

February 2008

GOVERNMENT DEBT MANAGEMENT PERFORMANCE REPORT – SÃO TOMÉ E PRÍNCIPE

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1. EXECUTIVE SUMMARY

During February 2-14, 2008 a World Bank team comprised of Per-Olof Jönsson and Frederico Gil Sander traveled to São Tomé e Príncipe to undertake an assessment of the government's debt management capacity and institutions using the Debt Management Performance Assessment Tool (DeMPA).¹ The DeMPA is a methodology for assessing government debt management (DeM) performance through a comprehensive set of indicators spanning the full range of DeM functions.

The mission had meetings with several officials from the Ministry of Planning and Finance (MPF) – in particular, from the Treasury Department, including the Debt Management Office (“Gabinete da Dívida,” GD), as well as the Budget, Planning and Internal Audit departments – and from the Banco Central de São Tomé e Príncipe (Central Bank). Meetings were also held with representatives from the Tribunal de Contas (TC), the autonomous supreme audit institution and with members of the international donor community (see Annex 1 for a full list of individuals and institutions).

The assessment reveals that despite notable progress since the inception of the debt office in 2004, overall São Tomé e Príncipe meets the minimum requirements set out by the DeMPA only in the fields of evaluation of debt management operations and coordination with monetary policy. The Government does not meet the minimum requirements in the other indicators. The gap between existing practices and the minimum requirements is narrow in some areas. Among the areas for improvement where greater effort is required to reach good practices, the mission identified the legal framework and the managerial structures as key priorities in a reform program.

Technical Assistance in Debt Management

The MPF currently benefits from technical assistance from the Commonwealth Secretariat (COMSEC) for the implementation of the CS-DRMS debt management system in the GD and the Central Bank. Debt Relief International (DRI) has provided a number of capacity-building activities including training courses for the staff in debt sustainability analysis (DSA) and related subjects. DRI also organized a seminar for the development of a debt strategy. A World Bank-financed project to develop the legal framework in public financial management as well as an integrated Budget and Treasury information system is

¹ The Debt Management Performance Assessment Tool as well as the accompanying Guide, which provides supplemental information and detailed descriptions of individual indicators can be downloaded from: <http://go.worldbank.org/WU75GZA040>. The report presents the findings of the mission that went to Sao Tome and Principe in February 2008, using the February 5, 2008 version of the DeMPA tool.

currently being implemented. The integrated system has so far been set up with the MPF, but it is expected to be rolled out to the line ministries shortly.

Recently, the Government of Portugal, through its Ministry of Finance, has started a three-year technical assistance program with the MPF. The project covers several activities, including debt management. Specifically, the program provides for on-the-job training of São Tomean staff in the Portuguese debt office, as well as assistance setting up the legal and administrative framework for a treasury bill program.

2. BACKGROUND

2.1 COUNTRY BACKGROUND

Following independence from Portugal in 1975, São Tomé e Príncipe's economy was characterized by state ownership of most enterprises, notably agricultural companies that managed cocoa plantations. In the late 1980s and early 1990s, a decline in the price of cocoa along with the loss of support from socialist countries in Eastern Europe led to a build-up in the country's external indebtedness. A program of privatization and other market-oriented reforms sponsored by the IMF and the World Bank was implemented, but results were mixed and external indebtedness continued to grow, reaching 861 percent of exports at end-1999.

In 2000, São Tomé and Príncipe reached the decision point under the Highly Indebted Poor Countries (HIPC) initiative and began receiving substantial debt relief from its main creditors, notably the World Bank and the African Development Bank. Following successful reforms, notably the creation of the Tribunal de Contas and the centralization of the programming and execution of foreign-financed capital expenditure in the MPF, São Tomé and Príncipe reached the completion point under the HIPC initiative in March 2007 and benefited from 100 percent debt relief from the World Bank, the African Development Bank, the IMF and Paris Club Creditors. At end-2007 São Tomé's debt had been reduced to about 105 percent of exports or 11 percent of GDP.

At present, São Tomé e Príncipe remains heavily dependent on foreign assistance, although long-term prospects may be substantially improved by oil production and the growth of tourism. A debt sustainability analysis (DSA) performed by the World Bank and the IMF points out that the realization of meaningful oil revenues in the future would be critical for debt sustainability – should such revenues not materialize, there would be a high risk of a return to a situation of unsustainable debt.

The World Bank is currently actively involved in two projects in the country, supporting reforms in public finance administration and improvements in social sectors. Following continued progress in public finance administration reforms, a budget support operation is under discussion; however, as at the time of the mission, political difficulties were preventing the presentation of the 2008 budget by the National Assembly. The World Bank has also provided direct assistance

under its public finance reform project for the purchase of the CS-DRMS debt management system and training on using the new software.

The years since 1999 have seen a build-up in capacity in the area of government debt management. The GD was created in 2004, taking over the responsibility for debt management from the Central Bank. The GD currently has with three staff members – a director, a technician and an administrative assistant. As a result of MDRI, the office follows approximately 47 multilateral loans. Most bilateral debt has been cancelled, with some active debt remaining to Angola (other bilateral debt is under negotiation, such as that to Portugal).

