



TOGO

SELECTED ISSUES

July 2019

This Selected Issues paper on Togo was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on June 10, 2019.

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Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.



TOGO

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June 10, 2019

Approved By
Dominique Desruelle
(AFR)

Prepared by a team led by Ivohasina Razafimahefa (AFR) and comprising Irina Bunda, Lars Engstrom (both AFR), Sampawende Jules Tapsoba (Resident Representative), Léleng Kebalo, Ibrahim Sowou (IMF Office in Togo).

CONTENTS

STATE-OWNED BANKS, PRIVATIZATION AND MACRO-FINANCIAL PERFORMANCE IN SUB-SAHARAN AFRICA _____ 3

A. Theoretical Background: Rationale for, and Pitfalls of, State-Owned Financial Institutions (SOFIs) _____	3
B. Cross-Country Evidence: SOFIs vs. Private Banks' Performance _____	6
C. State-Owned Bank Privatization in SSA _____	10
D. Policies for Successful Bank Privatization _____	15
References _____	21

BOXES

1. Costs and Relative Performance of SOFIs _____	7
2. Togo's Experience with Bank Privatization _____	13

ANNEX

I. SOFIs' Privatizations in SSA _____	20
---------------------------------------	----

EFFICIENCY OF SOCIAL SPENDING IN TOGO: AN OVERVIEW _____ 23

A. Introduction _____	23
B. Social spending in Togo: Measurements and Programs _____	24
C. Stylized Facts _____	24
D. A Frontier Analysis _____	266
E. Concluding Remarks _____	29

FIGURES

1. Overview of Health and Education Expenditures, 2001–16	277
2. DEA Efficiency Frontier	288
3. Efficiency Analysis of the Health and Education Sectors	30

ANNEX

I. Social and Education Indicators	31
------------------------------------	----

GOVERNANCE AND INSTITUTIONS 322

A. Overall Assessment	322
B. Fiscal Governance	333
C. Market Regulation	366
D. Rule of Law	38
E. Control of Corruption	400
F. Anti-Money Laundering (AML)	433
G. Summary	455
References	48

BOXES

1. Governance-Related Legislation	411
2. Control Organs and Anti-Corruption Agencies	433
3. Perception Indicators Quoted in the Report	444

FIGURE

1. Governance Indicators	46
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TABLE

1. PEFA Assessments	47
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STATE-OWNED BANKS, PRIVATIZATION, AND MACRO-FINANCIAL PERFORMANCE IN SUB-SAHARAN AFRICA¹

This paper investigates state-owned financial institutions (SOFIs)' performance in developing economies, the difficulty to ensure their long-term viability, and the conditions for their successful privatization. It focuses on Sub-Saharan Africa, zooming in on the Togolese experience with SOFIs and privatization, at a time when the Togolese government has decided to further disengage from the financial sector. Typically set up with a public interest and financial inclusion mandate, SOFIs tend to weaken financial stability and fiscal discipline in developing economies, especially if they are not typically regulated and supervised on the same basis as other banks. Togo's and cross-country experiences suggest that performance improves more after privatization when the government fully relinquishes control, when banks are privatized to strategic investors rather than through share issues, and when bidding is open to all, including foreign banks. The success of privatization also hinges on the business environment for competition, governance, and entry, on banks' valuation and how policy concerns are dealt with, as well as on owner's prudential review quality.

A. Theoretical Background: Rationale for, and Pitfalls of, State-Owned Financial Institutions (SOFIs)

1. State-owned financial institutions have typically been set up with a public interest and financial inclusion mandate. SOFIs have been established either as specialized development financial institutions or as commercial institutions, often due to a legacy of central planning or nationalization, and in which the state has total or majority direct ownership. Many public banks in Sub-Saharan Africa started life in the post-colonial period, with explicit mandates to serve the entire nation, for nation-building and sometimes socialist policy, or development reasons. They are therefore often the largest –or at least, relatively large– institutions with the only nationally-present branch network stretching to rural areas. The focus of the paper is on public commercial banks that take (demand) deposits and therefore can have systemic implications. They typically have a mandate for commercial viability, although sometimes less clear, which may conflict with their social and development objectives. In addition to direct bank ownership, political interference has also taken then form of loan guarantees, interest rate ceilings, or contract savings schemes to further encourage savings and investment.

2. According to the “development view” (Gerschenkron, 1962), in the absence of developed capital markets, publicly-owned banks spur the expansion of certain economic sectors or regions that the private sector cannot finance. In several SSA countries (e.g., Ghana, Tanzania, Madagascar), the nationalization of private financial institutions led to the emergence of rural development banks, industrial development banks, or national banks for commerce– with the

¹ Prepared by Irina Bunda. The author would like to thank Ivo Razafimahefa, Alvaro Piris, Luc Eyraud, as well as the participants at the CASEF presentation, Lomé, Togo, March 29, 2019, for their useful comments and suggestions.

purpose of extending loans to investors operating in these priority sectors. By channeling long-term investments into productive sectors, SOFIs promote growth and productivity gains, while extending banking services to underserved populations.

3. According to the “social view” (Atkinson and Stiglitz, 1980), SOFIs can overcome the market failures inherent to the banking sector by financing socially-desirable and welfare-enhancing investments. The existence of SOFIs is theoretically justified in the presence of financial market imperfections that make some socially-profitable investments and some parts of the population to be rationed. SOFIs should therefore finance investments in sectors with widespread market failures, namely, those associated with costly information asymmetries (e.g., agriculture), intangible assets, large external financing needs (e.g., aerospace industry), and significant spillovers (e.g., R&D).

4. State-owned banks can also be used countercyclically to smooth credit cycles (“macroeconomic view”)²– which, in fact, is interfering in arms-length, market-based lending decisions. Private banks tend to boost lending in boom times and cut back in a bust, potentially exacerbating an economic slowdown. A public bank which supports lending in a downturn may thus play a useful role in stabilizing the banking sector. Using public banks to spur lending when the economy shows signs of weakening could have some potentially beneficial short-term effects, namely, maintaining the flow of credit; yet it increases the risks to the public bank’s balance sheet. Interfering with prudent credit risk management will undermine asset quality and must be paid for in the end, with the additional risk of a financial–not just a fiscal– crisis.

5. Public sector banks have also been used in a non-transparent way as crisis resolution tools. Large public banks can help manage financial crises–another form of market failure–as a place for depositors to fly to safety, or as potential acquirers for failing banks. SOFIs can also be instrumental in absorbing bad loans from restructured banks, or in distributing subsidies to politically- sensitive sectors. However, their potential role in crisis management is certainly no substitute for rigorous regulation and supervision, as well as for deposit insurance.

6. The expectation that public banks should maintain loss-making services for policy reasons ends up eroding their viability. To the extent that publicly-owned, or newly-privatized banks are required to continue providing loss-making services in the public interest (such as loans to farmers or other sectors deemed policy priorities, a rural branch network, or to maintain staffing levels), this should be explicitly recognized in their business plan and budget funds provided. The reason for clearly delineating the subsidy elements is partly fiscal transparency, but also that using public banks to subsidize favored groups or activities not only leads to repeat recapitalizations and higher debt but generates also an additional externality through raising financial stability risks. The stabilization costs– potentially large in case of banks’ recapitalization/failure –crowd out other desirable public policies, increasing the scope of resource misallocation and inefficiency– going against their development objective.

² See Yeyati, Micco, and Panizza (2004), Hallerberg and Markgraf (2018).

7. Government’s conflict of interests in owning and supervising SOFIs weakens banks’ governance system and eventually impedes on their ability to carry out their mandate.

According to the “agency view” (Banerjee, 1997), the agency costs within government bureaucracy more than offset the social gains expected from state-ownership. The resulting weak managerial incentives, resource misallocation, and inefficiencies are exacerbated at a low level of development. The directly-appointed boards of directors – typically lacking independence and professional skills –are not adequately empowered to assume their strategic guidance and corporate performance role, while the government typically has extensive powers to override regulatory decision (regulatory capture).

8. Another strand of literature argues that market failures can be better addressed by regulation and subsidies than by the direct ownership of banks. According to the “political view” (Shleifer and Vishny, 1994, La Porta et al., 2002) the source of inefficiencies lies in the use of publicly-owned banks as a financial tool for politically-motivated projects. Public officials do not face incentives to ensure well-functioning public banks– rather, they are rewarded politically–leading to poorly supervised lending and risk management practices and to pervasive insider lending.

9. In the presence of weak supervision (with limited powers over commercial SOFIs), the policy choices –by the bank or the government– pose macro, financial stability, and fiscal risks.

- By lending to areas where they lack strong underwriting skills or by taking on excessively large exposures, SOFIs tend to underprice risks, accumulate NPLs, and build up losses. SOFIs’ growing clout –often the result of preferential treatment (for instance, if the regulations have special provisions for SOFIs)– hinders competition, prevents new private entry, and ultimately retards market development. Even non-systemic institutions can undermine creditor discipline and sound practice among other banks, through example of bad behavior having no consequences.
- SOFI’s financial distress can dent confidence and spill over to the rest of the financial system and onto the corporate/real sectors. Weak banks with poor portfolio quality are more likely to curtail lending, thus hurting growth and leading to higher NPLs. If the banks are systemic, the failed privatization or liquidation impose a heavy fiscal burden on the government, in the absence of an operational and well capitalized deposit insurance system. This creates incentives to delay addressing the difficulties.
- Losses tend to be carried over to other public entities, with no burden sharing for banks’ creditors. Government’s ownership of banks with weak governance softens the financing constraints of public sector entities themselves, thus hampering fiscal discipline.

10. To guard against the above-mentioned risks, the principle of viability should govern publicly-owned banks, against the background of strong institutional infrastructure and regulation and supervision of all financial institutions. The institutional infrastructure matters for the sound financial sector development for all banks, either public or private, namely, macroeconomic stability, legal infrastructure (particularly with respect to contract law and measures

for pledging collateral and enforcing security agreements), accounting standards and an appropriate safety net (lender-of-last-resort facilities, and, possibly, deposit insurance). To make government ownership sustainable, commercial viability should govern public banks. To prevent a vicious cycle of repeated recapitalizations or forbearance to deal with recurring losses of inefficient SOFIs, several principles can be observed: (i) a mandate to operate on a commercial basis; (ii) fiscal transparency; (iii) a governance structure to insulate the SOFIs from overt political influence;³ and (iv) implementation of the same supervisory regime that is applicable to private banks. Several codes of conduct on e.g., limits on activities, internal control, audit or reporting could be put in place to further alleviate the conflict of interest in both owning and supervising public banks.

11. In practice, it has been hard to ensure long-term viability of public banks in developing countries in Sub-Saharan Africa for the many reasons noted, thus making privatization a reasonable strategy for the government to restore their viability, save budgetary resources, and increase economic efficiency.

B. Cross-Country Evidence: SOFIs vs. Private Banks' Performance

12. In developing countries, public banks post significantly lower performance than their private counterparts. In a large panel of banks in 100 emerging economies, Mian (2005) found that state-owned banks perform uniformly poorly, and only survive due to strong public support. Micco, Panizza, and Yañez (2006) showed that in developing countries, SOFIs tended to have lower profitability and higher costs than their private counterparts, with the difference in performance mostly driven by political economy considerations, namely the electoral cycle.

13. SOFIs' corporate governance systems are also weaker than their private counterparts, with board structure often unable to provide a check on political control. In an analysis of the corporate governance of public banks in Spain, Italy, and Germany, before and after the global financial crisis, Hallerberg and Markgraf (2018) pointed out that the unitary board structure of Spanish *Cajas* did not provide a check on political control, with the conflict of interests making effective supervision difficult. In contrast to the Spanish savings banks, German public banks had a two-tier board structure, in which the supervisory board and management were (and are) clearly separated from each other without any personal ties between board and management. Moreover, public sector banks with a clear mandate and with regulatory constraints that clearly delineate their activities from those of commercial banks did better in the crisis.

14. At a macro level, empirical evidence suggests that fiscal discipline is weaker in countries with significant government participation in the banking system. In a dataset of 123 countries, Gonzalez-Garcia and Grigoli (2013) found that state-owned banks may help to soften the financing constraints of public sector entities and consequently become a factor that hampers fiscal

³ The governance structure of the bank is important in ensuring that the SOFI's commercial mandate can be fulfilled, with a balance of independence and accountability. A board comprised of independent directors serving for fixed terms can serve as important buffer between government and the SOFI and provide similar stewardship to that provided by directors of privately-owned banks.

discipline. The crowding-out effects are significant: a one p.p. additional share of government-owned banking assets is associated with a decrease in the share of credit to the private sector of about 0.5 p.p., an increase in public debt of 0.2–0.3 percent of GDP, and an increase in overall public deficit of about 0.15 percent of GDP.

15. Several examples from Sub-Saharan Africa suggest that the timely restructuring and resolution of state-owned banks are often delayed. In the D.R. Congo, three SOFIs have faced liquidity difficulties for the last ten years, which limited their economic programs and contribution to growth. Efforts to divest Ghana’s first development bank –set up in 1963 to promote rapid industrialization in all sectors of the economy– failed, despite management, institutional, and financial restructuring. In Kenya, the National Bank of Kenya–the main SOFI set up in 1989– has become severely undercapitalized and cash-strapped, recently prompting divestiture actions (together with two other SOFIs). Also, in Zimbabwe, the government has sought to merge or partially privatise the SOFIs struggling with high debt and poor levels of corporate governance. Finally, in 2018, the Bank of Tanzania closed five critically undercapitalized community banks and approved the merger of two small state banks, as part of a plan to improve financial stability and reduce the number of state-run lenders.

16. Togo’s SOFIs have encountered similar financial difficulties and restructuring delays. In the 1980s-90s when public banks used to dominate the banking sector (accounting for 55 percent of total banking assets), a volatile economic environment often led to widespread bank insolvencies. The Togolese banking sector has since expanded considerably with the entry of several pan-African banking groups headquartered in Togo. Nevertheless, SOFI’s systematic recapitalizations in absence of operational restructuring, and the failure to divest some of them as planned, have perpetuated their difficulties, posing financial stability and fiscal risks (Box 1).

Box 1. Costs and Relative Performance of SOFIs

In the 2000s, following another domestic crisis, the Togolese banking system became almost completely insolvent, with elevated levels of NPLs to state-owned enterprises (SOEs). During the mid-2000s’ financial crisis, some private banks– *Banque Internationale pour l’Afrique* (BIA), for instance– were bailed out by the government and became public. The public banks had since been recapitalized several times to no avail, as for instance, in 2004, with funds equivalent to 4.4 percent of GDP. Additional resources were injected in late 2008 to bring prudential ratios back to acceptable norms for the three state-owned banks–*Banque Togolaise pour le Commerce et l’Industrie* (BTCl), *Union Togolaise des Banques* (UTB), and BIA– and to remove NPLs to SOEs from the balance sheet of a large private bank (Ecobank Togo). Only the latter underwent restructuring. The securitization of NPLs required that the government issue bonds eligible for refinancing at the BCEAO equivalent to 6.2 percent of GDP. The NPLs were to be recovered by the newly-established *Société de Recouvrement du Togo* (SRT), which is a temporary state-owned entity with weak powers to effectively collect the loans.

