

**AFRICAN DEVELOPMENT BANK**



**AFRICAN DEVELOPMENT FUND**



**SAO TOME & PRINCIPE – EXTENSION OF THE INTERIM  
PERIOD WITHIN THE ENHANCED HIPCI FRAMEWORK \***

**INFORMATION NOTE ON THE EXTENSION  
OF THE INTERIM PERIOD  
IN FAVOR OF SAO TOME & PRINCIPE WITHIN  
THE ENHANCED HIPCI FRAMEWORK**

**I. INTRODUCTION**

1.1 This document is an information note to the Boards of Directors of the African Development Bank Group on the extension of the interim debt relief period granted to Sao Tome & Principe (STP) with effect from 1 January 2007, within the HIPC Initiative. It is based on the 29 June 2005 Board resolutions on the provision for extending debt relief to country beneficiaries under the initiative<sup>1</sup>.

1.2 The second section of this document summarizes recent political and socio-economic developments in STP. The third section discusses the extension of the country's interim relief period and the financing modalities. The fourth section presents the conclusions of the information note.

**II. RECENTS POLITICAL AND SOCIO-ECONOMIC DEVELOPMENTS**

2.1 The Results-Based Country Strategy Paper on STP approved by the Boards of Directors on 19 October 2005 offers a broad insight into recent political and socio-economic developments<sup>2</sup>. This section will sum up the country's recent socio-political and economic high points.

2.2 **Political Context:** from independence in 1975 to 1991, Sao Tome & Principe was a one-party socialist State. Economic liberalization and multi-party politics were introduced in 1987 and 1991, respectively, following political agitations and frequent change of government. The Government has been reshuffled four times since 2004 (March and September 2004, June 2005 and more recently April 2006 following the legislative elections). The re-election of the President in July 2006 offers prospects for enhanced political stability, having put an end to the recurrent tension of recent years.

2.3 **Social Context:** the population is estimated at about 140 000. The key social indicators are characterized by: (i) the ever increasing number of the poor – 54% nationwide and 65% in the rural area; (ii) life expectancy at 70 years; (iii) an adult literacy rate of 83.1%; (iv) a primary enrolment rate of 69.3%; (v) an infant death rate of 60.8‰; and (vi) the population with access to pipe-borne water at 19%.

2.4 **Economic Performance:** the STP economy is characterized by its insular location and narrow base. With a GDP estimated at USD 70.3 million in 2005, the STP economy inherited from the socialist system is highly dependent on the public sector (73% of the GDP services government expenditure). Foreign aid represented USD 166 per capita in 2002 – one of the highest in the world. This situation explains why the economy is highly vulnerable to external shocks. Furthermore, GDP growth has remained stable at about 4% since 2001; it grew by 6% in 2005 and

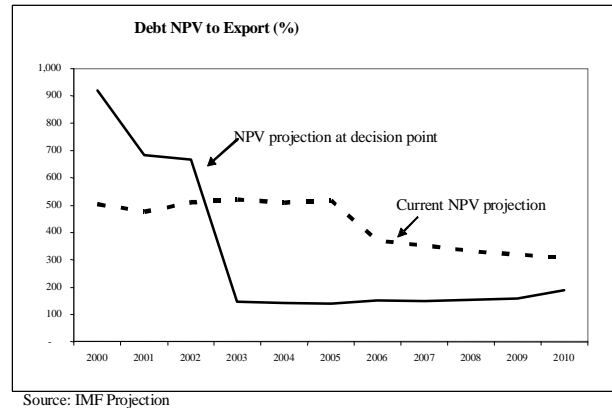
---

<sup>1</sup>Provision to grant supplementary debt relief during the interim period under the enhanced HIPC initiative (ADB/BD/WP/2005/44-ADF/BD/WP/2005/49) of 27 May 2005.

<sup>2</sup>Sao Tome & Principe – Results-Based Country Strategy Paper, 2005-2009 (ADB/BD/WP/2005/ 92, ADF/BD/WP/2005/104).

is expected to reach 8% in 2006, with the attendant inflationary pressures. The country strategy paper approved in 2005 rated the recent macro-economic performance and the implementation of structural reforms as generally satisfactory, based on the 2005-2007 three-year program framework supported by the PRGF that the IMF Board approved in August 2005. Following the adoption of the final PRSP by the Bretton Woods Institutions in 2005, the good performance of the program should enable the country to reach the completion point in 2007. Gradual economic stabilization through better budget deficit and inflation control remains the priority objective of the 2005-2007 three-year program.