Domestic debt is largely absent, except for some old loans made by the Central Bank's precursor to agricultural companies; these loans were kept in the government's (specifically the Treasury's) books at the time of privatization of the companies. The form of domestic credit normally used by the Treasury for cash management purposes are advances from the Central Bank that are nearly always fully repaid by the end of the fiscal year.

2.2 ASSESSMENT AND SCORING METHODOLOGY

The DeMPA comprises a set of 15 debt management performance indicators (DPIs), which aim to cover the full spectrum of government debt management (DeM) operations as well as the overall environment in which these operations are conducted. While the DeMPA does not specify recommendations on reforms and/or capacity and institution building needs, the performance indicators do stipulate a minimum level that should be met under all conditions. Consequently, if the assessment shows that the minimum requirements are not met, this will clearly indicate an area requiring reform and/or capacity building.

The scope of the DeMPA is central government debt management activities and closely related functions such as issuance of loan guarantees, on-lending, and cash flow forecasting and cash balance management. Thus, the DeMPA does not assess the ability to manage the wider public debt, including implicit contingent liabilities (such as liabilities of the pension system, losses of state-owned enterprises, etc.), as well as debt of state-owned enterprises if these are not guaranteed by the central government.

The DPIs have one or more dimensions linked to the subject of the DPI. Each of these dimensions is assessed separately. An aggregate score of each indicator is then based on the assessments for the individual dimensions of the indicator. For DPIs that have two or more dimensions, an aggregate score is determined by averaging the scores for individual dimensions of an indicator.

The scoring methodology assesses each dimension and assigns a score of either A, B or C based on the criteria listed. A score of C indicates that a minimum requirement for that dimension has been met. A minimum requirement is the necessary condition for effective performance under the particular dimension being measured. If the minimum requirements set out in C are not met, then a D score is assigned. In the cases where a dimension cannot be assessed, a "N/R" (not rated or assessed) score is assigned. The A score reflects sound practice for

that particular dimension of the indicator. The B score is an in-between score lying between the minimum requirements and sound practice.

3. PERFORMANCE ASSESSMENT

SUMMARY OF PERFORMANCE INDICATOR ASSESSMENT

Performance Indicators		Score
Governance and Strategy Development		
DPI-1	Legal framework	D
DPI-2	Managerial structure	D
DPI -3	Debt management strategy	D
DPI -4	Evaluation of debt management operations	C
DPI -5	Audit	D
Coordination with Macroeconomic Policies		
DPI -6	Coordination with fiscal policy	D
DPI -7	Coordination with monetary policy	C
Borrowing and Related Financing Activities		
DPI -8	Domestic Borrowing	N/R
DPI -9	External Borrowing	D
DPI -10	Loan guarantees, on-lending and derivatives	N/R
Cash Flow Forecasting and Cash Balance Management		
DPI -11	Cash flow forecasting and cash balance management	D+
Operational Risk Management		
DPI -12	Debt administration and data security	D
DPI -13	Segregation of duties, staff capacity and business continuity	D
Debt Records and Reporting		
DPI -14	Debt records	D
DPI -15	Debt reporting	D+

3.1 GOVERNANCE AND STRATEGY DEVELOPMENT

DPI-1 Legal Framework

Dimension	Score
1. The existence, coverage and content of the legal framework	D

The legal framework for public finance management has recently been reformed as part of a World Bank-sponsored project – the Public Finance Management System (known by its Portuguese acronym “SAFE”). The new legislation authorizes the Government to finance the budget deficit by undertaking credit operations, including contracting bank credits in an amount up to ten percent of the previous years’ revenues. It is not clear whether this ceiling applies to all deficit-related borrowing or only to bank loans, but in practice the authorities interpret it as a limit on advances from the Central Bank.

The SAFE law also provides that an opinion of the Minister of Planning and Finance is required for all external borrowings². In addition, the yearly budget for 2007 authorizes the Government, through the Minister of Planning and Finance, to undertake concessional external borrowing and also to utilize Central Bank advances provided these advances are paid back before the end of the year. In practice, however, the minister normally seeks explicit approval from the Council of Ministers and the Parliament for external borrowings.

The SAFE law also states that public entities (such as agencies or municipalities) may borrow only in the domestic market, and subject to approval by the Minister of Planning and Finance. State-owned enterprises may borrow externally, but also require approval by the Minister of Planning and Finance. An additional piece of legislation states that all loans (domestic and external) to public enterprises require an explicit government guarantee, which should be signed by the Minister of Planning and Finance.³

Secondary legislation includes decrees creating a Public External Debt Committee and the *Gabinete da Dívida Pública* (GD). The Debt Committee has not been operational, whereas the GD has been operational as a unit under the Treasury since 2004. According to the decree that creates it, the GD is responsible for debt management broadly speaking, working (in principle) under the supervision and guidance of the Debt Committee, while retaining some front office activities such as the coordination with creditors and the provision of inputs

² The law refers to all contracts signed with foreign parties and therefore applies to foreign loan contracts in particular.