Box 1. Costs and Relative Performance of SOFIs (continued)

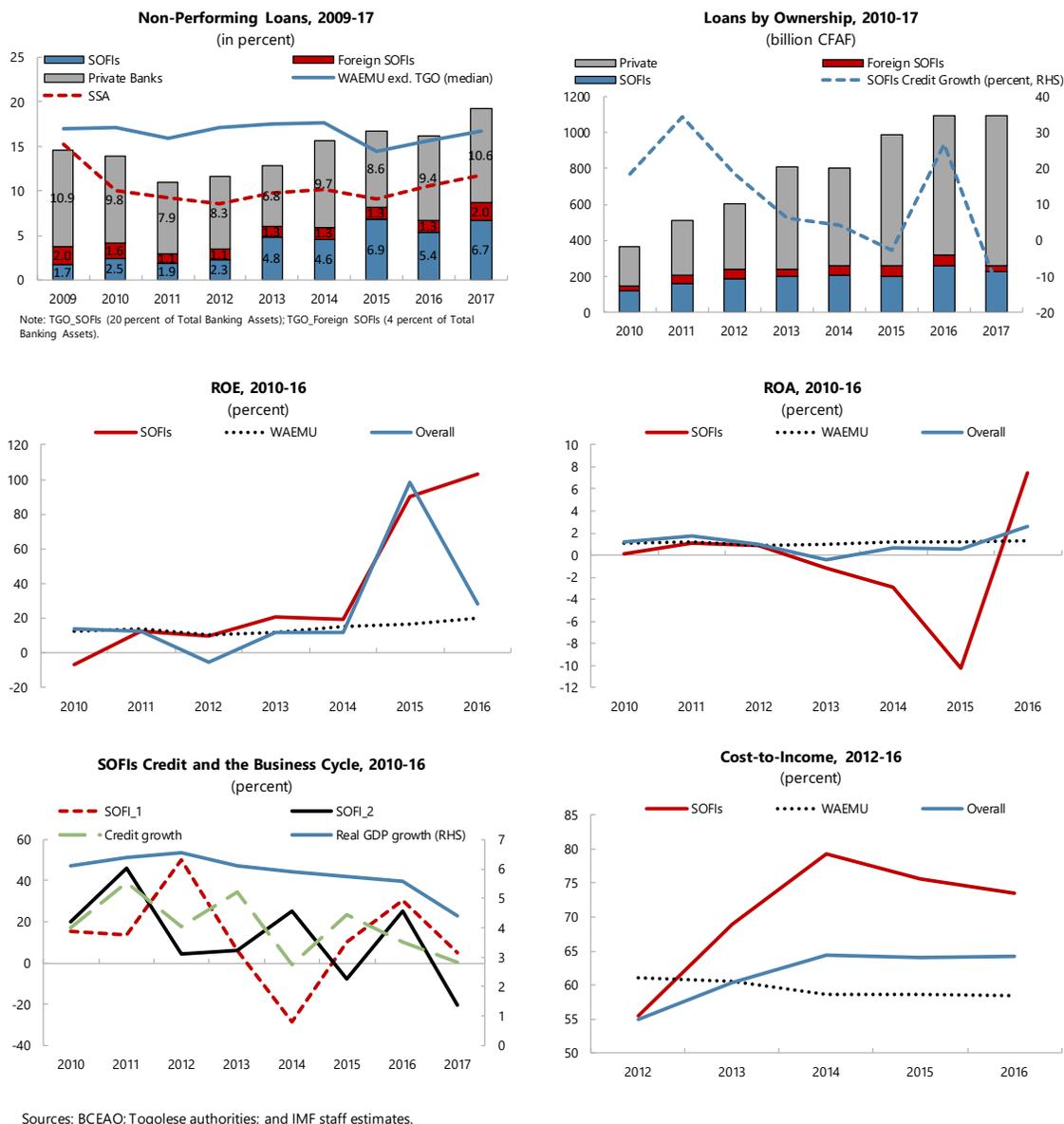
A few years later, the authorities sought to offset the marked budgetary impact of recapitalization and improve governance by divesting the three problem SOFIs and a fourth one (*Banque Togolaise de Développement, BTD*) which did not need financial restructuring in 2008. Financial intermediation deepened thru several measures to promote entry and regional integration. However, the financial restructuring of the public banks was not accompanied by rigorous asset quality reviews while their operational restructuring and privatization were consistently delayed. Three SOFIs had to again raise funds at end-2010 to meet newly established minimum capital requirements. The publicly-owned social security fund (*Caisse Nationale de Sécurité Sociale, CNSS*)—shareholder in two large SOFIs and with financial and governance problems on its own—injected CFAF 4.3 billion in the public banks.

Two public banks (UTB, BTCl) could not be privatized and their financial situation has steadily deteriorated. The process of privatizing UTB by public tender in 2012 was initiated but failed on procedural grounds during the selection phase of the offers and was not renewed soon afterwards. Following its recapitalization in 2008, net income has been somewhat volatile but was on average negative. BTCl's difficulties have been more severe and long-lasting. The early 2013 privatization attempts were undermined by poor governance and disclosure of the actual losses, and inadequate risk management capacity. BTCl did not meet most prudential requirements, including capital adequacy, liquidity, and borrower concentration, and was placed under several back-to-back provisional administration regimes until September 2017, with no palpable improvement. Following its last recapitalization in 2008, net income has mostly been negative (Box 1 Figure).

The two public banks have expanded credit, opened branches, hired additional staff and fulfilled a public mandate, despite their longstanding difficulties. Their loan portfolio expanded at 14-15 percent per year during 2014-16 despite BTCl's many provisional administrations and the Banking Commission's close surveillance of UTB. Concentration risk, NPLs, and cost-to-income ratios at the two banks have systematically been above the banking sector average. Complications have arisen from a longstanding coordination problem between the national authorities and the WAMU Banking Commission with regards to the situation of the two problem state-owned banks. The weak resolution powers (on the side of the regulator) and regulatory forbearance/conflict of interests (on the authorities' side) have perpetuated banks' difficulties.

The 2015 external shock and the end of prefinancing one year later found the two state-owned banks in a weak position: thin capital, high loan concentration and leverage, exposure to the main export-oriented sectors trade and manufacturing. Togo's widening fiscal deficits up to 2017 had partly been financed by the banking sector. The two banks were heavily involved in government's prefinancing schemes—an unorthodox way of financing public investments, which had led to a steep increase in public debt and was discontinued in late 2016. After a period of excessive risk-taking, the two banks saw a rise in dud loans and declining profitability.

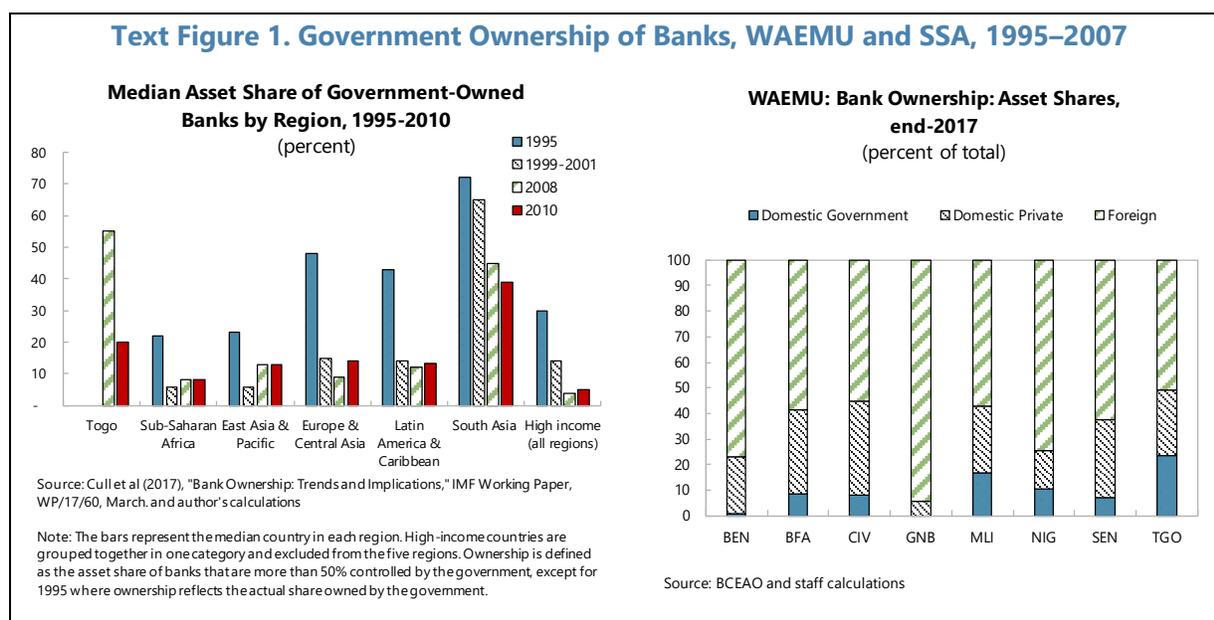
Box 1. Costs and Relative Performance of SOFIs (concluded)



Over 2013–16, several strategies to resolve the two banks were considered. In 2016, given the balance of risks and following expert advice, the merger of the two banks (with the bigger and better one, absorbing the weaker one) and thorough operational restructuring was retained. Although the authorities later changed strategy to privatizing the two banks separately, moving ahead with the merger and restructuring plans in 2017 allowed putting an end to BTCI’s provisional administration and has led to a change in direction, on sounder bases, at the two banks. The requirements for an upgraded governance system at the absorbing bank (UTB), in line with best principles, has led to an internal reorganization and a more prudent strategy for the bank.

C. State-Owned Bank Privatization in SSA

17. State participation in the SSA financial system declined following the financial sector liberalization in the 1990s-early 2000s. By 2010, the region had the lowest median foreign bank share of assets (73 percent) and lowest median government bank share (8 percent) in the developing world (Text Figure 1). These trends hide cross country heterogeneity, for instance, at end-2017, Togo has the highest government ownership of banks in the WAEMU (20.5 percent of total banking assets). The state accounts for more than 50 percent in Ethiopia and between 30 to 50 percent in Burundi, and Sierra Leone. In 2018, several SSA countries (Togo, Kenya, Zimbabwe, D.R. Congo) announced the privatization of some of the remaining public banks in financial difficulty.



18. In Sub-Saharan Africa, the privatization programs, including in the financial sector, occurred in successive waves, with some countries privatizing much earlier than others (Bennell, 1997, Estrin and Pelletier, 2018). Several WAEMU countries (Benin, Guinea, Niger, Senegal, and Togo) were the first to initiate privatization programs in the late 1970s to early 1980s—although with limited progress. A heterogeneous mix of countries followed (Ghana, Nigeria, Ivory Coast, Mali, Kenya, Malawi, Mozambique, Madagascar, and Uganda) in the late 1980s, also with limited progress, until the late 1990s, except for Nigeria. Finally, the third group of SSA countries started in the first half of the 1990s, with Tanzania, Burkina Faso and Zambia showing strong political commitment to privatization.

19. In the late 1990s, a growing number of Sub-Saharan Africa governments started to undertake significant economic reforms, which facilitated banks' privatization. The institutional infrastructure, namely, macroeconomic stability, legal infrastructure (particularly with respect to contract law and measures for pledging collateral and enforcing security agreements), accounting standards and appropriate safety net are key constraints for sound financial sector development for all banks, public and private. Political liberalization and the need for fiscal adjustment in the wake of

the 1990s fiscal crisis facilitated the implementation of privatization programs. Large privatization programs took place in Uganda, Kenya, Nigeria, and Malawi. For instance, Nigeria undertook a major privatization program in the early 1990s, divesting a total of 14 banks, which accounted for more than 50 percent of total banking sector assets.

20. The empirical literature on the impact of banks' privatization highlights that post-privatization performance tends to increase conditional on several clearly identifiable governance factors:

- **Ownership share retained by the government:** Otchere (2005) found that in the case of partially-privatized banks, continued government ownership might have hindered managers' ability to restructure the banks. The first round of privatization in the Czech Republic and Poland also showed that privatization produced few or no performance benefits in cases where the government retained majority control or even a sizable minority ownership stake in the bank (Clarke, Cull, and Shirley, 2005). These results also hold in a concentrated and under-developed banking system like Uganda. Clarke, Cull, and Fuchs (2009) showed that UCB's second privatization, in which government fully relinquished control, was a vast improvement over the first attempt, in which the government maintained a controlling share and did not attract a high-quality purchaser.
- **Type of transaction** (strategic investors or share offerings): In weak institutional environments share offerings produce lower performance gains than direct sales to strategic investors (Clarke et al, 2005). Cross-country analysis in Otchere (2005) also pointed out to few or no performance gains in banks sold through share offerings.
- **The extent to which foreign ownership was permitted:** Boubakri et al. (2005) used various measures of performance before/after privatization on a panel of 81 bank privatizations occurring during 1986-1998, in 22 low-and middle-income countries, to assess various categories of controlling owners. Whether profitability increased post-privatization depended on the type of owner (banks owned by local industrial groups and foreign owners exhibited higher economic efficiency); while environmental factors also played a role. Clark et al (2005) and Megginson (2005) showed that foreign ownership had been associated with superior business performance post-privatization, especially relative to "insider" ownership. Foreign bank entry can make domestic markets more efficient by forcing local banks to operate more efficiently, providing long-run benefits for banking customers in the form of lower intermediation and service charges

21. There have been cases in SSA when privatization has been beneficial in terms of restoring the credit flow and for the quality of credit extended to the economy. Clarke et al. (2009) studied the privatization of Uganda Commercial Bank to Stanbic (South Africa) during 1996-2005. The authors assessed the evolution of UCB, Stanbic, and the post-merger bank in terms of profitability, portfolio quality, operating efficiency, and credit growth, and highlighted improvements in profitability and rate of credit growth compared to pre-privatization for UCB. Moreover, Cull and Spreng (2011) examined the privatization of Tanzania's National Bank of Commerce (NBC) in a

sample of 42 banks operating in Tanzania during 1998- 2006 and showed that its sale to a foreign strategic investor (Rabobank) resulted in improved profitability and reductions in non-performing loans, along with an increase in the ratio of loans to total assets.

22. Privatization tends to boost competition in the banking sector. Otchere (2005) examined share-issue privatizations in middle and low-income countries and find that privatization announcements led to abnormally negative returns for rival banks—a sign of enhanced competition—with the effects being more pronounced for the remaining tranche sales.

23. In some cases, privatization can improve bank performance, despite an inhospitable macroeconomic and regulatory environment, and despite selling the weakest banks, provided the state fully withdraws from banks' capital. Beck, Cull, and Jerome (2005) examined Nigerian banks' privatization in the 1990s— a volatile macroeconomic and financial environment —on an unbalanced sample of banks three years before and eight years after privatization. They showed that performance improved following privatization (although it took place in the aftermath of economic recession and political instability), but the negative effects of the continuing minority government ownership on the performance of many Nigerian banks have persisted.

24. A strong, independent regulatory agency is not only essential to safe financial development for all banks but can also ensure that privatized banks play an efficient role in financial development. Because of broader institutional weaknesses, developing countries face many challenges in establishing a strong regulation. Azam, Biais and Dia (2004) examined the case of the WAEMU countries during 1990-97 by running panel regressions on profits, bad loans and ownership. In the late 1980s, there was a severe crisis in the West African banking system, partly due to government interference. The restructuring of the banking system entailed privatization and foreign share ownership, as well as the creation, in 1990, of the WAMU Banking Commission, the independent regional regulatory body—whose establishment was credited for the reduction in bad loans in the 1990s.

Box 2. Togo's Experience with Bank Privatization

Togo's share of SOFIs has declined since mid-2000s, following privatization initiatives, but remains higher than the Sub-Saharan Africa average. Bank privatization efforts were initiated in 2004, with the sale of a smaller public bank, SNI, to Financial Bank (which became Orabank in 2011). The privatization of the four remaining SOFIs was stepped up under the first 2008-11 ECF-supported program. The objective was to restore confidence in the Togolese financial sector, reduce the risk of new macro instability linked to the large loss-making banks (46 percent of total banking sector assets), and promote financial sector development and expansion of financial intermediation.

