

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

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Operation Name	SECOND SUSTAINABILITY AND COMPETITVENESS DEVELOPMENT POLICY LOAN
Region	AFRICA
Country	Seychelles
Sector	Central government administration (60%);Public administration- Financial Sector (20%);General public administration sector (20%)
Operation ID	P132425
Lending Instrument	Development Policy Lending
Borrower(s)	GOVERNMENT OF SEYCHELLES
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Implementing Agency	INISTRY OF FINANCE - SEYCHELLES
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Estimated Date of Board Approval	September 26, 2013
Corporate Review Decision	

I. Country and Sector Background

This program document proposes a Second Sustainability and Competitiveness Development Policy Loan (DPL1), in the amount of US\$7 million equivalent to the Republic of Seychelles. The proposed operation is the second in a series of three single-tranche operations, consistent with the World Bank Group's Country Partnership Strategy for FY12-FY15, discussed by the Board on April 3, 2012. This series builds on the achievements and lessons of preceding operations, and aims to consolidate reforms supported by analytical work and technical assistance, as well as an International Monetary Fund (IMF) program under the Extended Fund Facility (EFF). The development objective of the DPL programmatic series is to

improve fiscal sustainability and enhance private sector competitiveness for the Republic of Seychelles. To achieve these objectives, this series assist the government to implement reforms that will (i) improve business climate, (ii) enhance transparency, (iii) improve public financial management, (iv) improve targeting of social assistance, and (v) increase fiscal oversight and controls over public enterprises.

Seychelles has come a long way since the 2008 crisis. Seychelles has a high GNI per capita (US\$ 9,710 in 2010), high standards of living, good levels of human development and better governance indicators than many comparator countries. Since the 2008 crisis, it has strongly pursued reforms supported by Bank and IMF programs. The economic restructuring program focused on a fundamental liberalization of the exchange regime, significant and sustained tightening of fiscal policy backed by a reduction in public employment, reform of the monetary policy framework to focus on liquidity management, and a reduction in the role of the state in the economy to boost private sector development. The public debt portfolio was restructured with the Paris Club and other private creditors. Seychelles has managed to secure generous debt relief, which together with fiscal consolidation has led to a much better fiscal and debt picture than only a few years ago.

These achievements aside, a number of challenges remain to be addressed. Seychelles confronts the challenges of a small and remote island state, highly dependent on tourism, which is vulnerable to a range of potential shocks. Limited land, capital, and human resources restrict its ability to benefit from economies of scale in production. Seychelles has a high dependence on external markets because of its small domestic market, and it has limited institutional capacity. The investment climate needs to be strengthened to harness private sector growth. Seychelles ranks 74th in the World Bank's Ease of Doing Business Index for 2013 (an improvement from a rank of 103 in 2012). Bottlenecks in infrastructure remain critical constraints, and investments to reduce telecommunication costs and increase bandwidth capacity have high priority. To address inefficiencies, the utilities sector requires crucial policy measures and institutional reforms, including improved utility management, greater cost recovery, and better asset management. Seychelles is exposed to climate change, other natural disasters, and piracy in the Indian Ocean, a risk which primarily affects the fishing industry but also pose considerable risks for the budget and the livelihoods of poor and vulnerable people.

External economic conditions call for accelerated reforms. The need for reform is even more urgent in light of uncertainties in the global economic environment, especially in Europe, given the predominance of tourism in the Seychelles economy and the high numbers of Europeans in the tourist population. Global economic uncertainties pose an increasing threat to a small, open economy such as Seychelles, primarily on two fronts—the fiscal and external positions. Slower global economic growth could depress domestic growth and tax revenues, even as pressures on government spending would likely continue. The fiscal position remains fragile, with a public debt that is still high and projected to decline by only a modest amount in the medium term. Any major counter-cyclical fiscal policy would be difficult to implement if these external threats materialize with substantial impact on Seychelles. This situation highlights the need for measures that would substantially increase public sector efficiency, enhance private sector competitiveness, and improve social protection programs to better cushion poor and vulnerable people. Additionally, current account deficits, although high, have to date been financed mostly

through high foreign direct investment (FDI), but this trend could quickly reverse if international financial markets deteriorate. The concentration of national exports on a few markets (in Europe) and products (tourism and fisheries) could lead to further deterioration in the current account deficit, which would require accelerated reforms to increase competitiveness and position the economy to diversify into new markets and new products.

