

## **IFAD's participation in the Heavily Indebted Poor Countries Debt Initiative**

### **Proposal for the Republic of Togo and progress report**

Executive Board — Ninety-sixth Session  
Rome, 29-30 April 2009

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For: **Approval**

## **Note to Executive Board Directors**

This document is submitted for approval by the Executive Board.

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## **Recommendation for approval**

The Executive Board is invited to approve a new country case for debt relief under the Heavily Indebted Poor Countries Debt Initiative (Republic of Togo) and implementation of a settlement plan for the balance of arrears incurred by the Republic of Togo, in accordance with the recommendation contained in paragraph 23.



# **IFAD's participation in the Heavily Indebted Poor Countries Debt Initiative: Proposal for the Republic of Togo and progress report**

## **I. Introduction**

1. The objective of this paper is to:
  - Seek the Executive Board's approval of a new country case, the Republic of Togo, for debt relief under the Heavily Indebted Poor Countries (HIPC) Debt Initiative; and implementation of a settlement plan for the balance of arrears incurred by the Republic of Togo; and
  - Inform the Executive Board of the status of implementation of the HIPC Debt Initiative and of IFAD's participation in the Initiative.

## **II. New country case: Republic of Togo**

2. In November 2008, the executive boards of the International Monetary Fund (IMF) and the International Development Association agreed to support a comprehensive debt-reduction package for the Republic of Togo under the enhanced HIPC Initiative.
3. Togo has recently emerged from more than a decade of political instability and economic decline, during which time most foreign support was interrupted. This crisis took a toll on Togo's economy, infrastructure and institutions. The country's growth performance has been among the weakest in sub-Saharan Africa, with per capita income falling by an average of 1 per cent a year since the early 1980s. Traditional export sectors suffered from adverse terms of trade and mismanagement of state-owned enterprises. Governance problems and banking sector difficulties inhibited private investment. A heavy external debt burden and weak fiscal management led to the rapid accumulation of arrears.
4. Togo's long political crisis had a significant impact on social indicators, many of which lag behind those of neighbouring countries. Expenditures on health, education and public investment are far below regional averages, largely reflecting low external assistance, weak expenditure management and lack of prioritization. A survey on core welfare indicators carried out in 2006 indicated that about 62 per cent of the population was poor. The poverty level was twice as high in rural areas (about 74 per cent) than in urban areas (about 37 per cent).
5. The 2007 parliamentary elections marked a milestone in Togo's political reform and paved the way for donor re-engagement. In September 2008, a new prime minister was appointed and the cabinet was reshuffled. During a round-table meeting in Brussels on 18 and 19 September 2008, which IFAD attended,<sup>1</sup> donors pledged to step up their assistance significantly to help Togo implement its forthcoming poverty reduction strategy programme (PRSP) and address urgent spending priorities.
6. Togo has also been among the economies most adversely affected by increases in global food and fuel prices, reflecting the high fuel imports of its transport, industry and power sectors. While the country is nearly self-sufficient in food production, high food prices have created social tensions and severely eroded the real incomes of urban dwellers. The situation was worsened by heavy flooding in the summer of

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<sup>1</sup> IFAD also joined the IMF/World Bank/African Development Bank fact-finding mission to Togo in December 2007 to review the pre-conditions for the international community to resume cooperation with the country, including the settlement of arrears.

2008, which destroyed roads and bridges along Togo's main traffic artery from the Port of Lomé to the landlocked countries in the north. This paralysed Togo's vital trade and transport sector and disrupted exports of goods and services.

7. To revive the economy and reduce poverty, the Togolese authorities are seeking to consolidate macroeconomic stability and advance priority structural reforms, while securing stepped-up technical and financial assistance from development partners. The main medium-term policy objectives include:
  - Bringing public debt to a sustainable level through gradual fiscal adjustment, regularization of domestic arrears and comprehensive external debt relief;
  - Re-engaging with development partners to support a significant increase in financial and technical assistance for priority projects and to support reforms;
  - Increasing resources for health, education, agriculture and infrastructure by reallocating domestic spending and using the expected increase in external assistance effectively;
  - Strengthening fiscal governance to raise revenues and make spending more efficient and transparent;
  - Restructuring state-owned banks to strengthen their financial position, reduce risks to macroeconomic stability and enable the private financial sector to develop; and
  - Initiating growth-oriented structural reforms to improve the business environment and reform public enterprises, especially in the cotton and phosphate sectors.
  