The 2008 banking system was characterized by low financial intermediation, with the loan-to-deposit ratio below WAEMU, SSA, and LICs averages. NPLs ratios in 2008 stood at 20 percent for SOFIs and at 7 percent for private banks. Following a public tender for the four banks, at end-2012, Orabank, a large regional group, bought 56 percent of BTD capital and in September 2013, the State further sold 55 percent of its shares in BIA to Attijarwafa banking group. At end-2017, SOFIs accounted for 20.5 percent of the total banking system assets, still higher than the SSA median.

While the Togolese authorities had committed to substantial progress in banks' privatization by December 2009, the call for expression of interests was only issued in July 2011. The delays were linked to difficulties in updating the legal framework for privatization and in obtaining certain financial and balance sheet information for some of the banks, and political hesitation to assume ownership of the bank privatization process. Potential buyers demonstrated strong interest in the SOFIs, but expeditious actions by the Togolese authorities were necessary to avoid undermining the credibility of the process by further delays. The delays undermined the validity of financial data underlying the final call for bids. Thus, the privatization advisors were advised to rapidly update the financial data collected in 2010 to ensure that the intermediate steps leading to the final call for bids were not further delayed.

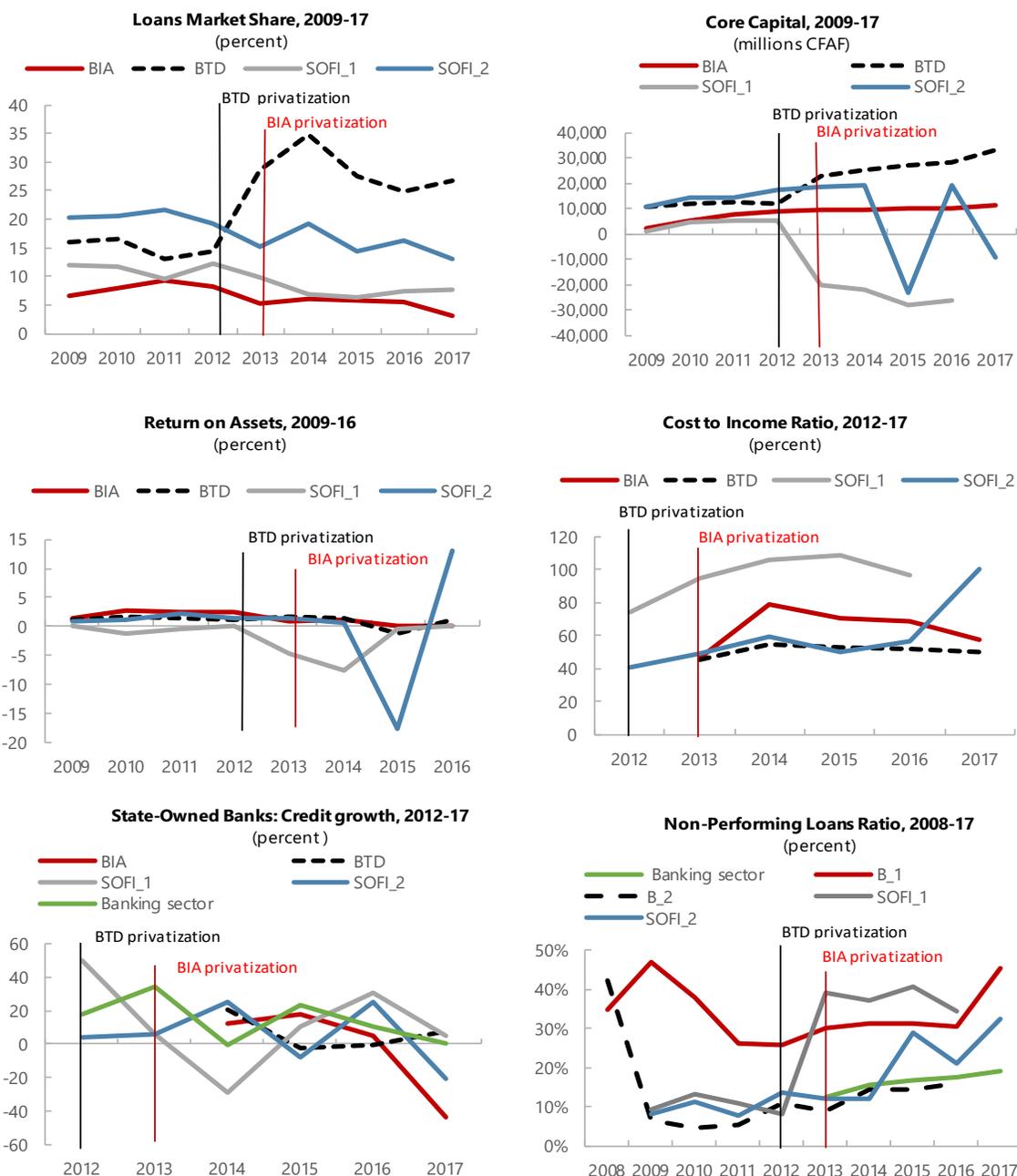
The process was further complicated by rising political tensions due to social pressures and disputes over electoral reforms. In early 2013, the privatization of BTCL was aborted and the financing from privatization and budget support fell well short of plans. The overall deficit more than doubled, to 7 percent of GDP.

Togo's experience with bank privatization was positive for the bigger bank (BTD) and broadly neutral for the smaller one (BIA). The privatization of BTCL and subsequent merger with Orabank yielded 0.6 percent of GDP. The new bank became the biggest Togolese bank, with 29 percent of loans and 23.5 percent of deposits in 2013. Lending has expanded at a fast pace, and earnings and profitability indicators have continued to improve. Its market share had stabilized at around 27 percent of total loans at end-2017. The privatization of BIA to a foreign government-owned bank yielded 0.7 percent of GDP. Lending expanded immediately following privatization in 2014-15, but the upward trend stalled subsequently. BIA has experienced profitability difficulties and declining market share. The difficulties are possibly related to imperfect cost adjustments (as shown by the relatively high cost-income ratio, of 0.66 on the average, after privatization, compared with 0.54 for BTCL) as well as a legacy of high NPLs kept on its balance sheet from before privatization. The NPL ratio at Orabank has been lower or close to the banking sector average; whereas BIA has experienced a further deterioration of asset quality over time. Both banks have comfortable core capital cushions and satisfy the new Basel 2-3 regulations.

Box 2. Togo's Experience with Bank Privatization (concluded)

During the current privatization round, the authorities sought to avoid several flaws that thwarted the previous divestiture of the two banks. A more recent law on state divestiture and privatization (2014) was further modified in September 2018 to allow the National Assembly to define the general legal framework of the procedures for the conduct of privatization operations –thus simplifying and making the privatization operations for the two banks more transparent. Unlike in the past –when an ad-hoc Privatization Commission had total discretion in deciding on each step –the authorities have now ensured stronger political support of the privatization process.

Togo: Selected Indicators for Former and Existing SOFIs



Sources: BCEAO and IMF staff estimates.

D. Policies for Successful Bank Privatization

25. Several lessons can be learnt from Togo's first privatization round. During that round, about half of the public portfolio in the banking system could be privatized. For the other half, delays, inaction, conflict of interests, and weak controls prevented the finalization of the privatization transactions. These experiences point to the need for a strong political support of the privatization process. A multiplication of privatization agencies with vested interests should be avoided. Actions should be undertaken swiftly as political pressures are high and the financial situation of SOFIs quickly deteriorates. High-quality expert advice on the privatization process and a realistic/up-to-date evaluation of the banks' value are important elements for success. The authorities need to carefully monitor the liquidity situations of the public banks engaged in a lengthy privatization process and with significant execution risks. Contingency plans should be put in place to prepare for an unsuccessful privatization, because the situation of the SOFIs which fail privatization surely deteriorates. In such a case, prompt corrective measure should be implemented, with strong resolution powers for the regulator, otherwise temporary administration may drag on for a very long period. The government should not plan on and spend the expected privatization proceeds as they may not materialize. Any financial restructuring needs to be accompanied by operational restructuring to ensure long-term financial viability and minimize the cost for the State. An efficient non-performing loans collection mechanism should be set up to minimize liquidation costs.

26. Other SSA case studies and cross-country analysis provide further lessons for a successful privatization. In developing countries, past experiences show that privatization of SOFIs does not automatically lead to higher performance, there are several preconditions for success.

Prior to Privatization

27. The institutional infrastructure shapes the design and the outcomes of privatization. An adverse macroeconomic environment reduces the benefits of privatization. Fiscal discipline is important. For instance, in Nigeria, Beck et al. (2005) showed that, after the privatization of the 1990s, the underlying distorted incentive structure coming from adverse macroeconomic conditions and regulatory arbitrariness led to high returns on investment in government bonds and non-lending activities, which seem to have penalized the private/newly-privatized banks focusing on retail lending. Moreover, the system of multiple exchange rates created arbitrage opportunities for financial institutions that had privileged access to foreign exchange, fostering a banking sector focused on rent-seeking rather than financial intermediation- and these incentives continued to influence the behavior of privatized banks. In the case of transition economies, Bonin, Hasan, and Wachtel (2005) described how the unstable macroeconomic situation made privatization infeasible in Bulgaria and Romania until the late 1990s. By the time, the situation of the state-owned banks had deteriorated so much such that substantial recapitalization was necessary to make the banks attractive to investors.

28. The regulatory framework—a product of the institutional and political environment—is a key factor of a successful privatization. The country needs to create regulatory capacity to enable successful privatization experiences. Privatization improves performance even in poor

regulatory environments, although poor regulations reduces the gains from privatization. For instance, the Nigerian banks' share issue privatization in the 1990s brought about only limited performance improvement in a relatively weak institutional environment (Beck et al., 2005).

29. Institutional setup for the privatization process. Governments must streamline the privatization process by creating a strong, lean, centralized, and transparent process by setting up a small yet effective focal point to privatize while keeping the process public and fair (Shirley, 1992). For instance, in Lesotho, despite early difficulties, the authorities advanced quite firmly with the privatization program after some crucial institutional reforms. In 1995, the parliament approved a Privatization Act, critically bringing privatization under the responsibility of one privatization agency, thus replacing the previous setup whereby relevant ministries— and their vested interests—played major and often conflicting roles in privatization.

30. Business environment fostering competition, good governance, and entry. Lessons can be learnt from privatization experiences in nonbank sectors (e.g., telecoms, Megginson, 2005). Privatization has greater benefits on firm performance in stronger business environments because the success of the process relies on effective corporate governance of the privatized entity, as well as effective market competition (Estrin and Pelletier, 2018). The absence of barriers to entry ensures that the bank can benefit from the best offers—including from foreigners. Therefore, policymakers must tackle obstacles in this area, namely, barriers to new domestic firm entry, quality of the legal system concerning corporate governance, and openness to foreign direct investment. This can be a constraint for many SSA public banks with a dominant rural network and little competition in many areas of the country. It is often the case that these dominant rural networks are loss-making, despite being the sole financial services provider. The bank typically collects few savings and must provide basic banking services at low cost to the user, while incurring high cost in salaries and overheads. Therefore, the government should create the right environment by undertaking other reforms designed to encourage competition and growth.

31. Timely and prompt corrective actions and implementation of pre-privatization plans. Many bank privatizations have been long delayed or aborted. Key issues to be managed include the cost⁴, sequencing of other reforms (e.g., business environment), and achieving political consensus. Policymakers should avoid the vicious cycle of repeated recapitalizations or forbearance to deal with recurring losses of inefficient SOFIs by putting in place several measures (namely, on regulation and supervision, clearly delineated mandate, sound governance system) to make government ownership viable, sustainable, and pave the way for ultimate privatization. For instance, the Bank of Mauritius vets the credentials of the external auditors of both private sector banks and public-sector banks before giving its approval for their appointment. The offsite surveillance and the onsite examination were conducted in the same manner for private sector banks and public-sector banks. Governance reform, new professional management and strengthened prudential regulation have all been used

⁴ Privatization entails various costs and contingent liabilities for the government. For instance, the government may need to provide guarantees for NPLs before being able to sell the bank. Organizational restructuring may entail various costs, such as packages provided to laid-off staff.

to stabilize state-banks in Central Europe and Latin America as part of the process leading to privatization (Hawkins and Mihaljek, 2001).

Privatization Process

32. Preparing a bank for privatization. An “as is” sale is theoretically preferable, because it can be completed quickly; but this will almost certainly not be possible if the bank is insolvent. SOFIs are frequently in poor condition and financial restructuring is required if reputable private investors are to be attracted (Andrews, 2003). For instance, in Uganda, the portfolio of the privatized bank was cleaned prior to sale; the bank remained relatively strong and profitability and credit growth are now on par with other Ugandan banks, while access to credit has improved for some hard-to-serve groups (Clarke et al, 2007).

- **Design of financial restructuring.** Since investors may be unwilling to pay anything for an insolvent bank, government (the owner) must provide the bank with enough quantity of good quality assets to equal its liabilities to attract new equity investors. One frequently used restructuring model is the “good bank-bad bank” split with nonperforming loans left in the bad bank, and government providing the good bank with assets, usually bonds, to fill the balance sheet gap (e.g., Argentina, 1990s). A variation of this approach used in Ghana, Tanzania, and Uganda, is to transfer the dud assets to a specialized asset management company. When the volume of bad assets is smaller, or if the decision is made that the bank should work out the problem loans itself, government as shareholder may subscribe to new equity issues; or, if the bank is already on a reasonably sound financial footing, the government may issue subordinated debt to bolster the capital base prior to privatization (Andrews, 2003).
- **Timing of operational restructuring.** There may also be situations where new owners are reluctant to take on the burden of staff reductions and branch closures. Particularly where strong political pressure is anticipated, new owners may require certain closures or lay-offs to occur prior to privatization. However, Welch and Fremond (1998) recommended that the pre-privatization restructuring should be brief and defensive, and limited to balance sheet and organizational changes such as closures, workforce reductions, and transfers of social services. Technology changes, capital investment, and major purchases should be left to the new owners, not to government officials.
- **Risks associated with sequencing of operational/financial restructuring prior to privatization.** When dealing with insolvent SOFIs, a delayed financial restructuring (e.g., delayed recapitalization) will almost always lead to higher losses and make operational restructuring more complicated since reorganizing bank activities requires additional liquidity. Also, an insolvent bank can lack enough income from its earning assets to cover its costs, and without the new earning assets acquired through recapitalization, it may not be possible to return to profitability regardless of the amount of operational restructuring undertaken, which may eventually jeopardize the privatization. On the other hand, when a

bank has been recapitalized, failed operational restructuring and long privatization delays can lead to further recapitalization expenses when the bank is finally ready for divestiture. To take into account these complementarities and synergies, a solution is to advance progressively on both the operational and financing restructuring fronts, by providing recapitalization in stages, contingent on meeting operational restructuring objectives (e.g., Indonesia following the Asian financial crisis).

33. Quality of the new owners. Performance improves more when government fully relinquishes control, when banks are privatized to strategic investors rather than through share issues, and when bidding is open to all, including foreign banks, as showed by Clarke et al. (2005) and Megginson, (2005). Transparency, fairness, and a level playing field are essential. Foreign ownership has been associated with superior business performance post-privatization, as successful privatizations in Madagascar (BNI-Crédit Lyonnais and BFV in the 1990s) and Tanzania (CRBD in the 1990s, National Bank of Commerce and National Micro Finance Bank in the 2000s) showed. Foreign owners also face regulation in their own country, which may lead to greater prudence.