³ The law in question deals with the operation of public enterprises and dates to 1979.

in the negotiation of new loans. In practice, however, the GD performs primarily back-office functions.

The borrowing mandate to the Government under the SAFE legislation is not well formulated, creating uncertainties on how it should be interpreted. What appears to be the central piece of the borrowing authorization, namely the critical explicit delegation of borrowing authority to the Minister of Planning and Finance, is provided in the yearly budget, which generates further uncertainties in case the budget is not approved in due time, as is the case for 2008. In addition, the regulation of loan guarantees is not clear or comprehensive, since it only deals with guarantees to state owned enterprises (there was no evidence of either a framework or an explicit prohibition for the issuance of government guarantees for the borrowings of domestic entities in the domestic markets, or of government guarantees for the external or domestic borrowings of private companies). Moreover, despite the existence of borrowing mandates in different forms, in the past there have been examples of borrowing conducted directly by the Prime Minister without prior approval of the Minister of Planning and Finance, or of additional layers of approval of loans signed by the Minister of Planning and Finance. In conclusion, neither primary nor secondary legislation provide sufficiently strong borrowing mandates, and hence the legal framework for debt management in São Tomé e Príncipe does not meet the minimum requirements.

DPI-2 Managerial Structure

Dimension	Score
1. The managerial structure for central government borrowings and debt-related transactions	D
2. The managerial structure for preparation and issuance of central government loan guarantees	N/R
Overall Score	D

Although external borrowings formally require approval of the Minister of Planning and Finance, negotiations of new foreign credits may be led by a number of different government entities, including the MPF, line ministries, the Prime Minister, and the Minister of Foreign Affairs and External Cooperation (“MFAEC”). Coordination between these different entities is often lacking, especially with regard to planning and information on loan disbursements. Most external loans are earmarked for specific projects, although recent improvements in the public finance administration have led some donors (notably the World Bank) to begin negotiations for direct budget support. Domestic borrowing consists essentially of advances from the Central Bank.

Projects are initiated by the line ministries with support from the Planning Department in the MPF. Where financing is expected to be realized in the form of grants, negotiations may be undertaken by the MPF, line ministries or the MFACE –the latter takes the lead on negotiations with most bilateral donors. In 2007, an office of coordination of external assistance (“Gabinete de

Coordenação de Assistências Externas”) was created under joint tutelage of the MPF and MFACE to coordinate the mobilization of external grant financing. In cases where the financing takes the form of loans, the contacts with the donors are initiated by the Planning department or directly by the Minister’s own staff or through a combined action. The GD is generally involved in the end of the phase, verifying whether the concessionality requirements and other debt objectives have been met. After initial agreement with the donors, the loan agreement is presented to the Council of Minister’s. After approval, the Minister signs the agreement, which is then sent to the Parliament for final approval. The President also has to ratify the Parliamentary resolution approving the borrowing. Finally, as required by many donors, the Attorney General provides a legal opinion on the process.

Requests for disbursements are normally initiated by the project implementation unit. The Budget Director signs the requests and the GD is normally notified about the request. Often the proceeds go into bank accounts in commercial banks managed directly by the project implementation unit. In some cases the disbursements will be deposited directly into the bank account of the supplier overseas, as in the case of foreign consultants. The GD will only be informed by the creditor sending payment information to the MPF or the Treasury, which ultimately will reach the GD. This implies that most of the reconciliation done by the GD is between creditor records (payment advices and disbursement notices).

The Treasury is directly responsible for the existing domestic borrowing, i.e. advances from the Central Bank. The Treasury requests advances from the Central Bank once or twice a year, when it is regarded necessary for the execution of the budget. The advances are expected to be paid back before the end of the year. In one occasion the advances were not repaid by the end of the fiscal year and were converted into a credit from the Central Bank; this credit was repaid as soon as oil bonus proceeds entered the Treasury’s account. Currently, there are no longer-dated credits from the Central Bank outstanding and up to the beginning of February there were no advances either. The GD is not involved and information is not normally shared.

Thus, debt management activities are undertaken by several entities and the coordination is weak in many aspects, notably disbursements on external borrowings, domestic borrowing, and information on planned external borrowing. The minimum rating requirement is therefore not met for this dimension.

There are two outstanding loan guarantees, both to state-owned water and electricity utility EmAE, only one issued in the past fiscal year. These guarantees were signed by the Director of the Treasury, who has an express delegation from the Minister of Finance (who is formally required to issue the guarantees

according to the law mentioned in footnote 3). Because preparation and issuance of guarantees could not be regarded an on-going activity, this dimension is not rated.⁴

DPI-3 Debt Management Strategy

Dimension	Score
1. The quality of the debt management strategy document	D
2. The decision-making process, updating and publication of the debt management strategy	N/R
Overall Score	D

Borrowing operations are undertaken within a loose guiding framework indicating to some extent how borrowings should be conducted. Most notably, the government is committed to borrowing only on concessional terms. The most recent published annual report of the GD does provide broad guidelines for a debt management strategy, e.g. that concessionality should be achieved and a target level has been established. However, the core of the guidelines referred to reaching the HIPC completion point, and new guidelines have not been established since that objective was achieved in March 2007. The guiding principles are to a certain degree based on a strategy paper prepared during a workshop sponsored by Debt Relief International (DRI). Although the annual report mentions that the strategy (as outlined in this document) has been approved, it is not operational in practice and its formal status is unclear.