The proposed programmatic series of DPLs will support the government's efforts to address some of the critical challenges it faces along with other instruments, including analytical work and technical assistance. The program will support the authorities with critical knowledge and technical assistance for reform implementation. Analytical underpinnings for the reform program will be provided both by existing and programmed analytical work. Existing analytical work that has shaped government's on-going reform agenda includes Public Expenditure Reviews (PERs), a Strategy for Strengthening Budget Management, a Public Financial Management Performance report, a review of Administrative Barriers to Private Sector Development and Business Environment in the Seychelles, and the Review of the Policy Regulatory and Administrative Environment. The government most values the technical assistance and policy dialogue that the Bank can provide through its DPLs. Technical assistance in this program will partly be funded by reimbursable technical assistance (RTA). The Bank brings global knowledge about good practice and helps to ensure evidence-based discussions around the reform agenda. The approach is particularly important in this context where the country has an ambitious reform agenda, capacity is weak and external factors calls for accelerated reforms

II. Operation Objectives

The development objectives of the DPL programmatic series are to improve fiscal sustainability and enhance private sector competitiveness for the Republic of Seychelles. To achieve those objectives, this series assists the government to implement reforms that will: (i) improve the business climate; (ii) enhance transparency; (iii) improve public financial management; (iv) improve targeting of social assistance; and (v) increase fiscal oversights and controls over public enterprises.

III. Rationale for Bank Involvement

The proposed DPL, in an amount of US\$7 million is the second in a series of three annual programmatic Bank operations in support of the government's reform program. The DPL series is the principal instrument identified in the Bank's CPS for supporting the government's reform program. The series envisages three annual DPLs over 2012-14, aligned with the budget cycle, which is the government's primary vehicle for introducing new policy initiatives. The DPL series takes a pragmatic approach to support the policy agenda over a three-year period in which realistic results can be defined and achieved. The approach is to focus on those reforms that can be completed in the medium term while building the necessary foundations for broader reform over the longer term. Within each of the areas of reforms supported by this operation, the DPL identifies several prior actions that will be required to create the basic institutions to support the reform processes. The specific measures that have been agreed as prior actions for the second DPL are presented in Annex 1

IV. Tentative financing

	(\$m.)
Source:	0
Borrower	0
International Bank for Reconstruction and Development	7
Borrower/Recipient	
IBRD	
Others (specifiy)	
Total	7

V. Risks and Risk Mitigation

The implementation of the proposed reform program entails four main risks, namely: (i) macroeconomic instability; (ii) limited institutional capacity; (iii) political and societal resistance; and (iv) impacts of natural hazards.

- (i) Global economic uncertainties in the euro zone continue to present a significant threat. The current level of foreign reserves (2.7 months of imports) provides a modest buffer against balance of payments deterioration, and the floating exchange rate may facilitate correction of external imbalances. Budget surpluses will provide limited fiscal space to cushion negative impacts. There is already a firm commitment by the authorities to rein in public expenditure if a substantial slowdown materializes. If a substantial revenue dip occurs, the authorities would request additional financial support from multilateral organizations.
- (ii) The limited institutional capacity for implementing reforms reflects a lack of technical expertise in some areas and the small pool of human resources in this small country. To mitigate this risk, the government will continue to use its successful participatory approach to implement reforms. The government is also benefiting from capacity-building programs and technical assistance on various fronts by the World Bank, African Development Bank (AfDB), International Monetary Fund (IMF), and the United Nations Development Programme (UNDP). AfDB is also providing support to develop a Human Resource Strategy. The government has requested the World Bank to provide further technical assistance to build institutional capacity in areas supported by this DPL series through a reimbursable technical assistance project, in addition to the Bank's analytical work program. Dialogue under the DPL itself will be another way to build bridges between the different ministries involved in the reform program and enhance coordination.
- (iii) Political and social resistance to reforms may arise. Reforms in housing, finance, and social protection may pose moderate political risks. Consensus building is very important. The government has successfully managed societal resistance throughout the first generation of reforms since 2008 by adopting a slow process built on programs to assess public opinion and gain consensus and on effective communication to sensitize the population about the benefits of the reform program. The authorities will draw on lessons learned from this successful approach. Additionally, in the case of housing finance, specific attention will continue be paid in the short term to the repayment capacity of beneficiaries. In this program, the government is improving its social safety net programs to ensure that the poor and vulnerable are adequately protected. A new Parliamentary elections, although still too early to foresee, may take place during the timeframe of this series, subject to the Electoral

Commission completing consultations on political reform and the recommendations agreed by the Parliament.