34. Prudential review of the new owner. The regulator should play a key role in the privatization process, and only approve the transaction if the potential buyers (new owners) are fit and proper, management is competent and experienced, the source of capital is verified, and the business plan is viable. Pressure to approve a transaction despite prudential concerns, lack of capacity to undertake a suitable review or proceeding with privatization without the regulator's involvement have all resulted in the need for subsequent intervention in failed privatizations in Croatia, the Czech Republic, Mozambique, and Uganda, among others (Andrews, 2003). In Mozambique, after Banco Austral was privatized in 1996, it started recording heavy financial losses, which led to the withdrawal of the successful bidder. It was then intervened, successfully restructured and re-privatized, and sold to the Amalgamated Banks of South Africa (ABSA) group in 2002. In 2005, Barclays acquired a 56 percent stake in ABSA, thus becoming the majority shareholder of Banco Austral. Barclays Bank Mozambique went on to have the second largest banking network in the country at end-2006.

35. Policy concerns and financial inclusion implications. The implications of the new bank strategy should be managed ex ante (Andrews, 2013). Policy concerns include the maintenance of services in all areas served by SOFIs prior to privatization (for instance, if the SOFI has financial inclusion functions by serving rural areas), continued servicing of specific sectors, and preserving employment. These concerns can go against efficiency, as new private owners typically look to close unprofitable locations, eliminate policy-driven lending to state-owned enterprises, and improve operating efficiency through staff retrenchments. The state-owned banks are typically systemically important elements of the payment system, as well as systemically large. This large branch network and staffing is often a source of high costs and loss-making, and yet, simply privatizing them and letting the new owners close the inefficient branch network could have high costs from an inclusion perspective. The privatization process will need to take these concerns into consideration ex ante, for instance by forcing the new bank to keep some branches in rural areas. These considerations may explain some of the conditions sometimes imposed on buyers during the privatization process.

At the same time, mobile banking may now offer a better route to financial inclusion—suggesting that such conditions should be balanced against the benefits from privatization (increased competition, financial market deepening).

36. Fair valuation. Expert advice plays an important role in the privatization process (Shirley, 1992). Often, the book value of a company bears no resemblance to the company's market value, especially if the company has a poor track record, redundant layers of employees, and a host of operating problems. Valuation is a difficult concept, and buyers will value a bank differently, depending on the synergies they perceive between their own bank (network) and a potential acquisition. The bank should be sold at fair market price, and the sale should not entail a net transfer of wealth from the public to the private sector. In practice, state assets have frequently been undervalued (Estrin et al., 2009). Examples are Czech Republic or Russia, where significant state assets were transferred to private hands at nominal or zero prices (Andrews, 2003).

37. Togo has several preconditions in place, for instance regarding the business environment, competition and entry, and the general environment conducive to privatization and economic efficiency. Bank privatization follows the privatization of the main Telecom company, while the privatization of other SOEs has been envisaged. The private sector is expected to play an increasing role as the engine of growth. However, if the direct sale of the first bank does not succeed, several options are available, each of them with costs and benefits: (1) equity sale (tender); (2) Purchase & Assumptions with a tender set up for the “good bank” while the “bad bank” is transferred to a legal entity for liquidation; (3) merger and restructuring of the two public banks; (4) deposit payoff and liquidation. Several measures can be put in place immediately to prevent further deterioration (e.g., prohibit accepting new deposit applications).

Annex I. SOFIs' Privatizations in SSA

Cameroon	Standard Chartered Bank (1994)
Cape Verde	Caixa Econômica Cabo Verde (1999); Banco Comercial do Atlântico (1999, trade sale)
Central African Republic	Union Bancaire en Afrique Centrale (1998)
Congo, Democratic Republic	Union Zairoise de Banques (1995)
Côte d'Ivoire	BIAO (2000, trade sale); SGBCI (1999, public offering)
Ghana	Merchant Bank (1995); Barclays Bank Ghana Ltd (1998, direct sale); Social Security Bank (1995, private sale); National Investment Bank (2000, partial divestiture)
Kenya	Kenya Commercial Bank Ltd (1988, IPO); National Bank of Kenya (1994, 1996, partial, PO)
Lesotho	Lesotho Bank (1999, IPO)
Madagascar	BNI-Crédit Lyonnais Madagascar (1991); National Bank of Commerce (1998, shares Sale on non-competitive basis); Bank for Rural Development (1999)
Mali	Banque Malienne de Crédits et de Dépôts (2000, partial divestiture)
Malawi	Malawi Savings Bank Limited (2015)
Mauritius	State Bank of Mauritius (1995, IPO, SEO)
Monzambique	Banco Commercial de Moçambique (1996, tender) ; Banco Populaire de Desenvolvimento (1997, private sale); Banco Austral (2002, tender)
Nigeria	Merchant Bank of Africa (1992, Private placement); Allied Bank (1993, PO); First Bank of Nigeria (1993, PO); Savannah Bank of Nigeria (1993, tender); FSB International Bank (1993, tender); Afribank Nigeria (1993, tender); Assurance Bank (2001); Union Bank of Nigeria (1993, 2007, tender); United bank for Africa (1993, tender)
Senegal	Banque Senegalo-Tunisienne (1999, 2007)
Tanzania	National Bank of Commerce (2000); CRBD (1996); National Micro Finance Bank (2005, divestiture)
Togo	Société Nationale d'Investissement (2004); BTB (2012, tender); BIA (2013, tender)
Uganda	Stanbic Bank (1997, direct sale), Uganda Commercial Bank (1997, 2001, direct sale, divestiture); Barclays Bank (1998, PO)
Zambia	Zambia National Commercial Bank (2007)
Zimbabwe	Commercial Bank of Zimbabwe (1998, IPO)
Sources: Andrews (2003), World Bank Privatization database (1988-2008), and banks' websites.	

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EFFICIENCY OF SOCIAL SPENDING IN TOGO: AN OVERVIEW¹

Togo has initiated a major fiscal consolidation since 2017. So far, the adjustment has relied heavily on capital expenditure cuts and recurrent expenditure containment. In this context, preserving public social spending and achieving better social outcomes are essential. Closing some efficiency gaps in health and education sectors could help the task of fiscal consolidation. This Selected Issues Papers (SIP) provides an overview of Togo's public spending in health and education sectors and assesses the associated input and output technical efficiencies using a frontier analysis. We find that in general, Togo's social performances are below those of selected countries with similar development stage. With the current spending levels, Togo can improve its health and education outcomes by 4.8 percent and 6.3 percent respectively. In addition, the spending leakages, of about 10 percent and 14 percent respectively in the two sectors, could be reduced to maximize the impact of social spending. Achieving these efficiency gains will require a series of structural reforms over the medium term in the health and education sectors.

A. Introduction

1. **Bold fiscal consolidation is underway.** Since end 2016, Togo has embarked on a major fiscal consolidation following a significant infrastructure upgrade through pre-financing. An IMF supported program has been agreed in May 2017. Since the onset of the program, public investment has been brought back to prior pre-financing levels and recurrent expenditure has been contained significantly. Domestic primary expenditure has been curtailed by 5 percentage points and Togo's public debt-to-GDP has been reduced by 7 percentage points between 2016 and 2018, from 81.1 percent in 2016 to 74.1 percent in 2018. This ratio is set to decline below the regional convergence criteria of 70 percent by end-2019.
2. **The envelope for social benefits is increasingly under strains.** Public social spending has fallen short off the mark of the targets set under the ECF program. For 2017-18, the indicative target on social spending was missed mainly because of difficulties in budget execution. This contrasts with the key policy objective of Togo's fiscal adjustment to preserve and generate space for public social spending and implement targeted social spending.
3. **Public social spending is a niche for longer-term human capital improvement.** Reducing inefficiencies in public social spending (education and health outlays) could improve substantially social services and human capital and therefore improve medium-term growth and productivity.
4. **In this SIP, we shed lights on the recent developments of public social spending and assess its efficiencies both on the means and outcomes sides.** The remainder of the note is organized as follows. Section II discusses the definition of public social spending under Togo's ECF

¹ Prepared by L. Kebalo, I. Sowou, and S. J. Tapsoba.

program. Section III presents some key stylized facts. Section IV assesses the input and output efficiencies of public social spending in Togo in comparison with the rest of sub-Saharan Africa (SSA) countries. Section V concludes.

B. Social spending in Togo: Measurements and Programs

5. General definition of social spending. Social spending includes public spending on education, health and social protection. Social protection includes contributory social insurance transfers (pension and unemployment benefits) and social assistance benefits (family benefits, unemployment assistance, and cash transfers). Given the low level of social safety nets program and the lack of comprehensive data, we focus in this SIP on education and health sectors.² Because of data availability, we use mostly data on General Government (central government and public entities) expenditures on health and education from the World Bank's World Development Indicators (WDI). According to the WDI, health expenditures include healthcare goods and services and expenditures on education include current, capital, and transfers expenses and cover all sectors (including health, education, social services, etc.).

6. Measuring social spending in Togo. For the ongoing ECF program in Togo, social spending is measured as follows. Total (current and capital) domestically-financed social spending is calculated for each category of current and capital accounts (wages, goods and services, transfers and subsidies, other) and capital accounts financed with domestic resources. In a national context, social spending is considered to be public expenditure targeting the following social sectors: (1) Ministry of Education; (2) Ministry of Health; (3) Ministry of Social Action, Advancement of Women, and Literacy; (4) Ministry of Grassroots Development, Crafts, Youth, and Youth Employment; (5) Ministry of Agriculture, Livestock, and Fisheries; (6) Ministry of Mines and Energy (rural electrification projects); (7) Emergency Program for Community Development (Programme d'Urgence de Développement Communautaire – PUDC); (8) Support Program for Vulnerable Populations (Programme d'Appui aux Populations Vulnérables – PAPV).³

C. Stylized Facts

7. Rising spending. Social spending steadily increased over the last fifteen years. Togo's social spending defined as the sum of health and education outlays grew from 5.4 percent of GDP in 2001 to 7.1 percent of GDP in 2016 (Figure 1a). This increase is mostly explained by the demographic trends, namely the increase of the share of the young (below 15) and old (above 65) populations, a key driver for social services *i.e* youth for education and elderly for health (see Annex I).

² For Togo, because of the lack of comprehensive database on social protection, social spending is measured as education and health expenditures. In 2015, social protection expenditure is estimated at 0.6 percent of GDP while pension funds amount to 1.8 percent of GDP (see Annex I).

³ Two social programs are under implementation. The program to support vulnerable groups (PAPV) is an emergency initiative aiming at renovating social infrastructure and expanding social projects. The program covers areas such as potable water, sanitation, electricity, education, health, housing, financial inclusion, and youth employment. The community development program (PUDC) aims at reducing social inequality by improving the living conditions of populations in remote places, with insufficient basic social infrastructure.

8. Shifting composition.

- *The share of social spending in total GG expenses has been broadly stable.* On average between 2001 and 2016 social benefits accounted for more than half of the budgetary expenses, about 29.1 percent (Figure 1b). The share of public social spending declined steadily from 33½ percent to 23½ percent between 2001 and 2016. This is related to the significant increase in public spending during the pre-financing episode. Nevertheless, public social spending accounts also for a large budget category and as such improving its efficiency in the medium term could deliver sizeable budgetary savings and improve social indicators.
- *In terms of composition, public social spending in Togo is skewed towards education outlays.* The share of the education sector stood at 20 percent of the GG expenditure on average whereas the health sector accounted for only 9.2 percent. This implies that efficiency efforts should concentrate on both sectors, with a stronger focus on the education sector (Figure 1b). Moreover, looking at the dynamic over the past 20 years, the increase in social spending trends is mostly attributed to education outlays Figure 1b. Education outlays picked up in 2009 from 4.1 percent of GDP to 5.1 percent of GDP in 2016. After increasing during the first half of the 2000s, health expenditure declined and stagnated since 2009 at around 2.0 percent of GDP.

9. Togo relative to SSA. Both health and education expenditures in Togo are on a par with the average of the SSA region, at around 2.1 and 5.1 percent of GDP in 2016, respectively. For health, in 2015 public funds accounted for 38.4 percent of the total, which was well below the average of the SSA region (Figure 1c). For the education sector, this share is estimated at about 18 percent (Figure 1d). As a result, out-of-pocket expenses for health and education are high by SSA standard.

Suboptimal Social Outcomes

10. In general, looking at cross-country data, the efficiencies of Togo's health and education sectors could be strengthened substantially.

- Togo's health performance is slightly below the average in SSA countries and Togo has a much lower spending level (Figure 1e). However, this outcome has been achieved at a relatively higher cost when compared with peers (for example Madagascar, Mauritania, Sudan, and Uganda). Togo spends about 2.0 percent of GDP for its health sector, while Madagascar and Uganda are devoting between 1.5 and 1.8 percent of GDP to achieve a better health adjusted life expectancy (HALE).⁴
- For the education sector, Togo's outcome is high by SSA standards but remain relatively costlier. In 2015 Togo's ranks among the top performers for net enrollment rates (Figure 1f). However, the related cost tends to be high. This conclusion holds with the primary completion rate as the education outcome (Annex I).

⁴ Health Adjusted Life Expectancy (HALE) is a measure of population health that accounts for mortality and morbidity. It adjusts overall life expectancy by the amount of time lived in less than perfect health. Health-adjusted life expectancy (HALE) is the average number of years that a person is expected to live in good health by considering years lived in less than full health due to disease and/or injury.

- Countries with analogous achievements (for instance Benin and Rwanda) are spending relatively less. Togo's education spending was estimated at 5.2 percent of GDP while Benin and Rwanda allocated between 3.6 and 4.4 percent for comparable outcomes.

11. These cross-country comparisons show that there is scope for strengthening the efficiency in Togo's health and education sectors. In the following section, we investigate the potential efficiency gains through a frontier analysis.

D. A Frontier Analysis

12. Methodology. A frontier analysis is used to assess the efficiency of Togo's health and education sectors. The methodology applied is the Data Envelopment Analysis (DEA).⁵ The DEA traces a "best practice frontier", populated by countries that provide the optimal combination of inputs and outputs. This frontier is constructed using linear programming techniques from the most efficient observations, which then "envelop" the less efficient ones. Efficiency gains are derived by measuring the distance from the frontier and expressing it as a ratio of an observation's distance from the efficiency frontier to the distance from the axis. These gains can be defined as the amount by which input could be reduced while holding constant the level of output (input inefficiency) or as the amount by which output could be increased while holding constant the level of input (output orientation), as shown in Figure 2. The efficiency score depends on the angle of efficiency examined. The input efficiency score measures the scope to produce the same level of output while streamlining the cost of production to be on the frontier. In contrast, the output efficiency captures the scope for improving the output to be on the frontier with the same cost. In the former, the input is minimized while the output is kept at its current level. In the latter, the output is maximized while the input is kept at its current level. The efficiency scores range from 0 to 1 and measures the conversion rate of input into output. Implicitly, the efficiency gains determine the size of potential savings. For each type of expenditure, Togo's conversion rate is then compared to that of other SSA countries. For this analysis, health adjusted life expectancy and the net primary enrollment rate are considered as the socially valuable outcomes for health (*i.e.*, longer life because of a good healthcare system) and education (*i.e.*, net enrollment in the primary as a product of good schools), respectively.

⁵ The DEA technique is more appropriate for homogeneous sample such SSA countries. Indeed, as a relative measure of efficiency, DEA is highly sensitive to sample selection and measurement errors in terms of quality of production factors. Outliers can exert a large effect on the efficiency scores and shape of the frontier.