Even if certain elements of a strategy exist, they are not sufficient for meeting the minimum requirement for this dimension as the debt management objectives are not clearly spelled out and no specific steps are suggested for achieving the concessionality targets mentioned. Moreover, although the strategy paper was prepared with inputs from the Central Bank, the MPF, MFAEC, as well as the social sectors, the paper does not constitute a debt strategy in practice and therefore the second dimension could not be assessed.

⁴ There was considerable uncertainty as to whether this dimension should be rated, since there are guarantees outstanding, one of which was issued in the past year. Moreover, new borrowings from public enterprises would be expected in the future, and they would require guarantees issued by the Minister of Planning and Finance. However, on balance, the team decided that the extremely small volume of such guarantees in the past (less than one per year over the past five years) meant that this was not an on-going activity and as such should not be rated in parallel to the external borrowing activities. (Subsequent guidance on this dimension is that even if a single guarantee is issued then the dimension should be scored).

DPI-4 Evaluation of Debt Management Operations

Dimension	Score
1. Level of disclosure in an annual report or equivalent of government DeM activities, central government debt, evaluation of outcomes against stated objective and compliance with the government's debt management strategy	C

The GD produces an annual report covering external debt activities and outstanding debt with breakdowns by creditors, currency composition etc. The report is submitted to the Minister of Finance. In addition, the Treasury in its report that accompanies the Table of Financial Operations of the State ("TOFE") also shortly describes the advances from the Central Bank that make up domestic borrowing. Thus, the minimum requirement for this indicator is met.

Nevertheless, the report does not include a detailed assessment of how the activities meet the stated objectives and/or have complied with the debt management strategy, but it does contain a concluding chapter with recommendations for improving the efficacy of its activities. With the preparation of an appropriate debt strategy, a more thorough evaluation of operations against such strategy could bring the existing report closer to international sound practice.

DPI-5 Audit

Dimension	Score
1. Frequency of internal and external audit of central government debt management activities, policies and operations, and publication of external audit reports.	D
2. Degree of commitment to address the outcomes from internal and external audits	N/R
Overall Score	D

The Tribunal de Contas is the supreme audit institution in São Tomé e Príncipe and is a member of INTOSAI (International Organization of Supreme Audit Institutions). It is part of the judiciary branch of government and hence not subordinate to the Parliament or the Government. The work of the TC auditors is guided by an annual plan of activities decided by the President of the Tribunal. According to the proposed plan for 2008 the Tribunal will conduct an audit of debt policies of the Government. The auditors have been trained in performance auditing and the office's mandate allows it to hire external consultants in areas outside their core expertise.

The minimum requirements for this indicator have not been met because the TC has not made any audit of DeM policies or operations since it was established in 2003, nor were the debt management activities audited before 2003, when the

Supreme Court was responsible for the auditing of Government operations (though only on an *a priori* basis).⁵

There is also an internal audit function in the Ministry of Finance mainly looking into the delivery of public services, revenue collection and state-owned enterprises. The work of the internal audit is guided by a plan approved by the Minister of Planning and Finance. The internal auditor has not conducted any audit of DeM activities and has no plans to do one either.

Since the minimum requirements for the first indicator have not been met, the degree of commitment to follow the recommendations by the auditors cannot be assessed.

3.2 COORDINATION WITH MACROECONOMIC POLICIES

DPI-6 Coordination with Fiscal Policy

Dimension	Score
1. Coordination with fiscal policy through the provision of accurate and timely forecasts on total debt and debt service under different scenarios.	D
2. Availability of a fiscal strategy and/or an analysis of debt sustainability, and the frequency with which these are undertaken	D
Overall Score	D

As part of the yearly budget preparation the GD presents forecasts on debt service to the Budget department with details of the payments both in domestic and in foreign currency. The GD does not provide any kind of sensitivity analysis, although the provided information would allow the Budget department to undertake some of this analysis itself; this, however, is not done. The information from the GD does not include any debt stock forecasts. Thus, under DeMPA guidelines, the minimum requirements for the first indicator are not met⁶.

The Government has not produced any kind of fiscal strategy document covering the medium to long term fiscal perspective, though medium-term macroeconomic scenarios are prepared jointly with the IMF during semi-annual missions; these scenarios are not normally shared with the GD or another Government entity that would use them for a fiscal or debt sustainability analysis. The IMF and the World Bank have undertaken debt sustainability analyses with

⁵ The Central Bank was the main debt management agent prior to 2003.