2.5 **Public Debt:** the country reached the decision point in December 2000, thanks to which it received interim debt relief within the HIPC framework. That assistance notwithstanding, the external debt level remains high particularly due to delay in reaching the completion point (initially scheduled for 2003 and 2006). The external debt NPV ratio to export stands at 500%; the same ratio to fiscal receipts was estimated at 278%. Both levels are relatively high compared to the ceilings set within the enhanced HIPC framework. The retroactive rescheduling agreement on the interim HIPC period agreed to in Cologne was exceptionally concluded with Paris Club creditors in September 2005. The Government pursues its efforts to reach the completion point in 2007, with a view to eventually benefiting from the Multilateral Debt Relief Initiative. This supplementary debt relief could substantially reduce Sao Tome & Principe's debt burden in the long term.



### **The Oil Sector**

The oil sector is expected to generate substantial resources for the country and bring about fundamental changes in the structure of the economy.

- Geological analyses have shown **the presence of significant amounts of crude oil and natural gas in the off-shore zones of STP islands**. A territorial agreement with Nigeria in 2001 led to the establishment of a Joint Development Zone (JDZ) managed by the Joint Development Authority (JDA) with headquarters in Abuja. Under the agreement, oil revenue derived from the JDZ **will be shared between STP and Nigeria (40% and 60%, respectively)**.<sup>3</sup> In May 2006, Chevron-Texaco announced positive results from its exploration in the JDZ; the commercial viability should be confirmed in 2007.
- **Oil income during the pre-production period will accrue from bonuses paid following the signing of block leases**. Exploration is underway but production is not expected before 2012. STP received its first oil bonus (USD 49.2 million, i.e. 75% of GDP) in July 2005. There have been allegations of lack of transparency over bidding for Blocks 2 to 6 (total of USD 54.7 million), on which some contracts were signed in March 2006.
- At the institutional level, the President in December 2004 signed the **Oil Revenue Management Law** which governs the legal mechanisms for transparent and efficient use of such resources. **Under the law, an oil fund was set up, part of the proceeds of which will cover the yearly financing of budgetary expenditure in the priority sectors. The remaining balance will be invested for future generations**. Parliament is considering additional provisions of the law. Oil bonuses on exploration leases are paid into the oil fund for gradual and full utilization to offset financial needs prior to the start of production.

2.6 **The Bank's 2005-2009 Results-Based Country Strategy Paper (RBCSP)** approved by the Board of Directors on 19 October 2005 hinges on two pillars: (i) rural poverty reduction; and (ii) promotion of governance in public finance management. The indicative program for 2005-2007 (ADF-X) includes provision for: (i) the Livestock Development Support Project – Phase II (UA 4 million); and (ii) the Institution Building for Governance Project (UA 1.30 million). Furthermore, a number of ESWs are being prepared, including the country governance profile, the joint study with the World Bank on integrated fiduciary assessment (PER, CFAA, CPAR) and the transport sector study. Furthermore, the Bank is in the process of putting together technical support for the implementation of the PRSP and a study on insularity costs for STP.

### **III. EXTENSION OF INTERIM RELIEF AND MODALITIES OF FINANCING**

3.1 Sao Tome & Principe reached the decision point under HIPCI in December 2000. Within that framework, the Bank Group undertook to grant the country debt relief estimated at USD 34.20 million in NPV, to enable it to reach the completion point by end December 2004. However, for reasons mostly related to political instability over the 2001-2004 period, Sao Tome & Principe recorded major delays in fulfilling the conditionalities for reaching the completion point. Consequently, after an in-depth review of the particularly precarious situation attributable to the recurrent dysfunction of governance and the country's persistent public finance tensions, the country was granted a first extension of the interim assistance to cover the 2005-2006 period. Taking into consideration the above-mentioned constraints, the extension of the period contributed to the mobilization of USD 3.09 million. In that regard, the last quarter of 2006 was targeted as the deadline for reaching the completion point.

<sup>3</sup> Some available preliminary estimates put STP's share at nearly thirty thousand barrels/day in 2013. With that scenario and assuming a constant price of USD 30/barrel, STP's annual income could reach nearly USD 92 million, i.e. 130% of the 2006 GDP. The oil fund reserves would then amount to USD 3.1 billion.

3.2 Despite the extension of the period by the Bank Group, the country is still late in fulfilling the conditionalities for reaching the completion point as scheduled. Even so, it is worth noting that the country has made satisfactory progress in terms of reforms and good governance. Within that context, the new government formed in the wake of the 2006 presidential elections has opened encouraging prospects for peace, political and social stability. In view of that and given the commitment by the authorities to pursue and deepen ongoing reforms, the Bank remains committed to maintaining its support to the country by granting it a second extension of interim relief. That decision is based on tripartite consultations between the Bank Group, the HIPC Trust Fund and the IMF aimed at accompanying Sao Tome and Principe up to the completion point. That support is in line with the 29 June 2005 Board resolutions authorizing Management to extend the debt relief period under the HIPCI.

