Dear Mr. Kim,

1. On behalf of the Government of Seychelles, I hereby write to request the approval for the Second Sustainability and Competitiveness Development Policy Loan to the Republic of Seychelles. This second development policy loan will support Seychelles in its ongoing reform process especially as we strive to improve the fiscal sustainability and enhance private sector competitiveness in order to sustain our achievements so far.

2. Our reforms up to now have achieved broad based support. As we forge ahead with the program, we continue to carefully consult with our partners in the private sector and civil society in order to ensure that the people have a sound understanding of the rationale of the ongoing reform process and their benefits. This domestic consensus has been bolstered by the international community, which has long played an important role in our country's development. Since the beginning of the economic reform program in 2008 Seychelles has also successfully implemented the Stand-By Arrangement and moved on from an SBA to an EFF, a borrowing program of SDR 19.8 million with the
International Monetary Fund. The EFF came to an end in December 2012 and in its quest for continued engagement with the IMF, the Government requested for an extension of the Arrangement and the Augmentation of Access, which was approved by the IMF Board on 17th December 2012. This extended program will end in December 2013.

I. SEYCHELLES REFORM PROGRAM

I.1 Overview

3. The core aim of Seychelles Medium Term National Development Strategy is to reduce its vulnerability and to provide the basis for long-term sustainable development. The overarching goal of Seychelles’ fiscal policy is to put public finances on a sustainable path, while creating the fiscal space to raise public investment and support targeted social safety nets. The 2013 budget reiterated government’s commitment in that direction. The budget is based on five principal objectives: (i) strengthen the foundations of economic growth; (ii) preserve macroeconomic stability within a substantial fiscal framework; (iii) ensure that people’s socioeconomic needs are not compromised; (iv) modernize the investment climate to further promote private sector-led development; and (v) further integrate Seychelles into the global economy.

4. The economic reform program has focused strongly on the liberalization of the exchange regime, the strengthening of the fiscal policy and improving public sector efficiency. As a result of these reforms we have consistently achieved budgetary surplus in the last few years, improved sovereign rating, modernized the tax system and there has been a reduction in external debt. Currently there is only one bilateral debt re-scheduling outstanding which is in its final approval stage.

5. Our macroeconomic and structural reforms have allowed the economy to bounce back from the financial crisis and become more resilient to shocks as evidenced by the 2012 growth in spite of the global challenging environment. The weakness in tourism arrivals from the traditional European markets has been offset by increases from other markets such as Germany and Russia and the regional markets. As tourism continues to diversify we expect growth in 2013 to average around 3.3%. Inflation which is currently one of our major concerns is expected to subside to close to 5 percent by the end of the year.
II. MAIN ELEMENTS OF POLICY REFORMS

6. In order to sustain the achievements of the economic reform program we will continue to ensure that we strengthen the institutional and governance framework in critical areas such as public finance management, public enterprise, and the investment climate among others.

1. Fiscal Policy

7. Strong fiscal adjustment has been and is central to the achievement of debt sustainability and sound public finances. In 2012 our primary surplus was 5.9 percent of GDP—1.6 percent higher than the program target of 4.3 percent. These objectives have been achieved through a combination of expenditure restraint and strong public financial management. For 2013 we are aiming for a primary surplus of 5.6 percent of GDP. It is imperative that we maintain a primary surplus above 5 percent through to 2018 in order to achieve the 2018 public debt target of 50 percent GDP.

8. We remain committed to having a modern tax system, an improved customs administration and to the improvement of the financial performance of the broader public sector. The Seychelles Revenue Commission is receiving technical assistance from South African Revenue Service for capacity building in the area of detecting transfer pricing. Reform is also ongoing in other areas such as post audit clearance. Technical assistance has also been sought from the World Bank for a Tax Gap analysis with strong focus on the diagnostics of the deficiencies in tax administration so as to improve and ensure efficiency of compliance measures.