⁶ These were the requirements in the February 5, 2008 version of the DeMPA tool which have been revised subsequently.

the assistance of the authorities, and Central Bank and GD staff members have been trained on debt sustainability analysis both using the DebtPro application as well as the joint World Bank-IMF- Debt Sustainability framework. However, due to the lack of resources (primarily, staff) and coordination with government entities that prepare macroeconomic forecasts, no DSAs have been prepared by the government. Thus, the minimum requirements for this indicator have not been met.

DPI-7 Coordination with Monetary Policy

Dimension	Score
1. Coordination with monetary policy implementation through information sharing on debt transactions and government's current and future cash flows	C
2. Extent of a limit to direct access of resources from the Central Bank	C
Overall Score	C

The Government does not raise any domestic funds other than those provided on a strictly temporary basis by the Central Bank at specific points in time (i.e. the advances do not work on the basis of a revolving credit line but rather as discrete advances). Given these exceptions, the Treasury account must at all times be balanced or have a surplus. Government cash flows in local currency nevertheless influence banking sector liquidity and should require monetary operations conducted on the basis of government cash flow forecasts. Some cash flow forecasting is conducted by the Treasury and the Budget department but the forecasts are not regularly updated. Coordination meetings with the Central Bank focusing on government cash flows are only held when new cash flow forecasts have been made at the time of IMF missions, which usually happens twice a year, and when meetings are necessary for other reasons, such as when the ceiling on central bank borrowing is close to being reached.

Currently, the Central Bank relies solely on foreign exchange auctions for its monetary policy operations. In an environment where the Government is borrowing externally to finance domestic expenditures, the Central Bank can sterilize the liquidity effect of the Government external borrowing by selling the foreign exchange the Central Bank receives from the Government. Apparently, this instrument has not been fully successful in achieving the desired results since the inflation is increasing and approaching 30%⁷. The high inflation suggests that the Central Bank may benefit from complementary instruments for conducting its

⁷ This was the situation at the time of the mission.

monetary policy. The Central Bank has previously issued certificates of deposit but the program was cancelled, being regarded as too expensive. The Central Bank is therefore recommending the Government to start issuing T Bills with 3 and 6 months maturities.

Irrespective of the result of plans to issue T Bills, in the short- and medium-terms the Central Bank will continue to rely on foreign exchange auctions as its main monetary policy instrument. Essential for this policy is information about Government foreign exchange transactions, i.e. new borrowing and debt servicing of external loans. The Central Bank receives the information it needs regarding debt service, and also closely participates in discussions of other parts of the Government foreign exchange budget (the expected inflows and outflows of foreign exchange). Thus, the minimum requirements for the first dimension are met.

The minimum requirements for the second dimension are also met given that the 10% borrowing limit imposed by the SAFE legislation is interpreted as a limit on Central Bank advances. While the text of the law is not entirely clear, both the Treasury and the Central Bank reported that they interpret the provision in the SAFE law as a ceiling, and they separately verify and enforce it. While the yearly budget specifies that such advances must be repaid within a period of time (by the end of the current fiscal year), this period is potentially longer than that required for a “B” rating in this dimension.

3.3 BORROWING AND RELATED FINANCING ACTIVITIES

DPI-8 Domestic Borrowing

Dimension	Score
1. The extent to which market-based mechanisms are used to issue debt, the publication of a borrowing plan for T-bills and T-bonds, and the preparation of an annual plan for aggregate amount of local currency borrowing in the domestic market divided between the wholesale and retail markets.	N/R
2. The availability and quality of documented procedures for local currency borrowing in the domestic market	N/R
Overall Score	N/R

The Government is not presently undertaking any domestic borrowing with the exception of the Central Bank advances discussed earlier. Thus, no market based funding is taking place and neither dimension under this DPI can be meaningfully rated.

Developing and maintaining a well functioning domestic securities market is normally seen as an important debt management activity since it allows matching liabilities with government domestic revenue sources. A well

developed government securities market is often also a prerequisite for the development of other parts of the financial markets. However, the development of a government securities market is also associated with costs for the financial infrastructure as well as costs for staff managing the transactions. In small countries these costs could be substantial compared with the expected volumes of transactions carried out. Therefore, before the Government takes a decision to start issuing Treasury Bills a careful analysis has to be undertaken. The consequences for the Central Bank in terms of options for conducting a prudent monetary policy should also be considered in this regard.

DPI-9 External Borrowing

Dimension	Score
1. Degree of assessment of the most beneficial/cost effective borrowing terms and conditions (lender or source of funds, currency, interest rate and maturity).	D
2. Availability and quality of documented procedures for borrowing in foreign markets.	D
3. Availability and degree of involvement of legal advisors	D
Overall Score	D

Central government borrowing is in many countries focused on achieving the required funding at the most favorable cost and risk combination. For the Government of São Tomé e Príncipe the focus is different. Due to the absence of a medium term budgetary framework putting a ceiling on expenditures, external borrowing in São Tomé e Príncipe is mostly a matter of attracting as much concessional funds as possible. Given this perspective, the first dimension is interpreted as the efficiency and documentation of the process of identifying donors willing to provide concessional credits and grants to the Government. The Government does generally follow this approach and officials in different areas can elaborate on potential donors and in which areas these donors are interested to provide support. However, these efforts and knowledge are not documented and extremely fragmented, very likely at substantial efficiency costs. Many Government entities are involved in the process of mobilizing funds. Line ministries, the MFAEC, the Planning department and direct staff of the Minister of Finance are all involved in donor relationships, creating a fragmented organization when instead there should be clearly dedicated staff assigned with the critical task of maximizing the volumes and concessionality of external financing. Given the absence of documented assessment of the most beneficial way to obtain external financing, the minimum requirement for the first dimension is not met.