(iv) Seychelles remains vulnerable to several natural hazards, including floods, rising sea levels, landslides, and tsunamis, all of which pose serious risks to the country. To mitigate these risks, the government is developing a master plan for Disaster Risk Management, which will be built on assessments of geological risks and other hazards. The government is also planning to set up an emergency assistance scheme for fishermen, given that the fisheries sector is considered to be the most vulnerable to climate change risks)

VI. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Poverty in Seychelles is relatively low. The most recent Household Budget Survey data (from 2007) indicate that less than 2 percent of the population lives on less than US\$2 per day and that around 13 percent of Seychellois live below a poverty line of SR 50 per day (approximately US\$3.5). Inequality remains a concern; between 1999 and 2007, the Gini coefficient went from 0.28 to 0.42.

The proposed DPL series is expected to favorably affect poverty and social indicators in Seychelles. The policy focus of the operation addresses poverty in the following three ways: (i) social protection programs will be more effective in protecting the poor and helping them to rise out of poverty; (ii) an improved investment climate will help increase investment and create jobs; and (iii) enhanced efficiency in public expenditure may provide more flexibility to support social programs. Analytical work, the dissemination of findings, and continued monitoring of economic and social developments will help to ensure that the poverty and social impacts of proposed reforms are clearly understood and communicated with stakeholders.

The focus on social protection programs should help make them more effective in protecting and supporting the poor. To better target assistance to poor and vulnerable people, this programmatic series provides support for a robust, automated MIS to replace two computerized systems that are not linked and that require the government to use manual cross-checks to review eligibility for benefits. One-third of welfare assistance recipients in Seychelles come from middle- or high-income brackets. Aside from adopting a unified MIS to help authorities target benefits to those who are eligible, this series will address the problem of management's discretionary power to override decisions on eligibility. These steps should reduce the number of non-eligible beneficiaries and better target the needy.

Reforms in social assistance policy supported by this operation should positively affect the equity and efficiency of safety net programs. No beneficiary will be excluded from the program during the payment cycle. Entitlements will be reassessed during the regular recertification cycle, which occurs every three months as stipulated under Social Welfare Agency legislation. The government will conduct a timely information and awareness campaign to inform the public about the reasons for reforms and the new eligibility rules. In addition, the proposed DPL is supporting the introduction of a grievance redress mechanism (an independent

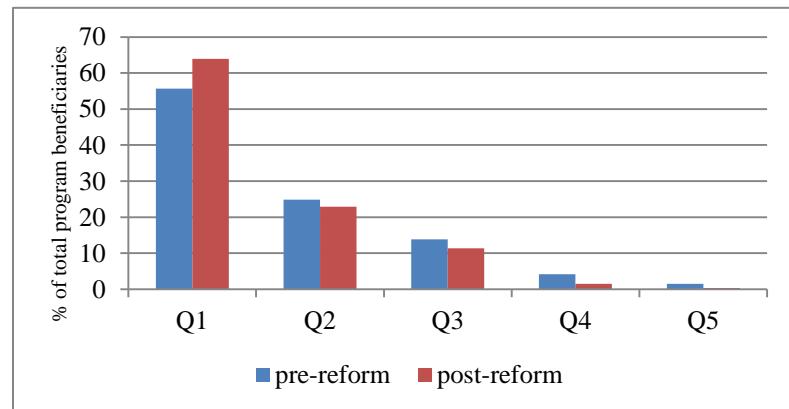
Review Panel) to drastically reduce the risk that the poor may be excluded from the Social Welfare Assistance Program.

Simulations of key aspects of the reform confirm its improved targeting outcomes. Figure 3 models the impact of reduced administrative discretion on the concentration of program benefits in different quintiles of the national income distribution. The concentration of the program in the first quintile¹ rises from 56 percent to 64 percent, while the number of beneficiaries from other quintiles falls commensurately.

The legislative changes that include more sources of income in the eligibility calculations will enhance these gains. Because the overall coverage of social welfare programs is reduced by these reforms, however, fewer households in the first quintile will be covered (coverage of the first quintile is estimated to fall from 60 percent to about 50 percent). The excluded households are expected to be at the higher end of the first quintile, ensuring that most poor households will

not be mistakenly excluded from programs. The Review Panel is an important mechanism for ensuring that this scenario plays out in practice. Finally, the government has indicated interest in undertaking a Poverty and Social Impact Analysis of the reforms. The goal is to understand household perceptions of Social Welfare Assistance and the potential for any significant negative impact as the reforms are implemented. The World Bank will support this work over the coming months.