Figure 1. Togo: Overview of Health and Education Expenditures, 2001–16

Figure 1a. General Government Social Spending
(percent of GDP)

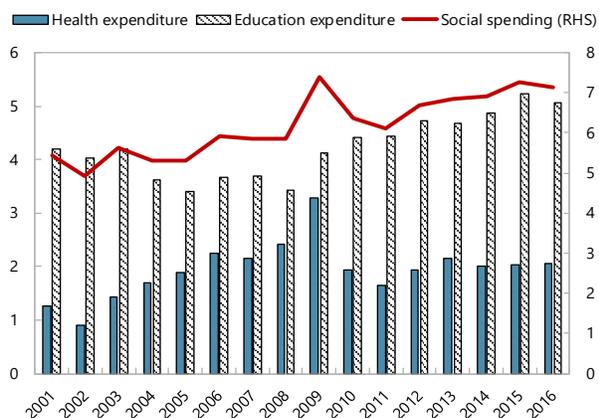


Figure 1b. General Government Social Spending
(percent of government expenditure)

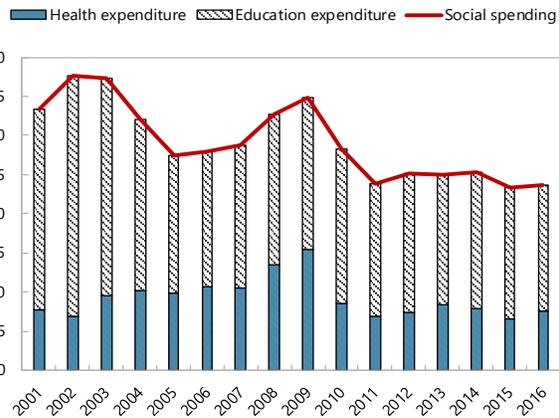


Figure 1c. Health Expenditure, 2015

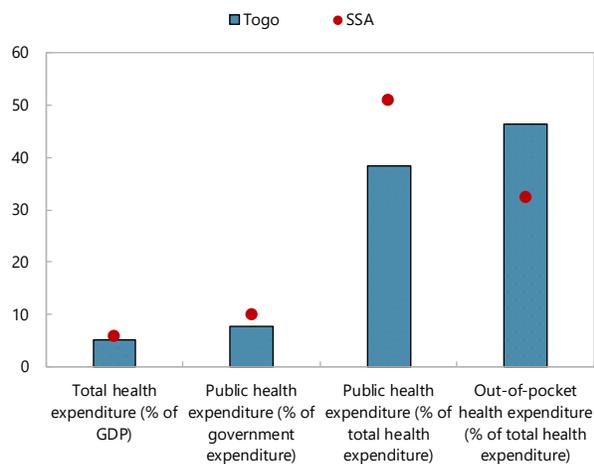


Figure 1d. Education Expenditure, 2015

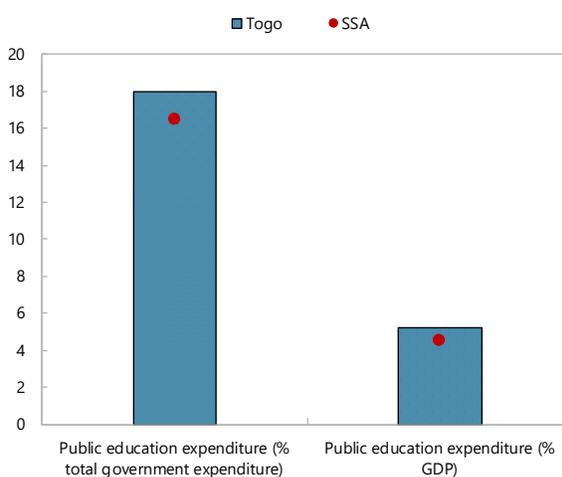


Figure 1e. Overview of Health Indicators, 2015

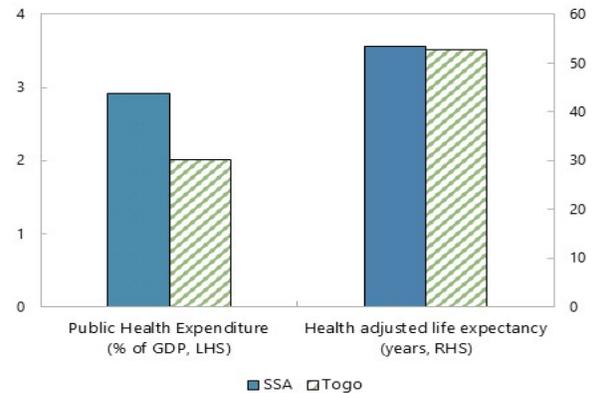
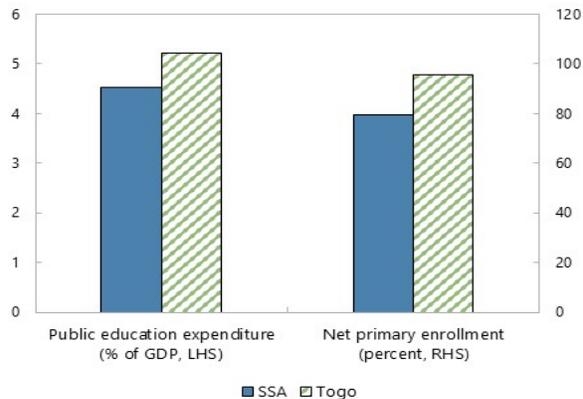
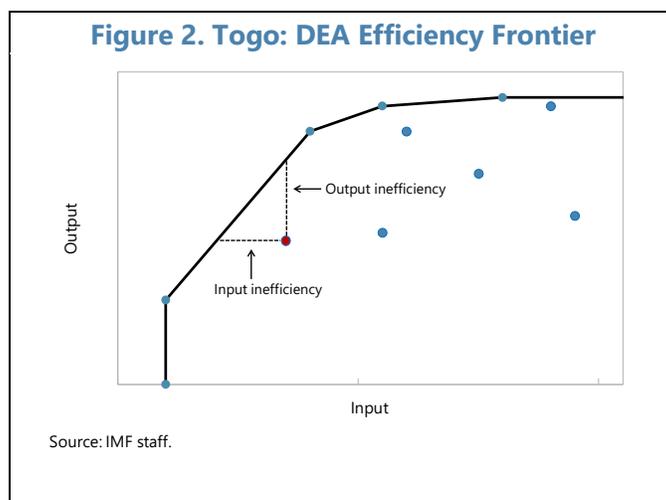


Figure 1f. Overview of Education Indicators, 2015



Source: World Development Indicators; and IMF staff estimates.



Health Sector

13. Using better HALE as the desired outcome of the health sector, Togo remains below the frontier implying that more output can be achieved with the current spending level.

- *Input efficiency*— In 2015, Togo allocated PPP\$ 76.3 per capita on the health system with a HALE of 52.3 years. This performance remains below peers with top performance (Figure 5). For instance, Guinea a country very close to the frontier, spends only PPP\$ 68.5 per capita on the health system with a similar HALE (51.7 years). This suggests Togo can save as much as PPP\$ 7.8 per capita to produce the same HALE. This is equivalent to an input-efficiency of about 10.2 percent.⁶
- *Output efficiency*—Ethiopia which is very close to the frontier spends on average PPP\$ 73 per capita on the health sector with a HALE of 56.1 years. The comparison with Ethiopia with a similar spending envelope implies that Togo can improve its HALE by as much as 3.3 years with a similar spending. This represents an output-efficiency of about 6.3 percent.⁷

Education Sector

- *Input efficiency*— Using net primary enrolment as the desired outcome, Togo is below the frontier. In 2015, Togo allocated PPP\$ 260.5 per capita on the education sector with a net enrolment of 95.4 percent. This performance remains below peers with top performance (Figure

⁶ The related calculation is as follows: $100 \times ((76.3 - 68.5) / 76.3) = 10.2$.

⁷ The related calculation is as follows: $100 \times ((56.1 - 52.8) / 52.8) = 6.25$.

(continued)

3). For example, Sierra Leone devoted PPP\$ 223.7 per capita to achieve an enrolment rate of 99.1 percent. The input-efficiency score is estimated at about 14.1 percent.^{8,9}

- *Output efficiency*—In terms of output efficiency, Togo can improve as much to 100 percent (per construction) with the same level of education spending. This means that Togo can still improve its enrolment rate by 4.8 percent with the current spending levels on the education system.^{10,11}

14. The frontier analysis suggests that Togo can do significantly more with the current spending levels.

E. Concluding Remarks

15. There is a scope for bold improvement outcomes in Togo's health and education sectors. A series of options should be considered.

- Immediate efforts should focus on continuing the implementation and expansion of various social benefits initiatives based on a targeting principle. These include the following actions: (i) finalize and implement the Unified Social Registry for social protection programs aiming at ensuring better coordination of social protection interventions; (ii) expand the implementation of the unconditional cash transfer (UCT) programs reaching 40,000 households and the school feeding program reaching 50,000 students; (iii) reinforce the implementation of the program to support vulnerable groups (PAPV) and the community development program (PUDC).
- A key step will be to continue improving the governance of the health and education sectors as planned in the sectoral strategies. In the health sector, focus should be on the equity in access to health services, affordability including expanding the prescription and use of generic drugs and cost-sharing mechanisms while ensuring necessary safeguards to prevent leakages. In the education sector, medium-term strategies should aim at achieving universal primary education and limit out of pocket expenses, expanding preschool coverage, and covering additional rural areas.
- It is also important to improve the execution of the budgeted social outlays. Allocations for social sectors in the budget are often characterized by a low execution. The insufficient

⁸ The related calculation is as follows: $100 * ((260.5 - 223.7) / 260.5) = 14.1$.

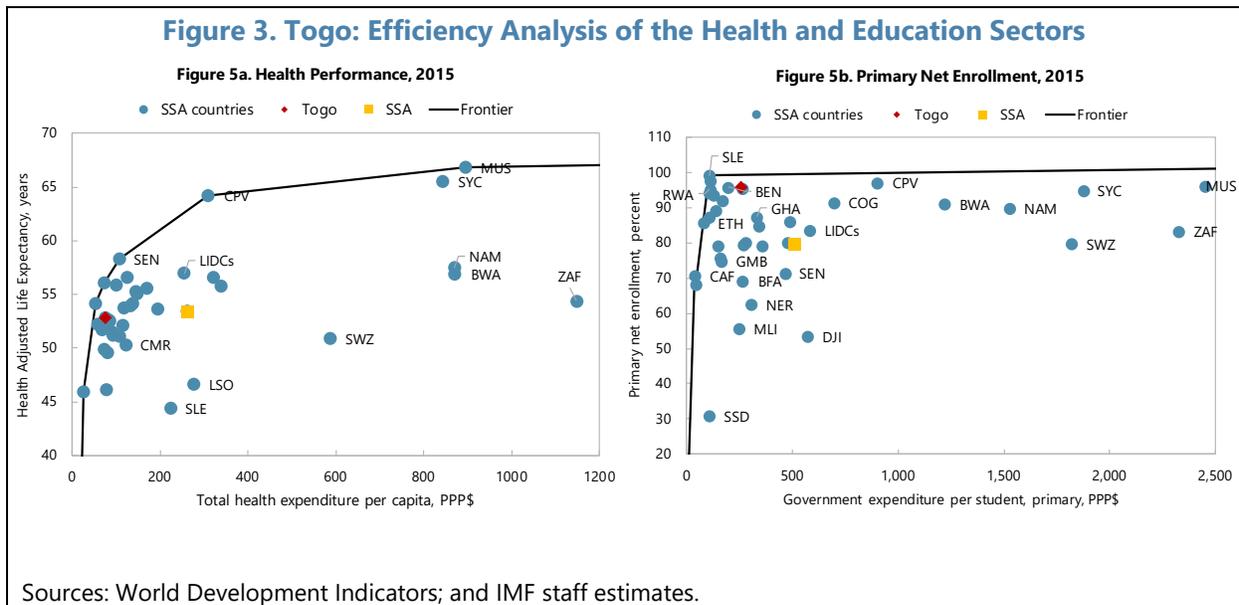
⁹ A similar conclusion is reached with the completion rate (see Annex I). In 2015, Togo allocated PPP\$ 260.5 per capita on the education system with a primary completion rate of 82.9 percent. Countries close to the frontier such as Benin, spends only PPP\$ 194 per capita on the education system with a similar primary completion rate estimated at about 81.1 percent. This suggests Togo can save as much as PPP\$ 66.5 per capita for the same result. This is equivalent to an input-efficiency of 25.5 of about percent. The related calculation is as follows: $100 * ((260.5 - 190) / 260.5) = 25.5$.

¹⁰ The related calculation is as follows: $100 * ((100 - 95.4) / 95.4) = 4.8$.

¹¹ With the primary completion rate, Togo can improve its education outcome by 9.6 percentage points which is tantamount to an output-efficiency of about 11.6 percent. The related calculation is as follows: $100 * ((92.5 - 82.9) / 82.9) = 11.6$.

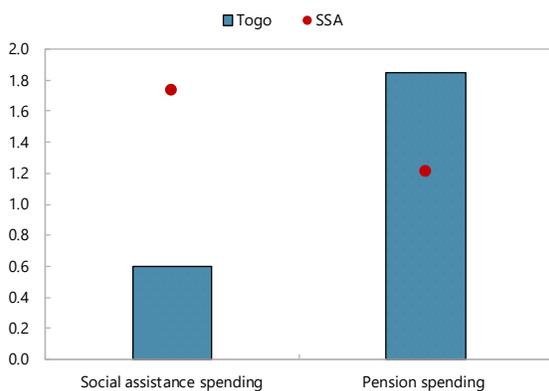
execution of budgeted social expenses might explain the difficulty of reaching the IT in the program on social spending.

- Finally, strengthening protection of the most vulnerable can be achieved by ensuring a sustainable financing source—e.g. revenue mobilization or the reallocation of spending from other areas—or improvements in the efficiency of social spending. In most economies, there is ample room to improve the efficiency of public spending, including social spending.



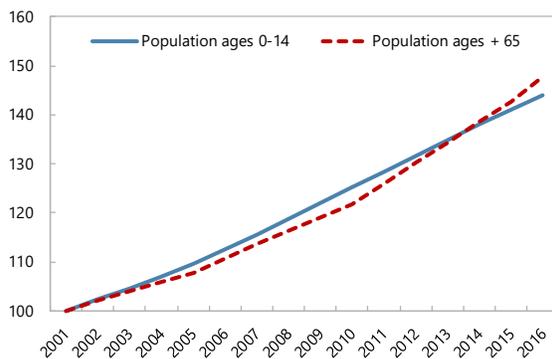
Annex I. Social and Education Indicators

**Social Assistance and Pension Spending, 2015
(percent of GDP)**



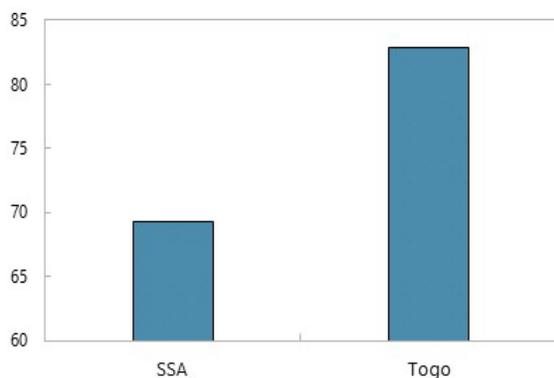
Sources: ASPIRE; EPD; and IMF staff estimates.