There are no specific documented procedures for external borrowing except from what is given in the legislation or the guidelines for the operation of the Debt Committee, which has never been operational. The dimension is oriented

towards more specific procedures and these are not documented at all. Thus, the minimum requirements for the second dimension are not met.

Legal advisers are not involved in the negotiating process at all.⁸ Thus, the minimum requirements for this dimension are not met.

DPI-10 Loan Guarantees, On-lending and Debt-related Transactions

Dimension	Score
1. Availability and quality of documented policies and procedures for approval and issuance of central government loan guarantees.	N/R
2. Availability and quality of documented policies and procedures for on-lending of borrowed funds	N/R
3. Availability of a debt management system with functionalities for handling derivatives, and availability and quality of documented procedures for the use of derivatives.	N/R
Overall Score	N/R

While loan guarantees and on-lending activities exist, the Government has not used them to a meaningful extent. As mentioned above there are two outstanding loan guarantees, both to EmAE, the state-owned water and electricity company. The first loan, for EUR1 million, was contracted over two years ago and is currently in repayment. The second guarantee, for a EUR 250 thousand loan, was approved in 2007. As argued in DPI-2, the issuance of guarantees cannot be considered an on-going activity, which creates uncertainty as to the appropriateness of rating this DPI as well. Therefore, although there are no documented procedures or guidelines for the approval and issuance of government loan guarantees (other than the requirement as originally set out in the 1979 law), to be consistent with DPI-2 this dimension is also not rated⁹. Nevertheless, given that public enterprises are expected to continue to borrow in the future (and thus require government guarantees), the development of such procedures should be an objective for the government.

On-lending arrangements are even rarer than guarantees. The examples given by the authorities are restricted to two cases: on-lending of AfDB funds to the now-privatized telecom company, and on-lending to the Water and Electricity

⁸ As mentioned earlier, some donors request an opinion by the attorney general before loans are made effective. However, this opinion only pertains to the internal procedures and does not consider the contract itself.

⁹ Subsequent guidance on this dimension is that even if a single guarantee is issued then the dimension should be scored.

Company; in both cases the transactions have not been conducted lately. Given the absence of either an on-going activity or any legal provisions for on-lending, this dimension cannot be rated.

The Government has not conducted any derivative transactions; therefore this dimension cannot be rated.

3.4 CASH FLOW FORECASTING AND CASH BALANCE MANAGEMENT

DPI-11 Cash Flow Forecasting and Cash Balance Management

Dimension	Score
1. Effectiveness of forecasting the aggregate level of cash balances in government bank accounts.	D
2. Effectiveness of managing the aggregate cash balance in government bank account(s), including the integration with the domestic debt borrowing program.	D
3. Where the Principal DeM Entity or the DeM entities operate their own bank accounts, the frequency of reconciliation of these bank accounts	C
Overall Score	D+

The Treasury is responsible for budget execution and cash management, i.e. ensuring that sufficient funds are available in the Treasury Single Account in the Central Bank.¹⁰ The Central Bank provides advances (which may be better characterized as short-term credits) into this account, with interest rate following the reference rate (currently 28%), after request by Treasury, and within the 10 % limit of previous year's revenues. Thus, the credit is not in the form of an automatic revolving credit line facility linked to the Treasury account; rather, the Treasury has to maintain a non-negative balance on the account. The Treasury does not earn any interest on any surplus in its account. Without a flexible source of financing for temporary cash shortages, the Treasury accumulates arrears when short of cash and repays the arrears when revenues have been collected (or when the Central Bank makes its advances).

The Central Bank provides daily statements on the Treasury account to the Treasury. A weekly statement also includes the balance on the account. Cash flow forecasts are produced in cooperation with the Budget department but only on a monthly basis and not updated very frequently

¹⁰ A treasury single account is required by the SAFE law. Although at present there is a main treasury account in domestic currency (and in particular, debt service payments are funded from this account), the single account has not yet been fully implemented.

Thus, since the forecasts are only on a monthly basis, which cannot be considered sufficient for cash management purposes and since the Treasury is not getting any market interest rate on surplus on the Treasury account, the minimum requirements for dimensions 1 and 2 are not met.

Like other budget expenditures, interest payments and principal amortizations on Government debt are debited to the Treasury Account (after conversion by the Central Bank from local currency). The Treasury verifies and confirms on a daily basis that payment orders sent to the Central Bank have been paid accordingly by checking the bank statement with the payment orders. Reconciliation with government’s overall financial accounts is undertaken on a monthly basis. Thus, for this dimension the minimum requirements are met.