9. Maintaining efficiency in public expenditure continues to be a key objective of our fiscal policy. The World Bank has been a key partner in assisting us with developing the capacity our staff in the process of conducting public expenditure reviews especially through the use of the BOOST database which provides key data on spending. The BOOST database has been developed jointly to analyze and monitor public expenditure efficiency.
2. **Public Financial Management Reforms**

10. Strengthening the Public Financial Management Framework and the budgetary process remains one of our key objectives and the PFM reform action plan 2012-2014 continues to be the guiding principle for ongoing reforms as we make considerable progress. The action plan addresses inherent weaknesses and focuses on the sustainability of reforms made to date, drawing from the recent PEFA assessment of 2011.

**New Public Finance Management Act:** The 2013 budget is based on the new legislation enacted in November 2012. Under the PFM Act improved information requirements and procedures such as a mid-year execution report and technical justifications underlying budget preparation are legal requirements. As of January 2013 Accounts staff of all Ministries and Government departments have been reporting to the Ministry of Finance, Trade and Investment.

**Government Audit Committee:** The PFM Act has formalized the Government Audit Committee, which will oversee the implementation of recommendations of the Auditor General’s annual reports. The Audit Charter was approved by Cabinet in January 2013 and it provides guidance to members of the Committee in discharging their respective duties. The Committee will consist of full-time dedicated employees and will be independent of the Ministry of Finance.

**Financial Instructions and Accounting Manual:** We are incorporating the revised articles of the new PFM Act into the Financial Instructions and accounting manual to explain to the users the regulations and procedures. The Financial Instructions and Accounting Manuals will be finalized by mid-August 2013.

**Public Sector Investment Program:** A detailed manual has been finalized to help line Ministries prepare their investment plans in line with their medium term plans. Technical assistance is also being sought from the World Bank.

**International Public Sector Accounting Standards (IPSAS):** We are working towards adopting the International Public Sector Accounting Standards (IPSAS) classifications. Late 2012 we benefited from an AFRITAC South mission to assist the Government in implementing cash based IPSAS for Government accounts. The mission helped to identify gaps between the existing practice in Seychelles and the mandatory requirements under the cash-basis IPSAS. We are now in the process of developing the action plan to meet the IPSAS
requirements, with an improved disclosure statement being the short term priority.

**Program Performance Based budgeting (PPBB):** In January 2013 Cabinet approved the policy paper on PPBB and its implications for the public finance of Seychelles (*Prior Action DPL 2*). The Government is receiving technical assistance from the World Bank to develop guidelines on PPBB and an implementation strategy. A major step will be the introduction of PPBB in two pilot ministries, The Ministry of Education and Ministry of Natural Resources and Industry in 2014. We intend to extend PPBB to all ministries by 2015 (*indicative trigger for DPL3*)

3. **Public Enterprise Reforms**

11. The Government remains committed to the pursuit of its public enterprise reform strategy aimed at achieving greater efficiency, accountability and transparency. In order to strengthen the framework for the monitoring of public enterprises and to minimize the risks of negative spillovers from these entities to the budget and real economy, as part of the first DPL operation the Government proposed amendments to the Public Enterprise Monitoring Act, to strengthen monitoring and improve governance framework, among other things. The Public Enterprise Monitoring Act requires that entities submit a statement of corporate intent one month after the coming into operation of the revised Act and monthly statement of financial and operational performance including details of debt performance (*Prior Action DPL 2*). This applies to all public enterprises. In its continued effort for improved oversight, the Public Enterprise Monitoring Division previously a division in the Ministry of Finance has turned into an independent Commission. In addition the Ministry of Finance is strengthening and streamlining parastatal’s legal disclosure requirements, and a committee is reviewing large investment projects of state owned enterprises. Within three months of the end of their fiscal years, as from this year, each public enterprise will have to submit their audited financial statements to the Public Enterprise Monitoring Division (*indicative trigger for DPL3*)

12. We continue to advance our privatization program. Government has successfully sold over 23 percent of its shares in the Seychelles Savings Bank in 2011, and will complete the sale of the remaining 17 percent in 2013. In addition
government is currently reviewing its position with regards to the sale of minority shareholdings in cargo handling and stevedoring (Land Marine), ship repair (Naval Services) and insurance (Sacos Insurance Company Limited).