**Evolution of Population (children and elder), 2001–16
(index, 2011=100)**



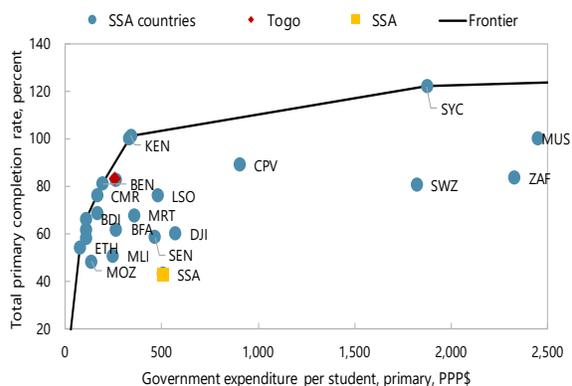
Sources: World Development Indicators; and IMF staff estimates.

**Primary Completion Rate, 2015
(percent of relevant age group)**



Sources: World Development Indicators; and IMF staff estimates.

**Primary Completion Rate, 2015
(percent of relevant age group)**



Sources: World Development Indicators; and IMF staff estimates.

GOVERNANCE AND INSTITUTIONS¹

The strength and quality of Togo's public institutions are improving. Togo's governance indicators that were comparable with a typical fragile country in Sub-Saharan Africa (SSA) 15 years ago are approaching SSA and WAEMU averages. The focus on institutional reform has increased further in recent years, mainly through efforts to improve fiscal governance so far. While the priority given to fiscal governance is warranted, more emphasis should be given to enforcement of anti-corruption legislation by effective and independent institutions. This paper provides a brief overview of the strength and weaknesses of Togo's public institutions.²

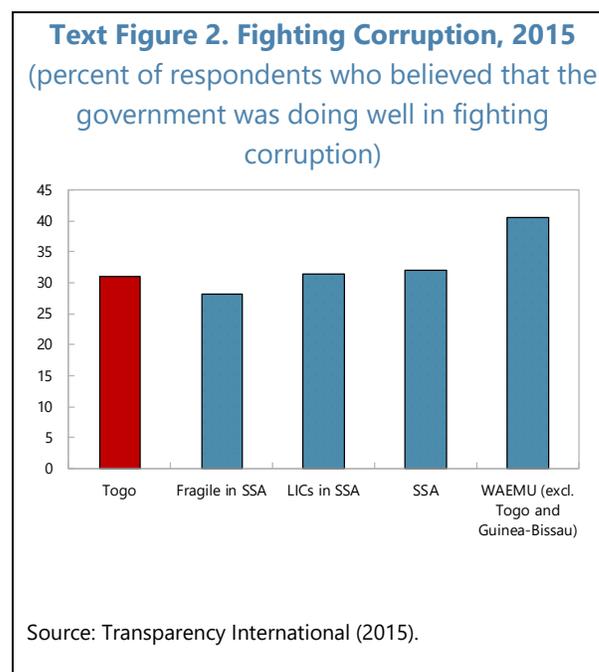
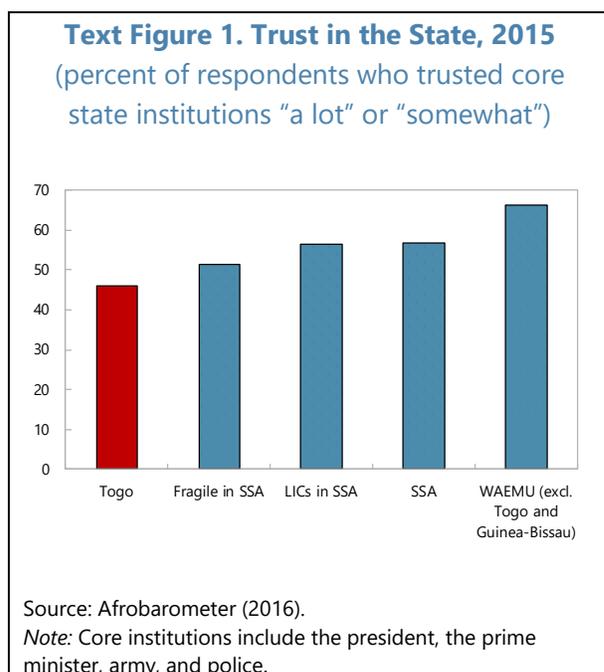
A. Overall Assessment

1. **While improving, Togo's general governance structures still seem somewhat weaker than the average of WAEMU and SSA.** Starting from a position close to an average fragile SSA country 15 years ago, the World Governance Indicators are now rating Togo more like a low-income country (LIC) and in rule of law an average SSA country (Figure 1). Prevailing weaknesses in fiscal management and other governance challenges continue to constrain the delivery of public goods and services with a plausible negative impact on economic growth and poverty reduction.
2. **People's trust in public institutions is an indicator of the quality and capacity of the institutions.** When the citizens are asked to assess their trust in the state, Togo's score is also weaker than the WAEMU and SSA average. A survey in 2015 reported that 46 percent of respondents in Togo trusted the core state institutions "a lot" or "somewhat" compared with an average of 57 percent for SSA and 65 percent for WAEMU (Text Figure 1).
3. **Dedicated support from the country leadership is essential in the attempt to build strong institutions and combat corruption.** Reducing corruption will be challenging if there is doubt about the political commitment. Corruption is a symptom of a poorly functioning government, addressing it requires change on many various levels. It is, therefore, of some concern that only 31 percent of Togo's citizens in the 2015 survey responded that the government did well in fighting corruption compared with a WAEMU average of 41 percent (Text Figure 2).
4. **In recent years, the government has become increasingly engaged in institutional reforms to strengthen governance and fight corruption.** The public financial management (PFM) system is going through a comprehensive overhaul and Togo has adopted new anti-

¹ Prepared by Lars Engstrom. The author is grateful for comments from colleagues in several departments.

² The paper uses several survey-based perception indicators. Caution is needed when comparing these indicators across countries and over time. See Box 3 for further information.

corruption legislation and established several control and anti-corruption institutions, including the anti-corruption agency HAPLUCIA that became operational in 2017.



B. Fiscal Governance

5. Togo’s fiscal governance seems weaker than the SSA and WAEMU averages. The Worldwide Governance Indicator of government effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressure, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies. While improving, over 2015-17 Togo’s score remained close to fragile and LIC SSA countries and below the average of SSA and WAEMU countries (Figure 1).

6. Directives issued by WAEMU contain many provisions on PFM. The provisions include better access to budget information, multi-year budgeting, results-oriented management, decentralized budget execution, and a new accounting and financial monitoring framework.³ The most recent Public Expenditure and Fiscal Accountability (PEFA) Assessment published in 2016 showed that Togo was either the weakest or one of the weakest in most PFM categories when compared with neighboring WAEMU countries (Table 1).⁴ Against this

³ Directive 06/2009/CM/UEMOA on budget laws; Directive 07/2009/CM/UEMOA on the general public accounting rules; Directives 08/2009/CM/UEMOA on national budget classification; Directive 09/2009/CM/UEMOA on national chart of accounts; and Directive 10/2009/CM/UEMOA on national summary fiscal tables.

⁴ PEFA (2016). Togo is compared with neighboring countries that have completed a PEFA assessment in recent years.

background, the authorities' current ECF supported program has given priority to an ambitious agenda of PFM reforms.

Transparency

7. The publication of fiscal data could be more transparent. There are many shortcomings that limit the ability to maintain an effective oversight of government functions. The current presentation of the budget is primarily based on the administrative and economic classification. Key information is missing including: (i) the outcome of the previous budget; (ii) complete data on the debt stock; (iii) comprehensive data on financial assets; (iv) wide-ranging information on budget risks; and (v) a comprehensive analysis of the budget impact from new initiatives and public investment. Significant amounts of public revenue and spending are excluded from the budget, for example data covering: (i) autonomous public institutions; (ii) the social security fund; and (iii) the pension fund. Information about the activity of extrabudgetary units is incomplete. The budget document does not include sufficient information about the expected result and actual outcome of different activities and the data is too aggregated to make it possible to track the allocation of fiscal spending. The public does not have access to several key documents, including regular reports on budget execution and audited financial statements.

8. Recent measures to increase transparency include: (i) estimates of all tax expenditures were attached to the budget for 2019 and (ii) a decision that the budget for 2020 will be presented and adopted based on specific programs in line with the public finance reforms undertaken among WAEMU members.

Revenue

9. While tax and customs administration reforms have advanced in recent years, revenue performance has improved more slowly than expected. The tax and customs administrations were unified when the Togolese Revenue Authority (OTR) was established in 2014 and tax revenues increased from 15.9 percent of GDP in 2013 to 16.9 percent of GDP in 2016 but then fell back to 16.1 percent of GDP in 2017 (a year of political turmoil). Tax revenues recovered to 16.5 percent of GDP in 2018, which is above the SSA and WAEMU averages and about 1½ percent of GDP below the estimated tax frontier (Text Figure 3).

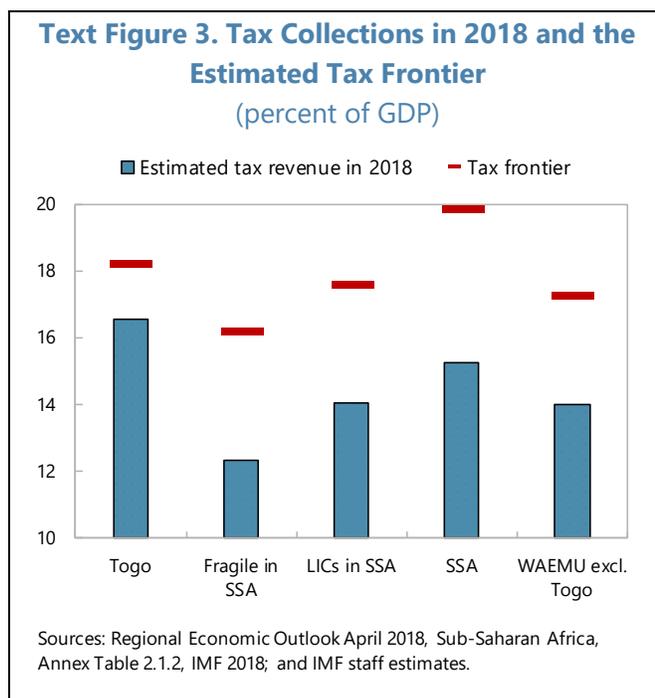
10. Revenue mobilization will be improved further by: (i) broadening the tax base, increasing the efficiency and equity of the tax system, and reducing tax exemptions that amounted to 3.5 percent of GDP in 2016; (ii) strengthening measures to identify tax fraud; and (iii) increasing the recovery of tax arrears. The tax authorities are refining the use of risk-based analysis and reconciliation of different data sources. For example, to identify potential underreporting by taxpayers, procurement data collected by the Public Treasury can be reconciled with turnover data reported to OTR. Procedures for reconciliation of data covering tax assessments, contested tax payments, and recovered tax arrears are also essential and processes to recover payments from declarative defaulters have been made systematic. Online tax

reporting has become mandatory for large companies and customs clearance procedures and related documentation will be gradually digitalized. Custom clearance will be prevented for merchandise of importers with outstanding tax arrears.

Spending and Investment

11. To increase value for money, new measures aim to make the management of public spending and investment more efficient:

- Defective cashflow plans* have triggered cashflow constraints and an increased risk of arrears. Many public arrears have remained unresolved, pending agreements with creditors. In response, the Ministry of Economy and Finance started to prepare monthly procurement and commitment plans consistent with the approved budget in 2018. A major lasting problem for cashflow forecasts is the non-respect of the procurement and commitment plans. Public procurement regulations impose maximum deadlines for the validation of contracts that are not respected in practice. Some credits provided in the cashflow plan are, therefore, not available at the payment stage. Challenges also remain for converting the Treasury settlement account at the central bank (BCEAO) that was opened in 2018 into a functioning Treasury Single Account.
- Spending arrears* will be cleared based on an audit of existing arrears in 2017 and an agreed schedule. The authorities are putting in place a comprehensive system to prevent new arrears.
- Public investment management has been weak* and the 2016 Public Investment Management Assessment (PIMA) ranked Togo in the bottom quartile of countries in the public investment management index (at 0.3 in a scale of 0-1).⁵ Collection of project data by line ministries has been generally poor with sporadic monitoring reports and as a result, public investment projects have been selected based on insufficient technical and financial information. A multi-year program budgeting process is now under preparation and the public investment program (PIP) covering 2019-21 was published as an annex to the 2019 Budget. A circular



⁵ IMF (2016a).

letter issued in December 2018 mandates future investment projects to be selected based on methodological guidance for project selection and to include in the PIP and the budget only those that have been selected accordingly. At the end of each fiscal year, a report for all completed major projects, including ex-ante and ex-post assessments, will be prepared.

Asset and Debt Management

12. The management of public assets and liabilities needs to be reinforced. The fiscal reporting of public assets is weak and there is currently no administrative structure capable of monitoring public enterprises. While a list of government participation in different companies exist, the monitoring authorities do not receive financial statements on a regular and systematic basis. Reporting by regional authorities and controls of guarantees are insufficient. Monitoring and management of public debt have improved in recent years. The debt management directorate has been reinforced with all debt management functions centralized in one entity. A procedures manual for debt management has been developed. The authorities have also prepared a medium-term debt strategy that will be updated on a regular basis. The situation of Togo's state-owned banks, which have been in repeated financial difficulties and required recapitalization, is discussed further in another selected issues paper.