3.5 OPERATIONAL RISK MANAGEMENT

DPI-12 Debt Administration and Data Security

Dimension	Score
1. Availability and quality of documented procedures for the processing of debt service	D
2. Availability and quality of documented procedures for debt data recording and validation, and storing of agreements and debt administration records	D
3. Availability and quality of documented procedures for controlling access to the central government debt recording/management system and payment system	D
4. Frequency and off-site, secure storage of debt recording/management system back-ups	D
Overall Score	D

The analyst in the GD prepares provisional payment orders for debt servicing in advance, based on the information in the debt database. Comparisons are made with the payment advices sent by the creditors and if the differences are “small” the payment advices are accepted and the payment orders modified. The payment advices are normally addressed to the MPF or the Treasury but ultimately they reach the GD, sometimes with substantial delay. The payment order together with supporting documents, advice and extracts from the system, is signed by the technician, the head of the GD and the head of Treasury. It is also checked by the Budget. Treasury sends the payment order, without supporting documents, to the Central Bank for payment, but first after checking that there are sufficient funds available on the Treasury account in local currency allowing the Central Bank to debit the account after currency conversion. Thus, payments are not always executed on due date. The Central Bank adds bank account information to the payment order and executes the

payment through SWIFT. The Central Bank sends verification back to Treasury and GD.

The payment procedures do not meet the minimum requirements since a) they are not documented and b) payments are not always made on due date. The part of the process that consists of verifying payment advices with internal records is also weak due to the nature of the database, currently still on an Excel file, and the lack of duality when checking with the system.

Debt data are recorded in an Excel spreadsheet in the format used as an input for DebtPro, a program used not for debt recording but for DSA and other types of analysis. The government has installed CS-DRMS to manage the debt database. However, technical issues with the CS-DRMS system (namely compatibility issues with the version of Oracle that had been in use when the database was originally installed) have prevented full implementation to date, and the database recorded in Excel spreadsheets was still in active use at the time of the mission.

Data are entered into the system from the loan agreement, disbursements and payment advices. Information on actual disbursements is sent to the GD by the creditors and compared with the request but the disbursement is difficult to reconcile since it is usually deposited in accounts of the projects and in some cases directly into the bank account of the supplier. The normal procedure is to enter the disbursements into the system following receipt of the information from the creditor. The debt data is constantly validated against payment advices and once a year (usually the first quarter) an overall reconciliation with creditor information is also conducted.

All loan and payment documentation are stored in excellent order in the GD. However, the security is weak. The GD is located in a building without any reception or guards and the documentation is not stored in a secure and fireproof filing cabinet.

The debt data recording procedures do not meet the minimum requirements since a) they are not documented, b) data entries are not separately checked and c) the documentation is not stored in a secure and fireproof location.

The Excel database is located on the technician's hard drive with limited specific security measures (other than those of access to the workstation) and the office itself is not well protected. Only the analyst himself uses the system except when he is away, in which case a backup staff from Treasury conducts the operations. Thus, there are essentially no procedures for controlling access to the debt management system and there is no documentation. The minimum requirements are not met for this dimension

The debt data are backed-up once a month. The back-ups are not stored in a separate secure and fireproof location. Thus, the minimum requirements are not met.

DPI-13 Segregation of Duties, Staff Capacity and Business Continuity

Dimension	Score
1. Segregation of duties for some key functions, and the presence of a risk monitoring and compliance function	D
2. Staff capacity and human resource management	D
3. Presence of an operational risk management plan including business continuity and disaster recovery arrangements	D
Overall Score	D

The staff involved in negotiating and contracting debt is clearly separated from the staff responsible for recording and payment of debt transactions. However, there is no separation between the staff doing debt recording and arranging payments, which implies a "D" rating in the first dimension of this DPI. There is no staff separately checking the data entries and there is no person responsible for risk monitoring and compliance. The head of GD does check documents sent to the Treasury, but she refers to the head of Treasury as ultimately responsible in compliance matters also for the operations of the GD since it is organized under Treasury. This is not regarded as meeting the minimum requirements for risk monitoring and compliance. For the dimension as a whole, the Government is not meeting the minimum requirements either.

The GD has a head of the unit, called coordinator, an analyst, who works mainly with debt recording and forecasts, as well as the preparation of payment orders. In addition there is an assistant. The number of staff is not sufficient for the operations. There must be enough staff in order to make meaningful controls possible. The head of the unit could of course assume part of these controlling tasks but that would on the other hand create problems if she would be more involved in the negotiating and contracting process. There are job descriptions for the staff in the decree establishing the GD. However, these job descriptions are not reviewed and updated periodically. Thus, the minimum requirements for the second dimension are not met.

The GD has no business continuity or disaster recovery plan which is a minimum requirement for the third dimension.

3.6 DEBT RECORDS AND REPORTING

DPI-14 Debt Records

Dimension	Score
1. Completeness and timeliness of central government debt records	D
2. Completeness and up-to-date records of all holders of government securities in a secure registry system	N/R
Overall Score	D

The GD has a complete set of records for the external debt but it can take up to six months to receive information from the creditors about disbursements, which prevents the GD from having accurate debt stock figures within a reasonable time frame. Due to the time delays for the external debt disbursements the debt records will be provisional for a substantial time and longer than what is required to meet the minimum requirements.