8. The authorities plan to complete the full PRSP in the first half of 2009. The PRSP is to be prepared with broad stakeholder participation and clear prioritization of reforms. Given Togo's capacity and financing constraints, a critical challenge will be to identify specific development partners to support priority reforms. The September 2008 conference of Togo's development partners was an important step in that direction. Possible medium-term expenditure priorities for agriculture and food security include:
  - Increasing income-generating activities at the community level, including those that increase food production and/or facilitate the supply of food products to markets and the population; and
  - Expanding availability of quality services to producers – advice, agricultural education and training, and research and development for improving the supply of agricultural inputs.
  
9. At end-2007, Togo's public and publicly guaranteed external debt (including arrears) before traditional debt relief was estimated at US\$2.2 billion in nominal terms. The corresponding net present value (NPV) (US\$1.8 billion) equals about 72 per cent of GDP, 191 per cent of exports, and 396 per cent of fiscal revenues. Togo qualifies for debt relief under the HIPC Initiative's fiscal window based on end-2007 data; the common reduction factor is estimated at 19 per cent. After full application of traditional debt relief mechanisms, Togo's NPV of debt is estimated at US\$1,411 million at end-2007, equivalent to 309 per cent of fiscal revenues. The amount of debt relief needed to bring this ratio down to the 250 per cent HIPC threshold is estimated at US\$270 million in end-2007 NPV terms. Based on proportional burden-sharing, multilateral assistance, including from IFAD, would amount to US\$150 million (in NPV terms), and bilateral and commercial assistance to US\$120 million (also in NPV terms).

10. The Executive Board is requested to approve the Fund's contribution to debt relief for Togo in the amount of 2.3 million special drawing rights (or about US\$3.5 million) in 2008 NPV terms.<sup>2</sup> The debt service relief would be provided in one single payment once Togo had passed the HIPC completion point.
11. Largely as a result of political and economic instability over the previous decade, Togo accumulated payment arrears to nearly all of its creditors. Since then, however, it has cleared or signed arrears rescheduling agreements with several creditors, and has initiated negotiations with other multilateral creditors. This has included detailed discussions with IFAD resulting in a formal agreement establishing an arrears settlement plan, signed by the Ministry of Economy and Finance in December 2008. This established that the Government would make a payment of EUR 542,395 to initiate clearance of arrears and, following a grace period, clear remaining arrears in six equal instalments. In addition, the Government has resumed the repayment of principal and service charges on existing loans. It should be noted that, under IFAD's Debt Sustainability Framework, Togo is currently assessed as having low debt sustainability and would therefore receive future IFAD financing under grant terms.
12. Taking into account the Government's initial payment, and following confirmation by the World Bank's Banking and Debt Management Department and the HIPC Trust Fund, the NPV of the balance of arrears has been included as part of the agreed debt relief at decision point. However, since the debt reduction factor for reducing Togo's debt to manageable levels has been established by the World Bank/IMF at only 19 per cent, the amount of debt relief to be provided by IFAD at completion point will not be sufficient to finance the clearance of all the arrears to IFAD. Following the grace period therefore, the balance of arrears will be cleared by six equal instalments. Given the Government's proactive response to this arrears settlement plan and the resumption of loan repayments, IFAD intends to actively seek supplementary financing support from bilateral donors to assist the Government in clearing the balance of arrears.
13. Upon reaching the HIPC completion point, Togo will also qualify for additional debt relief under the Multilateral Debt Relief Initiative (MDRI). Three creditors would provide debt relief under the MDRI: the International Development Association, the African Development Bank and the IMF. These creditors would provide 100 per cent debt relief on all debt disbursed. After delivery of HIPC and MDRI assistance, Togo's NPV of debt-to-exports ratio is expected to fall significantly to 65 per cent the year following completion point.
14. Togo will reach its completion point under the enhanced HIPC Initiative when the following sector-specific triggers have been reached (in addition to the standard triggers): public financial management; governance (particularly in the phosphate sector); debt management; and basic health and education reform. Togo is expected to reach its completion point by the end of 2010.