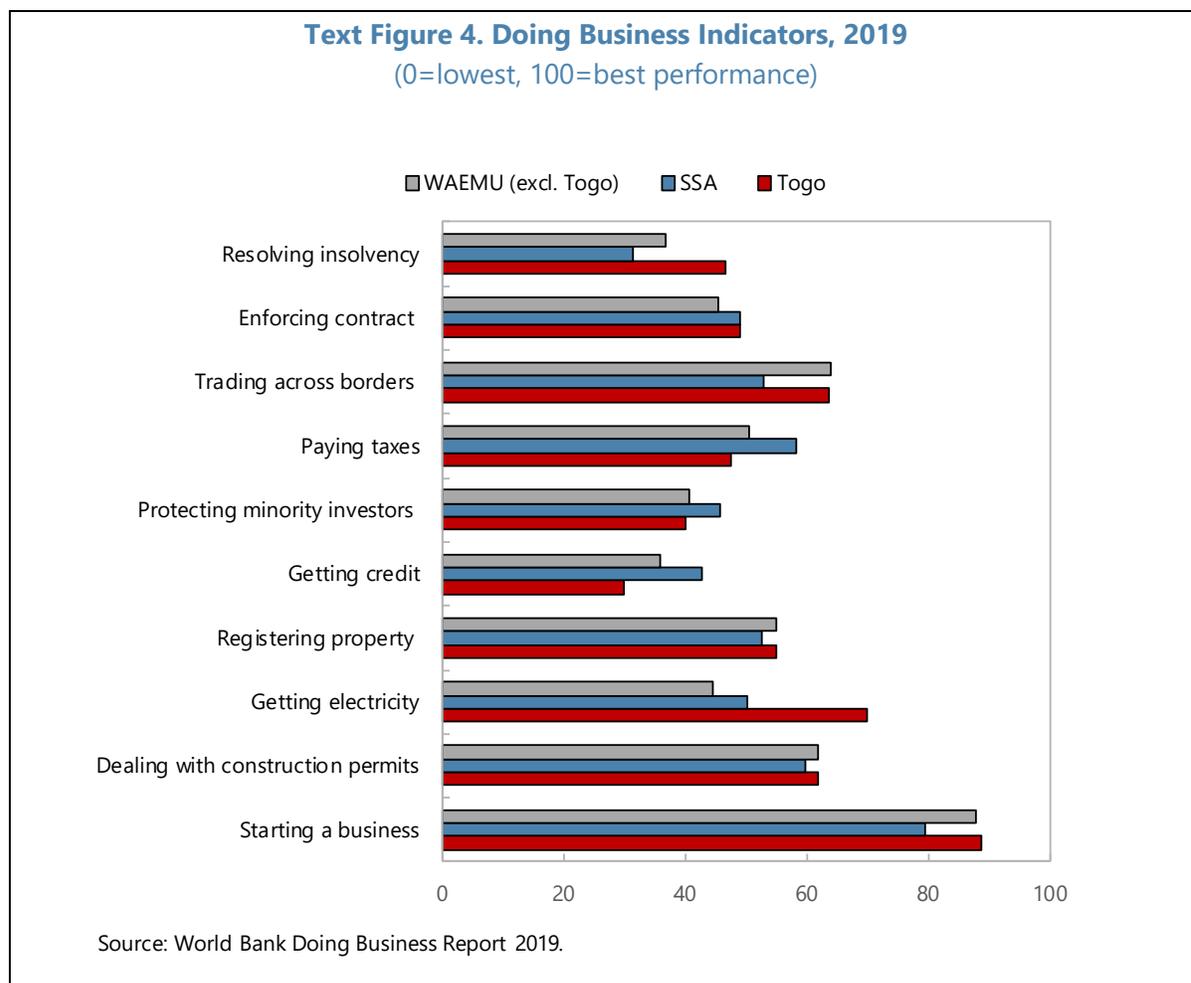
Procurement

13. The WAEMU countries initiated an extensive process of public procurement reforms in 2005. Transparency was reinforced in Togo by the law on government procurement and contract delegation in 2009. ARMP (*Autorité de Régulation des Marchés Publics*), established in 2009, regulates public procurement and DNCMP (*Direction Nationale du Contrôle des Marchés Publics*) is responsible for the control of public procurement procedures and issues non-objection notices on bidding documents. Calls for bids are published in newspapers and on the DNCMP website. In general, the calls contain specifications and terms of the offer, as well as the evaluation criteria. Companies found guilty of violating procurement regulations are prohibited from participating in future bids and their names are published on the ARMP website. Notwithstanding these positive measures, ministries would generally need stronger procurement capacity, including developing electronic management of tender processes and establishing procurement compliant reviews and auditing mechanisms.

C. Market Regulation

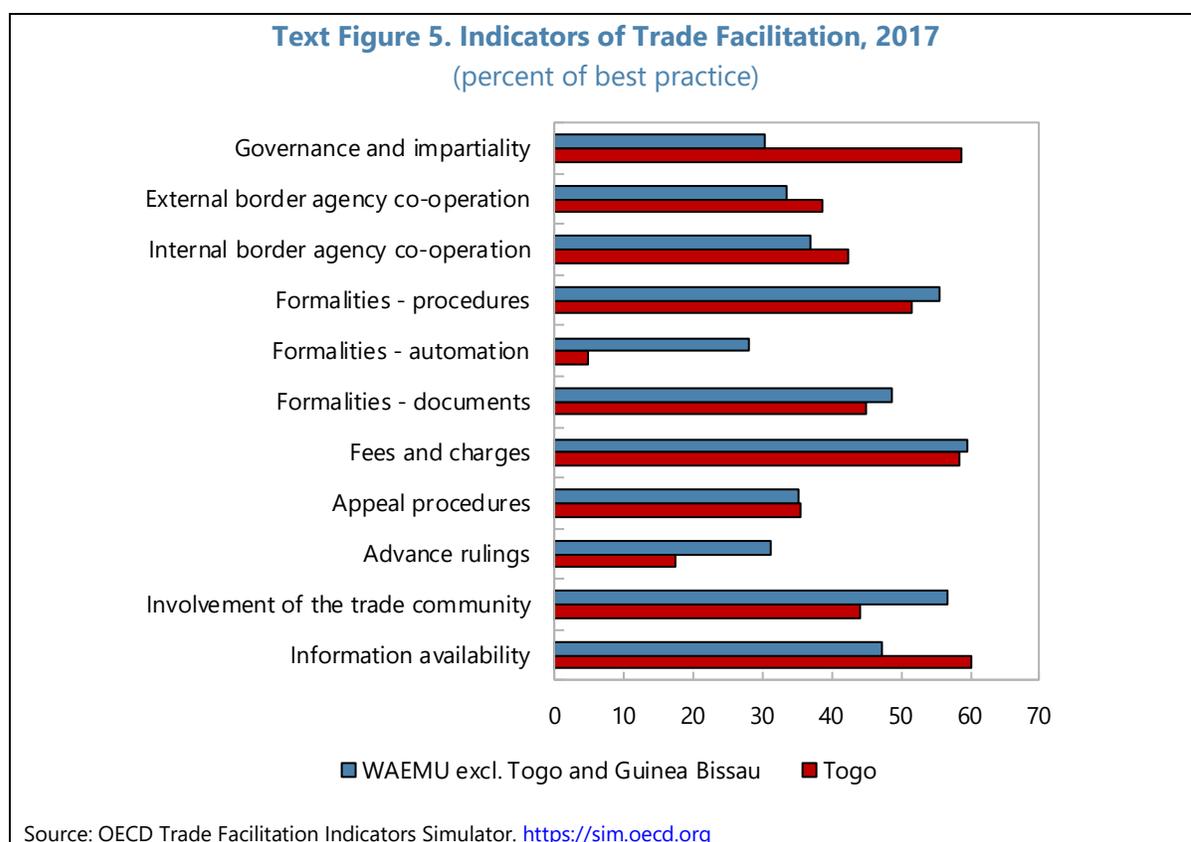
14. Indicators of Togo's regulatory environment give a slightly mixed message. The Doing Business indicators measure the legal/regulatory aspect of the business environment. The 2019 Doing Business report indicates that Togo's regulatory performance is comparable to other WAEMU and SSA countries in most areas (Text Figure 4). Togo is a better performer on getting electricity and weaker than the SSA average in paying taxes and getting credit. At the same time, Togo's regulatory quality is scored significantly lower than other WAEMU countries by the Worldwide Governance Indicators in 2017 (Figure 1). This contradiction might be explained by gains from recent regulatory reforms. For example, Togo has caught up with other WAEMU

countries in registering property, an area in which Togo used to be far behind. The time needed to register property in Togo has dropped from 283 days two years ago to currently 84 days (see next section for more details).



15. A closer analysis of regulations related to foreign trade reveals that there is room for further reforms. The OECD trade facilitation indicators measure the full spectrum of border procedures (Text Figure 5). Togo is far below best practice in all areas and particularly so in:

- *Automation:* Automated procedures are a powerful tool to facilitate trade because it supports implementation of modern customs management practices.
- *Advance rulings:* The time needed for declaration and clearance is reduced when the Customs administration offers binding decisions in advance on the classification, the origin or the Customs value of the goods to be imported or exported.
- *Appeal procedures:* Strong and transparent appeal procedures give the importer and exporter additional guarantees that all actions taken by the border agencies are based on existing laws and regulations.



16. While still well below best practice, Togo scored significantly better than other WAEMU countries in governance and impartiality as well as information availability. The border agencies have transparent structures and functions with effective sanctions against misconduct of border agency staff. Information is available on the national customs website, duty rates are published, and required documentation is easily accessible for downloading. Nonetheless, to ensure that the Port of Lomé is competitive and able to defend its position as a regional transportation hub, as envisaged in the National Development Plan, the authorities would be well advised to set ambitious targets and aim for border procedures that are close to best practice in as many categories as possible.

D. Rule of Law

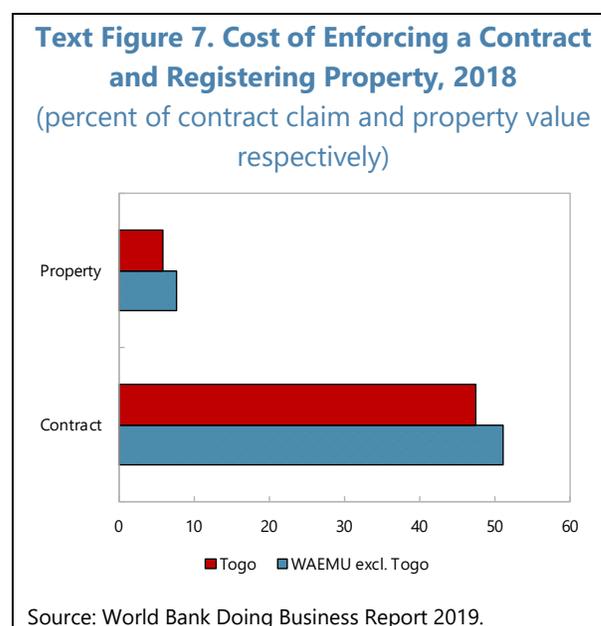
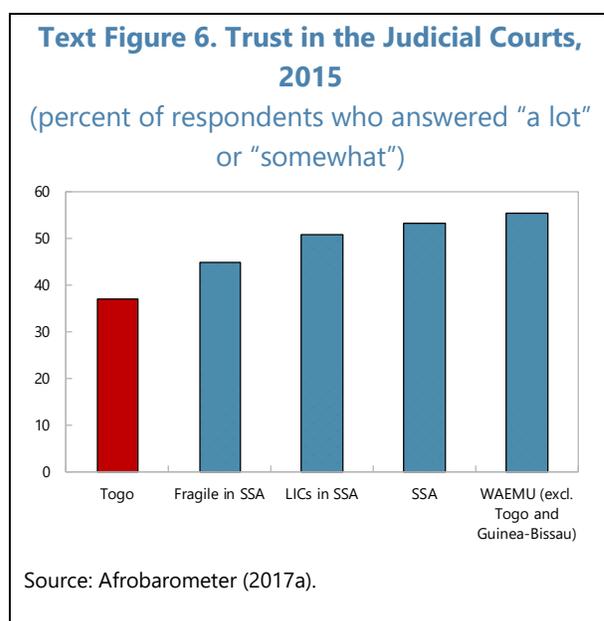
17. Information on the rule of law suggest a divergence between the existing legal framework and what happens in practice. The constitution provides that the judicial branch is independent from the legislative branch and the executive branch. Togo is one of the few francophone countries in Africa where the president does not chair the high judicial council, or an equivalent entity in charge of recruiting, disciplining, and removing judges.⁶ Nonetheless,

⁶ Global Integrity (2016).

(continued)

recent surveys show weak market trust in the judiciary, which undermines the business climate, amidst persistent perception of political interference and corruption:⁷

- The Worldwide Governance Indicator of rule of law captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and the quality of contract enforcement, property rights, and the courts, as well as the likelihood of crime and violence. Togo's score has improved over time and was close to the average of other WAEMU countries and SSA over 2015-17 (Figure 1).
- Survey data from 2015 indicate weaknesses in the legal framework. When asked if they trusted the judicial courts, only 37 percent of the respondents in Togo answered "a lot" or "somewhat" while the correspondent averages were 53 percent for SSA and 58 percent for WAEMU (Text Figure 6).



18. Courts are clearly not an efficient option for creditors who want to enforce a contract. The cost of contract enforcement in Togo is prohibitively high at 48 percent of the claim value according to Doing Business 2019, but this is in fact slightly less than the average of other WAEMU countries at 51 percent of the claim value (Text Figure 7). In response, the government recently decided to create two commercial courts focused on business conflicts. New land registration procedures have reduced the cost of registering property in Togo. The tax authority (OTR) has taken over the responsibility for the land register and it has computerized land titles and launched a nation-wide land census. As a result, the cost of land registration has decreased from previously about 9 percent of the property value to currently just under 6

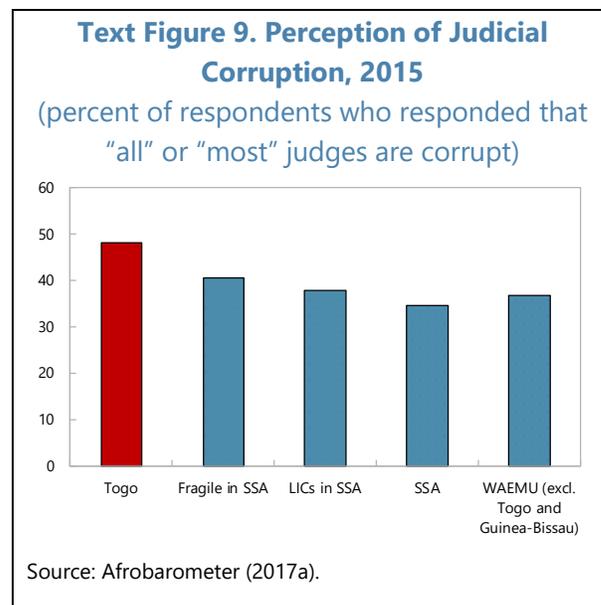
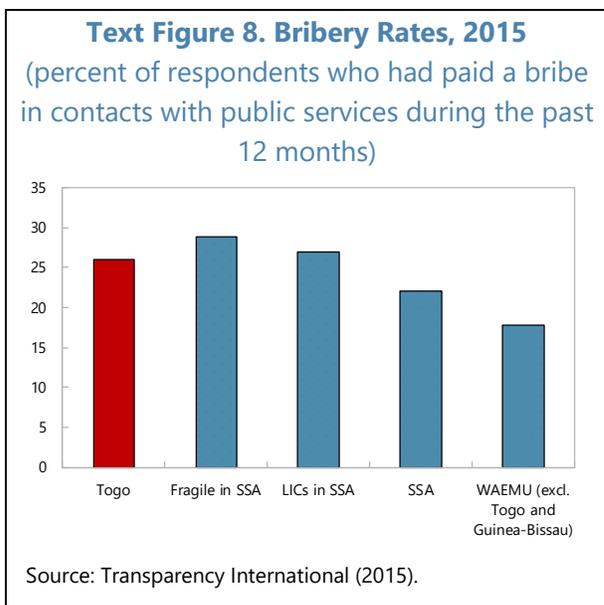
⁷ See for example Afrobarometer (2017a).

percent, which has reduced the cost of registering property from above to below the average of other WAEMU countries.

E. Control of Corruption

19. The control of corruption in Togo seems weaker than the WAEMU average. The Worldwide Governance Indicator of control of corruption signals that Togo's control of corruption has improved and is better than in SSA fragile and LIC countries, but other WAEMU countries are on average slightly ahead of Togo (Figure 1). A survey in 2015 reported that 26 percent of the Togolese paid a bribe in contacts with public services to be compared with on average 22 percent for SSA and 18 percent for WAEMU (Text Figure 8). Bribes were most common in contacts with the police, courts, utility companies, and when asking for permits or other documents. Bribes were less common in contacts with schools and health services. When asked if they thought that judges were corrupt, 48 percent responded "all" or "most" in Togo, while the corresponding averages were 34 percent for SSA and 37 percent for WAEMU (Text Figure 9).