Due to a lack of coordination with the entities responsible for disbursements (notably the project implementation units), the GD does not reconcile stocks reported by creditors with information reported from the beneficiaries of the disbursements; rather, the GD compares the information it receives on creditor statements with creditor disbursement reports, which by definition cannot be regarded as a reconciliation.

Records on domestic debt, guarantee and on-lending contracts reside at the Treasury, although the GD is mandated to follow domestic as well as external debt. The Government has not issued any securities. Thus, there is no registry system to assess according to the second dimension.

DPI-15 Debt Reporting

Dimension	Score
1. Meeting statutory and contractual reporting requirements of central government debt to all domestic and external entities	C
2. Meeting statutory and contractual reporting requirements for total non-financial public sector debt and loan guarantees to all domestic and external entities	N/R
3. Quality and timeliness of the publication of a debt statistical bulletin or equivalent covering central government debt	D
Overall Score	D+

The GD is aware of reporting requirements to the World Bank's debt reporting system and to the IMF. No other statutory and contractual reporting requirements, including to the Parliament were reported to the mission. The Government fulfills its reporting requirement to World Bank and the IMF on central

government domestic and external debt, thus, the minimum requirements for dimension 1 are met.

The World Bank and IMF reporting requirements do not cover the non-financial public sector debt or loan guarantees and the Government therefore does not provide this information and the second dimension cannot be assessed.

Regarding a statistical bulletin or equivalent, the GD prepares an annual report with details of Government external debt and the Central Bank prepares quarterly and annual reports that also cover key Government debt information. However, neither the GD nor the Central Bank reports fully qualifies for the requirement of a Debt Statistical Bulletin since they present no debt ratios. Thus, the minimum requirements for dimension 3 are not met.

4. CONCLUSIONS AND NEXT STEPS

Although this report identifies substantial weaknesses in debt management in São Tomé e Príncipe, it is important to place the evolution of debt management capacity in context – notably, the debt department has been in place for less than four years, and within that time much of its efforts were necessarily directed towards reaching the completion point under the HIPC initiative. This required maintaining an accurate and complete debt database – work in this area is evident by the state of organization of existing loan contracts – as well as in the system for the processing and forecasting of debt service payments, which was essential to avoid the re-accumulation of external arrears.

Following the HIPC completion point, there is an opportunity for the debt office to take essential steps in the improvement of the legal and institutional framework surrounding debt management. However, the reduction in debt stocks could also bring the risk that debt management might not be viewed as a priority. This risk appears relatively limited, however, as the authorities have shown great sensitivity to the need to continue to improve capacity in debt management, and to place debt management among the pillars of the country's development strategy.

In practical terms, the authorities are currently analyzing the options for improving the legal and institutional framework. In the context of the legal framework, assistance from the Portuguese Ministry of Finance could be very useful. Moreover, support from the World Bank and other partners in the context of broader public finance administration reforms could also be critical in assisting the authorities' efforts to arrive at an appropriate legal framework.

Attention should also be given to the institutional framework. While the creation of the office of coordination of external assistance could be seen as a step in the right direction, the team believes the separation between mobilization of grants and loans in different offices (under the auspices of different ministries) may not be ideal; rather, the coordination of all financing, whether in the form of grants or loans, should be centralized to allow the government to prepare a long-term development strategy where the financing needs are matched with information on all potential sources of financing.

Efficiency gains could derive from a closer working relationship between the MPF and staff from the donors. This would allow the MPF to acquire a thorough understanding of donor's policies and operations. MPF staff should also closely monitor the overall donor activity in the region. One possibility would be for the GD to be delegated the task and resources to function as a front office for the MPF vis-à-vis donors for concessional credits and also for grants (especially since some key creditors – notably the World Bank and the African Development Bank – also provide grants). Thereby, the required information on donors could be most easily collected and analyzed so it could be used by the Planning department for designing and presentation of projects to the donors.

Annex 1 – List of Meetings

S. E. Arlindo Afonso de Carvalho, Minister of Planning and Finance

Sra. Ana Maria da Conceição Silveira, Director of the Treasury

Sr. Américo d'Oliveira Ramos, Director of the Budget

Sr. Manuel Filipe Moniz, Director of Planning

Sra. Maria dos Santos Lima da Costa Tebus Torres, Coordinator of the Debt Office

Sr. Carlos Alberto Costa, Debt Office Technician

Sra. Angela Viegas Santiago, Coordinator of the Technical Assistance Project in the area of Governance and Public Finance Administration

Sr. Luis Fernando Moreira de Sousa, Central Bank Administrator

Sr. Calixto Moniz, Central Bank of Sao Tome and Principe

Sr. José António Monte Cristo, Associate Justice, Auditor General's Office

Sr. Raul Viana, Internal Auditor of the MPF

Sr. Luis Saramago, Advisor, Portuguese Ministry of Finance