### **III. Progress in implementing the HIPC Initiative**

15. Since the inception of the HIPC Initiative 12 years ago, there has been substantial progress with respect to the implementation of HIPC debt relief. More than three quarters of eligible countries (33 out of 41) have passed their decision point, qualifying for HIPC assistance. A total of 23 countries have now reached the completion point and 10 are in the interim period between the decision and completion points (see table below). The pace at which countries in the interim

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<sup>2</sup> As of 31 December 2008, Togo's outstanding principal debt to IFAD stood at SDR 4.3 million. This amount includes the principal element SDR 3.1 million of arrears at that date (service charge arrears amount at that date to SDR 1.2 million).

period have reached their completion points has accelerated over the past two years as countries have made progress in implementing their macroeconomic programmes and poverty reduction strategies. Since September 2005, Cameroon, the Gambia, Malawi, Rwanda, Sao Tome and Principe, and Sierra Leone have all reached their completion points, with the IFAD Executive Board approving top-ups for Malawi and Rwanda. In 2008, the Executive Board approved IFAD's contributions to debt relief for the Central African Republic in the amount of SDR 10.4 million (US\$15.7 million) in 2006 NPV terms and for Liberia in the amount of SDR 13.8 million (US\$21.0 million) in 2007 NPV terms. It is anticipated that Burundi, Haiti and Guinea could reach their completion points in mid-to-late 2009.

16. Maintaining debt sustainability beyond the completion point remains a concern, particularly during the current financial crisis. Debt sustainability analyses confirm that post-completion point countries are in a better debt situation than are other HIPCs and even non-HIPCs. But their debt sustainability outlook remains vulnerable to shocks and is highly sensitive to the terms of new financing. Only about 40 per cent of post-completion point HIPCs currently have a low risk of debt distress according to the most recent debt sustainability analyses; and those with a high risk rating are increasing. This highlights the need for post-completion point HIPCs to implement sound borrowing policies and strengthen their capacity to manage public debt. IFAD is supporting this through its participation in the Debt Sustainability Framework, reporting of all debt information, and liaison with the World Bank and regional development banks.

#### **A. Total cost of the HIPC Debt Initiative to IFAD**

17. The total NPV cost of the Fund's participation in the overall HIPC Debt Initiative<sup>3</sup> is currently estimated at SDR 317.7 million (equivalent to about US\$487.6 million), which corresponds to an approximate nominal cost of SDR 466.2 million (about US\$715.8 million).<sup>4</sup> The current cost estimates are likely to increase as a result of countries' delays in reaching decision and completion points, worsening economic conditions leading to the need for completion point top-ups, and continuing low discount rates. Total debt relief payments are estimated at US\$36.5 million for 2009.

#### **B. IFAD commitments to date**

18. To date, IFAD has committed the required debt relief to all 32 HIPCs that have reached their decision point. IFAD's total commitments so far amount to SDR 238.5 million (approximately US\$366.1 million) in NPV terms, which amounts to SDR 349.5 million (approximately US\$536.7 million) of debt service relief in nominal terms.

#### **C. Debt relief provided**

19. As of 31 December 2008, IFAD has provided SDR 140.4 million in debt relief (approximately US\$215.5 million) to the 23 completion point countries.

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<sup>3</sup> This includes all countries eligible under the Initiative, including pre-decision point countries.

<sup>4</sup> 31 December 2008 base estimates at exchange rates prevailing at 31 December 2008.



