

**PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

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Operation Name	Togo: Second Economic Recovery and Governance Grant (ERGG-2)
Region	AFRICA
Sector	General industry and trade sector (45%);Central government administration (25%);Banking (10%);District heating and energy efficiency services (10%);Agricultural extension and research (10%)
Project ID	P113456
Borrower(s)	GOVERNMENT OF TOGO
Implementing Agency	Ministry of Economy and Finance coordinates the implementation in close association with several line ministries
Date PID Prepared	January 23, 2009
Estimated Date of Appraisal Authorization	February 16, 2009
Estimated Date of Board Approval	March 31, 2009

1. Key development issues and rationale for Bank involvement

Togo has emerged from a decade-plus-long socio-political crisis marked by heightened tensions, instability, and withdrawal of donor support that took a toll on Togo's economy, infrastructure and institutions. 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. Togo's progress toward political stability and improved economic performance during 2005-2008 paved the way for clearance of arrears and reengagement with the international community in 2008. Having reached its HIPC decision point in November 2008, Togo is now on a path toward reducing its debt burden and freeing up fiscal space over time.

Despite the progress achieved, Togo continues to face daunting institutional and economic challenges, including: (i) poor governance and low administrative capacity; (ii) excessive external public debt and domestic arrears; (iii) undercapitalized state-owned banks with a high share of nonperforming loans; (iv) a severe energy crisis resulting in frequent power outages; (v) weakly performing state-owned cotton and phosphate enterprises; (vi) a poor business environment; and (vii) deteriorated social conditions stemming from inadequate management of public resources. Real GDP grew 4 percent in 2006; however it slowed to 2 percent in 2007 and an estimated 0.8 percent in 2008 due to several exogenous shocks to which Togo is periodically vulnerable. 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 proposed grant is an integral part of the Bank's Interim Strategy Note (ISN) for Togo for the period FY08-10 that is closely aligned with the Government's I-PRSP adopted in March 2008. The grant directly supports the first of three ISN pillars and provides financing for budgeted fiscal needs during 2009 aimed at pursuing the objectives of the I-PRSP. The proposed reforms are essential to the Government's ability to use public resources efficiency and effectively to support the country's economic and social recovery. These actions will be followed by a more comprehensive program of reforms that the Government is preparing in its full PRSP, to be finalized in the first half of 2009.

2. Proposed objective(s)

Given the complex socio-political environment and past governance and transparency issues facing the Government, the key objective of the ERGG-2 is to support government-owned reforms to improve public finance management and restore performance of key public enterprises and banks. It would also contribute to creating the conditions for increased private sector confidence, investment and growth recovery through improved governance and transparency in the identified sectors. In supporting key governance reforms, the grant would facilitate Togo's progress toward debt relief under the HIPC Initiative and MDRI upon reaching the completion point. These reforms would lead over time to strengthened fiscal sustainability, improved economic governance and enhanced transparency of State institutions and processes. The resources made available by this grant will assist the Government in implementing activities that would otherwise be beyond its fiscal capabilities, including financing the provision of basic public services.

3. Preliminary description

The Grant is a one-tranche development policy operation which would assist Togo in supporting the government's economic recovery program. In addition to measures to restore fiscal and debt sustainability, the reform program focuses on (i) improving public finance management, and (ii) strengthening governance and transparency in the management of key public enterprises and banks. Under the first policy area, the government intends to advance reforms to improve budget formulation, execution and controls, and public procurement. The second policy area includes reform measures aimed at facilitating recovery in, and good performance of, the phosphate, cotton, energy and financial sectors.

4. Environment Aspects

These reforms that deal mainly with economic governance and institutional issues are not likely to have significant negative impacts on the country's environment and natural resources.

The reforms supported by the proposed development policy grant represent a first round of a broader program of actions to promote the recovery of key sectors, notably cotton, phosphates and energy, in addition to strengthening public financial management and reforming the financial sector. These reforms, dealing mainly with economic governance and institutional issues, are not likely to have significant negative impacts on the country's environment and natural resources.

5. Poverty and Social Impacts

The proposed ERGG II is expected to have a significant positive direct impact on poverty reduction. There are likely positive distributional effects from the improved public financial management and key reforms in the cotton, phosphates, energy and financial sectors. Specifically, efforts to improve the capacity of the State to implement its budget priorities and strengthen public financial management would enhance efficiency, transparency and accountability in public resource use, and increase the country's absorption capacity for external resources. Strengthening governance and transparency in the cotton sector is expected to facilitate a rebound in cotton production in the short term, thereby improving the livelihood of a large sector of the population (about 300,000) which relies on this cash crop as a dominant source of earnings. Liquidating the poorly functioning SOTOCO and creating a new company with significant farmer participation (40 percent equity representation) and strengthening its financial and operational management systems would help restore confidence in the sector and help production recover from the current low levels.

Improving governance in the energy sector should contribute to the easing of electricity constraints to economic growth. The resultant increase in economic activity would increase government revenues, which could be used to increase expenditures for basic social services. Reforming the financial sector would help strengthen the financial situation of institutions affected by the crisis and improve the soundness of the banking sector, which in turn would contribute to macroeconomic stability and help re-launch economic activities which have been severely affected by the crisis. The grant would also help fund the provision of basic public services during 2009 with a high beneficial impact on the poor, in complement to implementation of the Togo Community Development Project (approved FY08) and the additional financing (approved FY09) under the Global Food Crisis Response Program.

6. Risks

The proposed operation presents significant country and fiduciary risks. The four principal risks are: (i) **political risk** stemming mainly from possible political tensions that could slow the current reform momentum; (ii) **macroeconomic risk** stemming from the vulnerability of the Togolese economy to exogenous shocks (such as the recent increases in international food and oil prices, or the severe domestic floods) or a possibly prolonged global downturn caused by the financial crisis. Other possible shocks include euro appreciation, a worsening regional energy crisis, bad weather affecting agriculture, loss of confidence that could cause capital outflows, and delays in rebuilding the transport infrastructure destroyed by the recent flooding which could also hinder the economic recovery; (iii) **fiduciary risk** arising from failure to avoid corruption or failure of the government to make effective and efficient use of the fiscal space made available by arrears clearance, budget support and debt relief; and (iv) **implementation capacity risk** arising from an insufficient number of professional staff in government and weak institutional capacity and coordination.

It is expected that frequent broad-based consultations with stakeholders to strengthen the case for reforms and the Government's commitment to them would help mitigate the political risk. Also, the proposed prior actions focus on areas in which the Government has demonstrated ownership. To reduce vested interests' resistance to reform in critical sectors and to enhance governance, steps are being taken to set the stage for more transparent and accountable practices in the phosphates, energy, cotton and financial sectors. Close coordination with the IMF, AfDB and bilateral donors and intensified sector dialogue will help ensure that top priority is given by the Government to the reform of these sectors. The PRSP preparation process also provides an opportunity to foster national consensus across the Togolese society and among Government representatives on a medium-term reform agenda. The macroeconomic risk is mitigated by ongoing close economic monitoring and coordination by the Bank, the IMF and other donors, and the Government is committed to achieve rapidly the HIPC completion point. The fiduciary risk is mitigated through the focus of the operation on measures to improve public financial management and capacity building provided by the Bank and other donors. The implementation capacity risk is mitigated through the provision of extensive technical assistance by the Bank and other donors in the areas covered by the proposed operation, including through the recent PEMFAR, an ongoing LICUS Trust Fund grant, the planned Financial Sector and Governance Project and other activities.

7. Tentative financing

Source:	(US\$m.)
International Development Association (IDA) Grant	20
Total	20

8. Contact point

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