20. Appropriate criminalization of acts of corruption is essential to strengthen governance and fight corruption. Togo has adopted laws on the prevention, detection, and sanctioning of corrupt practices (Box 1). Corruption is also prohibited in article 46 of the Constitution (*Loi fondamentale*) and Togo ratified the UN Anti-Corruption Convention (UNCAC) in 2005 and the African Union Anti-Corruption Convention in 2009. Togo is preparing to adopt legislation establishing a requirement for all civil servants who are professionally or politically exposed to the risks of corruption to declare their assets. This legislation should clearly identify the assets to be declared which should include assets beneficially owned, and liabilities and interests of high-level officials, establish a mechanism for the publication and verification of submitted declarations, and provide a framework for the application of dissuasive sanctions. Togo would also benefit from establishing clear procedures for the recovery and management of property that has been acquired through illicit activities related to corruption, money laundering, and organized international crime.



Box 1. Governance-Related Legislation

The law on government procurement and contract delegation adopted in 2009 (2009-014).

The law on transparency in public financial management adopted in 2014 (2014-009).

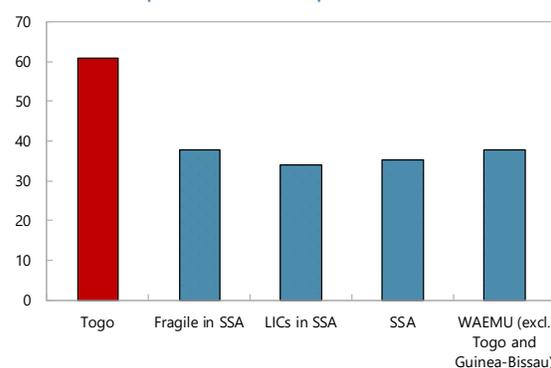
The organic budget law adopted in 2014 (2014-013).

The new Criminal Code (*Code pénale*) adopted in 2015:

- Clarifies (i) the cases of passive corruption (the public official is at the initiative of corruption) or active (the private person is at the initiative of corruption); and (ii) existing offenses considered as corruption.
- Introduces (i) bribery offenses of foreign public officials and international civil servants; (ii) the general offense of bribery in the private sector; (iii) abuse of office as the act of performing or non-performing an action to gain an undue advantage; and (iv) illicit enrichment as the acquisition of property without being able to justify the legal origin of the funds used.
- Defines (i) influence trading as the act of abusing one's real or supposed influence to obtain an undue right; and (ii) the illegal taking of interests as the act of taking or receiving an interest in a transaction that one is responsible for carrying out or monitoring.
- Punishes these acts of corruption severely from 5 to 10 years of criminal imprisonment.

21. Corruption is underreported and often because of fear. According to a 2015 survey, about 85 percent of the respondents in SSA who had been requested to pay a bribe did not report the incident to the authorities—and the main reason was fear of the consequences. On average, 34 percent of the respondents did not report the bribe because of fear of retaliation or other negative consequences and 14 percent (the second-most common reason) believed it was meaningless—nothing would be done anyway. Fear of the consequences of reporting corruption plays an especially large role in Togo (61 percent, Text Figure 10).

Text Figure 10. Corruption not Reported because of Fear of the Consequences, 2015
(percent of respondents)



Source: Afrobarometer (2017b).

22. Anti-corruption legislation is only credible if enforced by effective institutions.⁸ The Togolese government has established several important institutions designed in part to reduce corruption by eliminating opportunities for bribery and fraud (Box 2). The anti-corruption agency HAPLUCIA became operational in 2017 and started investigating the first corruption cases in late 2018 following a corruption awareness campaign launched in September 2018. Existing institutional weaknesses include insufficient follow-up of audits made by IGE, IGF, and ARMP, and lack of systematic follow-up of the reports by the Auditor General (*Cour des Comptes*). The challenge is now to make these institutions fully operational and address fear of retaliation or negative consequences.

⁸ IMF (2016b).

Box 2. Control Organs and Anti-Corruption Agencies

Inspection Générale d'Etat (IGE): The General Inspectorate of the State supports administrative reforms by undertaking administrative and financial controls of the central government, SOEs, companies with public participation, companies receiving financial assistance from the state, the army, and the judicial system.

Inspection Générale des Finances (IGF): The General Inspectorate of Finance exercises control over the operations carried out by financial controllers of public revenue and public expenditure as well as public accountants.

Autorité de Régulation des Marchés Publics (ARMP): The regulator of public procurement.

Direction Nationale du Contrôle des Marchés Publics (DNCMP): Responsible for the control of public procurement procedures and issues non-objection notices on bidding documents.

Cour des Comptes (CC): The Auditor General is responsible for controlling government accounts, supervising the implementation of budgets, and monitoring public entities.

Conseil Supérieur de la Magistrature (CSM): Charged with the appointment, transfer, and dismissal of judges. CSM is chaired by the President of the Supreme Court.

Haute Autorité de Prévention et de Lutte contre la Corruption et les Infractions Assimilées (HAPLUCIA): The anti-corruption agency investigates complaints of corruption and submits cases of alleged corruption to the public prosecutor.

Cellule Nationale de Traitement des Informations Financières (CENTIF): The financial intelligence unit was created in 2009. It receives and analyzes suspicious transaction reports and disseminates financial intelligence to the public prosecutor for investigation and prosecution.

F. Anti-Money Laundering (AML)

23. Reducing illicit financial flows, including the laundering of proceeds of corruption is a challenge for Togo. Togo's porous borders, susceptibility to corruption, and large informal sector create important vulnerabilities to money laundering. In June 2018, the CENTIF launched a national money laundering and terrorism financing assessment which will help authorities gather a comprehensive understanding of threats and vulnerabilities, including with respect to corruption, to better orient their policies and allocate their resources.

24. Strengthening the AML regime would help support Togo's anti-corruption efforts and tackle the laundering of proceeds of corruption. The Financial Action Task Force (FATF), the international standard setter for anti-money laundering and combating the financing of terrorism (AML/CFT), calls for the mobilization of the AML framework to help detect and trace the laundering of proceeds of corruption, and assist in the investigation and prosecution of bribery⁹. Specific elements of the AML/CFT framework are particularly relevant: implementation

⁹ FATF (2013).

of enhanced due diligence requirements for domestic politically-exposed persons (PEPs), including the identification of PEPs that are the beneficial owners behind legal persons, and reporting by financial institutions of transactions when they suspect or have reason to suspect that the funds are the proceeds of criminal activity, including corruption.

25. Togo should ensure the effective implementation of its 2018 AML/CFT law to support its anti-corruption efforts. The new law transposes the uniform WAEMU AML/CFT law into the national legal framework. Togo's AML/CFT regime is scheduled to undergo a mutual evaluation by the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA) next year, so the authorities should address remaining technical deficiencies in their legal and institutional framework and ensure the AML/CFT regime's effectiveness at mitigating risks related to ML and related predicate crimes, including acts of corruption. In particular, Togo should strengthen its due diligence measures on domestic PEPs, including their family members and close associates, and transparency of beneficial ownership structure should be improved to better allow for the identification of PEP. In addition, banking sector AML supervision by the Banking Commission should be bolstered to ensure that preventive AML measures are effectively implemented¹⁰.

Box 3. Perception Indicators Quoted in the Report

Afrobarometer: Produced by a pan-African research network that conducts public attitude surveys on governance, economic conditions, and related issues in more than 35 countries in Africa. It is carried out through a partnership of research institutions based in Benin, Ghana, Kenya, South Africa, and the United States. The surveys are based on a series of face-to-face interviews with a random sample of either 1,200, 1,600 or 2,400 people in each country.

Doing Business Indicators: Produced by the World Bank. The indicators provide perceptions of experts based on laws and regulations.

Trade Facilitation Indicators (TFIs): Produced by the OECD. The indicators provide perceptions of experts based on information of border procedures reported in the TFI database.

Transparency International: An international non-government organization based in Berlin, Germany. It publishes the Corruption Perceptions Index that provides perceptions of business people and country experts of the level of corruption in the public sector within the past two years.

Worldwide Governance Indicators (WGI): Produced by Daniel Kaufmann, Natural Resource Governance Institute and Brookings Institution, and Art Kraay, World Bank Development Research Group. The dataset summarizes the views on the quality of governance provided by many enterprise, citizen and expert survey respondents in over 200 countries. These data are gathered from several survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms. WGI reports margins of error to encourage caution in making comparisons across countries and across time. Caution is also needed as the quality of underlying data can vary across countries and data sources.

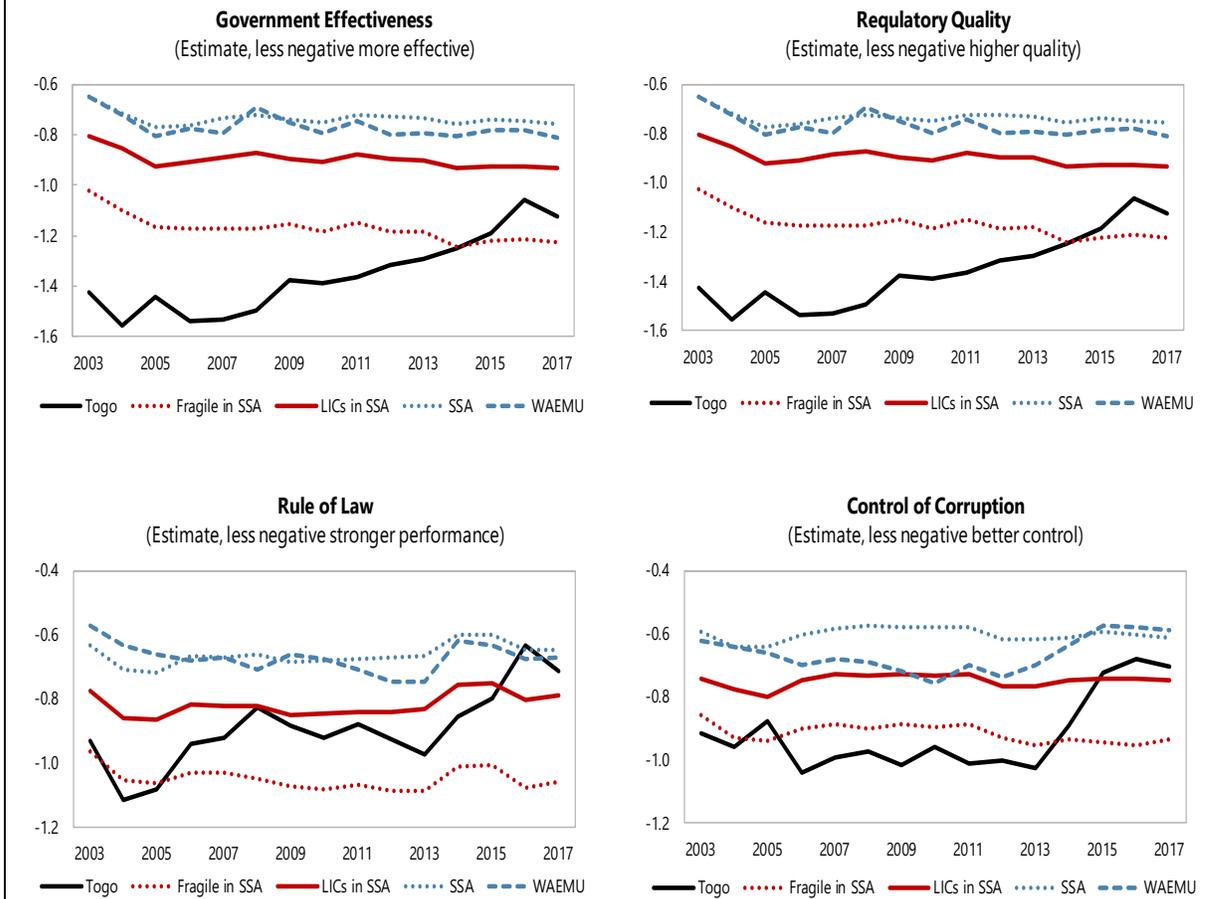
¹⁰ IMF (2019).

G. Summary

26. While improving, Togo's general governance structures seem somewhat weaker than the WAEMU and SSA averages. Against this background, the government has become increasingly engaged in institutional reforms to strengthen governance and institutions. At this time, the authorities would be well advised to focus on:

- *Continuing broad-based fiscal governance reforms.* Publish more transparent fiscal data, deepen revenue reforms and increase the use of risk-based analysis, ensure that public investment projects will be prioritized based on rigorous cost-benefit criteria, strengthen the monitoring of public enterprises, and establish procedures for systematic follow-up of audit reports by the Auditor General (*Cour des Comptes*) and other control organs. Transparent reporting of fiscal data is important because access to information protects results and efficiency and empowers civil society and legislators to be a watchdog with effective oversight of government functions.
- *Strengthening anticorruption measures.* Togo is preparing to adopt an asset declaration legislation for all civil servants who are politically exposed to the risks of corruption. This legislation should aim at meeting international good practices, including on comprehensiveness of disclosed information, its publication and verification. Togo would also benefit from establishing clear procedures for the recovery and management of property that has been acquired through illicit activities as well as strengthening AML tools that support anticorruption measures, such as improving the transparency of legal entities, establishing preventive measures for domestic PEPs and ensuring the implementation through effective supervision.
- *Ensuring a fair and effective execution of existing laws and regulations.* This will require capacity building and avoiding political interference that undermines predictability and effectiveness of the judiciary, anti-corruption institutions, and control organs and impacts negatively on the investment climate. The competition to attract private sector investment is intense and countries with a predictable legal and regulatory environment will be at an advantage when investors decide where to make critical investments.
- *Streamlining border procedures and establishing a more solid regulatory framework for public projects delegated to private-sector providers.* Cost-effective procedures and regulations are always vital and particularly so for a country like Togo, which is aiming for a position as a growing regional transportation hub based on goods shipped through the Port of Lomé.

Figure 1. Governance Indicators



Source: Worldwide Governance Indicators.

Table 1. Togo: PEFA Assessments

Indicator	Togo	Burkina Faso	Cote d'Ivoire	Mali	Niger
	2012-14	2014-16	2014-16	2013-15	2012-14
Budget reliability					
1. Aggregate expenditure outturn	C	D	A	D	D
2. Expenditure composition outturn	D	D	C	D	D
3. Revenue outturn	D	C	B	C	C
Transparency					
4. Budget classification	C	A	C	C	C
5. Budget documentation	C	B	B	B	D
6. Central government operations outside financial reports	D	D	D	D	D
7. Transfers to subnational governments	D	B	C	B	C
8. Performance information for service delivery	D	D	D	C	D
9. Public access to fiscal information	D	D	D	D	D
Asset and liability management					
10. Fiscal risk reporting	D	D	D	D	D
11. Public investment management	D	D	C	C	D
12. Public asset management	D	D	C	D	C
13. Debt management	D	C	B	B	C
Budget strategy and budgeting based on public policies					
14. Macroeconomic and fiscal forecasting	D	B	B	B	D
15. Fiscal strategy	D	D	C	C	D
16. Medium-term perspective in expenditure budgeting	D	B	D	D	D
17. Budget preparation process	D	B	B	B	B
18. Legislative scrutiny of budgets	C	C	C	B	B
Predictability and control of budget execution					
19. Revenue administration	D	C	D	D	D
20. Accounting for revenue	C	D	C	D	D
21. Predictability of in-year resource allocation	D	C	C	B	C
22. Expenditure arrears	D	D	D	C	D
23. Payroll controls	D	D	B	C	D
24. Procurement management	B	D	B	C	B
25. Internal controls on nonsalary expenditure	C	B	B	B	C
26. Internal audit	D	C	D	D	D
Accounting and reporting					
27. Financial data integrity	D	B	D	D	D
28. In-year budget reports	D	D	C	C	D
29. Annual financial reports	C	C	B	D	C
Oversight and external audits					
30. External audit	C	D	D	D	D
31. Legislative scrutiny of audit reports	No score	D	C	D	C

Rating	
	A
	B
	C
	D

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