3.3 **Justification for Extending the Period:** the relevant May 2005 resolutions of the Boards of Directors clearly state the four eligibility criteria for any country to qualify for the enhanced HIPC program: (i) reach the decision point and implement reforms for at least three years; (ii) use up debt relief resources approved during the decision point; (iii) receive less than 40% of total debt relief in Net Present Value approved at the decision point; and (iv) make significant progress in reaching the completion point as attested to by evidence presented by sister multilateral finance institutions and the Bank Group's evaluation. It should be pointed out that the World Bank continues to grant debt relief within the HIPC assistance framework.

3.4 An analysis of these criteria lends support to Management's decision to grant an additional interim period to Sao Tome & Principe. Indeed, the country has been within the interim period since 2000 – in fulfillment of the first criterion.<sup>4</sup> For criteria (ii) and (iii) above, it should be stressed that the resources allocated to the country as interim assistance have been used up since the October 2006 maturity. The cumulative debt relief granted is estimated at USD 8.56 million, equivalent to USD 7.35 million in NPV, i.e. 21.5% below the authorized threshold of 40% of total Bank Group commitments. In terms of the fourth criteria, recent missions by the Bank and the Bretton Woods Institutions confirm that the authorities are not only committed to pursuing the reforms indispensable for the country's development but also to implementing the program with the IMF.

3.5 Given these favorable trends and the fulfillment of the eligibility criteria set out by the Boards in May 2005, Management, after consulting with the Bretton Woods Institutions, decided to grant Sao Tome & Principe an extension of the interim period in support of the ongoing structural reforms and adjustment programs. The decision requires the mobilization of an additional USD 1.83 million from the HIPC Trust Fund to enable the country to reach the completion point before the end of 2007.

3.6 The debt relief thus granted will increase the Bank's cumulative assistance to Sao Tome & Principe from USD 7.35 million to USD 8.67 million in NPV (equivalent to USD 10.40 million in nominal terms) at the end of the second interim period. Thus, that assistance will bring the debt relief extended to the country to 25.3% of total Bank Group commitment. The relief effort will enable Sao Tome & Principe to receive nearly 80% reduction of debt service commitments due the Bank Group with effect from 1 January 2007 until the completion point (*details of the operation are given as annex*).

---

<sup>4</sup> For additional information, see Sao Tome & Principe: Country Strategy Paper – 2005-2009 (ADB/BD/WP/2005/ 78/Rev.1 - ADF/BD/WP/2005/82/Rev.1) of 10 August 2005.

#### **IV. CONCLUSION**

4.1 The Boards are invited to take note of the extension of the debt relief period for Sao Tome & Principe within the HIPC implementation framework. This decision is necessary in order to support and assist the Government in implementing structural reforms and adjustment programs geared towards enabling the country attain its millennium development goals by 2015. In that regard, reaching the completion point in 2007 will win the country dividends accruing from the Multilateral Debt Relief Initiative (MDRI). In the long run, that additional assistance will enable the country to further consolidate its performance in terms of good governance and promotion of private sector activities as an engine for stronger and sustainable growth. Measures will be taken with the country's authorities and the support of the international community to guarantee the medium- and long-term sustainability of the country's debt, based on the related prospective analyses.

Annex

**Table: Interim Period – Projection of the HIPC Implementation**

(in USD million)

**SAO TOMÉ &  
PRINCIPE**

Decision Point:  
December 2000

YEAR	ADF TOTAL	ADF PERCENTAGE OF THE TOTAL	TOTAL (ADB/ADF)
2001	1.311638	100.0	1.311638
2002	1.375594	100.0	1.375594
2003	1.383608	100.0	1.383608
2004	1.401287	100.0	1.401287
2005	1.462615	100.0	1.462615
2006	1.628912	100.0	1.628912
<b>2007</b>	<b>1.834900</b>	<b>100.0</b>	<b>1.834900</b>
	<b>10.398554</b>	<b>100.0</b>	<b>10.398554</b>

**Summary**

Total relief commitment, nominal	78.932921 mn
Total relief commitment, NPV	34.200000 mn
Interim relief, nominal	10.398554 mn
Interim relief, NPV	8.667783 mn
<b>Resources needed for the extension</b>	<b>1.834900 mn</b>
End of the extension period	Dec. 2007
Total duration of HIPC assistance	38 years