Figure 1: Distribution of Social Welfare Assistance, by quintile



Reform of utility tariffs will be accompanied by measures to shield the impact on the poor. Measures to improve efficiency are not expected to affect employment in utilities, but they will affect utility prices paid by consumers. The ASP is a modern agency that can scale up programs as needed to respond to idiosyncratic or covariate shocks, including rising utility prices. When the government increased utility tariffs in May 2012, it also increased the ASP budget by 20 percent to protect poor and vulnerable consumers from rising utility costs. The Social Welfare Assistance Program already compensates beneficiaries for utility costs, which are one component in the measurement of welfare assistance. Following the utility tariff increase in May 2012, the maximum utility allocation in the calculation of assistance increased from SR 370 to SR 444. The restructuring of tariffs for domestic consumers supported by this operation would reduce electricity bills for a large proportion of those consumers, based on preliminary rates under discussion as part of the utility tariff study. As part of the same study, the potential social impact of rate changes will be assessed and results and mitigating measures presented in the Program

¹ Note that these estimates are based on an assessment of “pre-transfer” income and therefore differ slightly from estimates presented in the section discussing the policy reform, which are based on “post-transfer” income levels.

Document for the second operation. The team is also working closely with the National Bureau of Statistics to revise the Household Budget Survey questionnaire to better capture the impact of electricity tariffs on household budgets. The improved targeting of social protection services supported under this operation will better identify and protect vulnerable households from additional tariff increases in the future.

Improving the business environment will help increase investment, facilitate business operations, and thus create jobs. Regulatory and administrative costs place an additional burden on businesses and render them less competitive. The burden is also likely to be regressive, affecting smaller firms that employ less-skilled people more than larger enterprises. Streamlined business regulations will benefit small and medium enterprises and in turn translate into increased private sector activity and improved competitiveness, which can raise incomes and add jobs. By the same token, the new commercial division in the Supreme Court will expedite commercial cases and further improve the business environment and potential for job creation. Insolvency legislation will make it easier to restructure viable businesses, which also fosters job creation.

Efficiency in public expenditure may provide more flexibility for social programs. Actions supported in this operation, including PBB and enhanced oversight of state-owned enterprises, are expected to enhance the efficiency and effectiveness of public resources in the delivery of development services. As spelled out in the Millennium Development Goals, weak PFM systems and poor governance are critical causes of poverty, because weaknesses in PFM lead to inefficiencies in public spending and fiscal losses, which affect the government's ability to deliver public services to the poor. The DPL series is supporting actions to improve predictability in the use of public funds as well as service delivery. Greater predictability in the use of funds over the medium term improves the precision of projections of the funds available to cushion the effects of unexpected shocks, especially for the poor.

Environment Aspects

Policy actions supported by this DPO series are unlikely to have negative effects on the country's environment and natural resources. The policies supported under this programmatic series primarily address institutional reforms. The reforms focus on improving the investment climate, on transparency and accountability in the use of public resources, on the efficiency of public expenditures, on improving targeting, and on fiscal sustainability of provision of utility services. Reforms supported by the proposed DPO are expected to facilitate the creation of formal businesses that are more likely to comply with environmental regulations.

In the fisheries sector, improvements in accountability and governance will generate positive long-term impacts on the environment and natural resources. Greater transparency in the fisheries sector may strengthen civil society's role in oversight. It may also step up participation by civil society and stakeholders in the debate on sound fisheries policy. These activities may encourage operators to adopt practices that use aquatic resources more efficiently and indirectly generate environmental benefits.

In the oil sector, adhering to EITI principles and criteria may also strengthen civil society oversight and indirectly support environmental stewardship. EITI supports improved governance through the full publication and verification of company payments and government revenues from natural resources. Civil society can pressure the authorities to use oil revenues to mitigate projected environmental impacts of extractive activities. Although economically viable oil extraction may be quite a few years down the road, the authorities recognize the likelihood of environmental impacts and would like to develop the legal and institutional capacity to better manage environmental concerns. Discussions with PetroSeychelles and the Ministry of Energy and Environment highlight that the capacity to manage potential environmental impacts of oil extraction is limited in Seychelles at present. The United States Bureau of Ocean Energy Management, Regulation, and Enforcement (BOEMRE) provides technical and capacity building assistance to Seychelles under the Energy Governance and Capacity Initiative of the United States Department of State.² To date, this assistance has been delivered in the form of workshops and seminars held in Victoria. Topics included: (i) authorizing and inspecting exploration and production infrastructure; (ii) oil spill response planning; (iii) environmental review and compliance; and (iv) platform safety and inspections. BOEMRE plans to continue its capacity-building engagement with Seychelles authorities in these and other petroleum regulatory areas.

Implementation of cost recovery utility tariffs and adjustment mechanisms will help reduce inefficient energy consumption. More efficient energy use will have a positive environmental impact. The reforms will also foster incentives for the government to promote the use of clean renewable energy, which they have started to consider.

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² The initiative is designed to give assistance to countries identified as having world-class hydrocarbon resource potential.

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