**IFAD Member States participating in the HIPC Debt Initiative, by stage**

<i>Completion point countries (23)</i>	<i>Decision point countries (10)</i>	<i>Pre-decision point countries (7)</i>
Benin	Burundi	Comoros
Bolivia	Central African Republic	Côte d'Ivoire
Burkina Faso	Chad	Eritrea
Cameroon	Congo	Kyrgyzstan
Ethiopia	Democratic Republic of the Congo	Nepal
Gambia (The)	Guinea	Somalia
Ghana	Guinea-Bissau	Sudan
Guyana	Haiti	
Honduras	Togo*	
Madagascar	Liberia	
Malawi		
Mali		
Mauritania		
Mozambique		
Nicaragua		
Niger		
Rwanda		
Sao Tome and Principe		
Senegal		
Sierra Leone		
Uganda		
United Republic of Tanzania		
Zambia		

\* Subject to approval by the Executive Board at its April 2009 session.

## **D. Financing of IFAD's debt relief**

20. IFAD is funding its participation in the HIPC Debt Initiative through its own resources and through external contributions that it receives directly or through the World Bank-administered HIPC Trust Fund. IFAD's own-resource contributions amount to about US\$94.7 million (33.2 per cent) under Executive Board-approved transfers in 1998, 1999, 2002 and 2007. External contributions (paid or pledged) amount to about US\$85.9 million<sup>5</sup> (30.2 per cent). Funds transferred from the World Bank-administered Trust Fund total US\$104.1 million to date (36.6 per cent). The balance has been covered by investment income from the IFAD HIPC Trust Fund balance.
21. To mitigate the impact of debt relief on IFAD's resources available for commitment to new loans and grants, IFAD's Member States have supported the Fund's formal access to the World Bank-administered HIPC Trust Fund. This was agreed at the HIPC information and funding meeting held on 19 November 2006 in Washington, D.C. It was recognized that this would add to the overall financing requirements of the Trust Fund. IFAD received the first transfer from the Trust Fund (US\$104.1 million) in October 2007, following the receipt and signature of the grant agreement. Separate grant agreements for supporting debt relief for The Gambia, Sao Tome and Principe, and Sierra Leone, totalling about US\$18.1 million, are being finalized by the HIPC Trust Fund administrators. The total financing gap

<sup>5</sup> This amount also includes the cumulative interest earned on HIPC Trust Fund liquidity of US\$7.8 million.

(in terms of needed commitment authority) for the HIPC Trust Fund, taking into account IFAD's and the African Development Bank's funding needs, is estimated to be US\$308 million.

22. While giving priority to ensuring that the IFAD HIPC Trust Fund is adequately financed, Management will also continue to encourage IFAD's Member States to provide the Fund with additional resources directly to help finance its participation in the HIPC Initiative.

#### **IV. Recommendations**

23. It is recommended that the Executive Board:
  - (i) Approve the proposed contribution to the reduction of the Republic of Togo's debt to IFAD as of 31 December 2008 (see paragraph 10), in the amount of SDR 2.3 million in end-2008 NPV terms. This relief will be provided in accordance with the terms of the following resolution:

“RESOLVED: that the Fund, upon the decision of the Executive Board, shall reduce the value of the Republic of Togo's debt to IFAD through the integration of its arrears to IFAD into the debt relief up to the aggregate NPV amount of SDR 2.3 million”;
  - (ii) Approve the consolidation of remaining arrears with the rescheduling of repayments over a three-year period, with an initial grace period of two years starting from 1 January 2009;
  - (iii) Approve the payment of the arrears on a semi-annual basis, with the first payment falling due on 1 June 2011. These payments will also include the interest accrued during the consolidation period, and will amount to six equal semi-annual instalments of EUR 538,111 on the following dates: 1 June 2011; 1 December 2011; 1 June 2012; 1 December 2012; 1 June 2013; and 1 December 2013; and
  - (iv) Take note of the status of implementation of the HIPC Debt Initiative and IFAD's participation therein and the request for support for the clearance of the balance of the Republic of Togo's arrears to IFAD.