13. Following the adoption of the new Housing Finance Policy in December 2011 (prior action for DPL1), the World Bank through the FIRST Initiative is providing technical assistance for the implementation of the reforms in the housing finance sector. The main element of reform is improved targeting and the introduction of a subsidy policy for low income households in need of assistance (Prior action DPL 2). Such reforms in the housing finance landscape will also allow for the private sector to play a greater role in this market. The next hurdle that we will tackle in this process is title registration which currently at times takes months to complete and deter commercial banks from providing mortgages (indicative trigger for DPL3)

14. Challenges in the utility sector are being addressed. The Seychelles water supply is unsustainable in the long term, and water losses are the main issue. Although measurements of those losses are not very accurate, they are estimated to range from 40 percent to 60 percent. Annual increases in demand, estimated at about 6.5 percent, add to the pressure on the limited water supply. The high share of fuel in national energy costs is a source of financial problems. Ninety percent of the primary energy supply is generated from imported fuel. Fuel price variations were not always fully passed on to consumers, causing PUC to operate at a loss.

15. The Government intends to invest massively in this sector to address those challenges. It secured a concessional loan of €27 million from the European Investment Bank, which it has on-lent to PUC to develop the water sector. These loans will be used to address various issues and needs, including leakages and unaccounted-for water, the replacement of pipes, metering, and storage capacity.

16. The Government remains committed to taking the necessary steps to maintain the financial viability of the Public Utility Corporation (PUC). There has been tariff increases in November 2011 and May 2012 and we are now virtually at a full pass through as the next step in transitioning to an optimal electricity tariff. Based on the results of the optimal tariff study which the World Bank assisted us with, the Government is pursuing further reforms in the utilities sector. A new Energy Act came into force in late 2012, and the Act makes provisions for tariff adjustments and introduction of social tariffs. An adjustment mechanism has
been approved by Cabinet (*Prior action DPL 2*) and by virtue of that electricity tariffs is adjusted on a quarterly basis to reflect changes in the price at which PUC purchases fuel from SEYPEC. The Government also adopted a tariff rebalancing plan in March and has begun its implementation in July, 2013 and which will simplify the electricity tariff structure (*indicative trigger for DPL3*).

17. To reduce the dependence on fuel, Seychelles has a number of ongoing and anticipated renewable energy and energy efficiency projects and programs. The European Union (EU) and Indian Ocean Commission are expected to fund a Regional Program on Renewable Energy and Energy Efficiency. The Abu Dhabi Development Fund has provided US$28 million in grants for a 6-megawatt wind power installation on the main island of Mahé. The Bank, under the SIDS DOCK Program, is supporting with the preparation of grid codes, feed-in tariffs, and model energy supply purchase agreements for renewable energy technologies.

4. Social Sector Reforms

18. We remain committed to the needs of the most vulnerable groups of our society as we strive to ensure that we deliver targeted assistance. With the introduction of a Personal Income Tax in 2011, social security contributions were abolished. All assets in the fund were frozen and transferred to a new fund managed by a Board of Trustees. The Agency for Social Protection (ASP), created in 2012 by merging the Social Security Fund and the Social Welfare Agency, has improved the monitoring of statutory and means-tested benefits, both of which it administers.

19. The Agency of Social Protection has successfully merged and upgraded the two stand-alone management information systems (MIS) that previously existed and that were operating in parallel (*prior action for DPL1*). With time other benefits will be integrated into the MIS, leading to better targeting and efficiency gains. The Agency of Social protection has also strengthened its appeal procedures with the establishment of a Review Panel (*prior action for DPL1*). The Review Panel has in turn established an independent investigative unit and has to date reviewed over 300 cases of which only 25 cases were accepted and on grounds of missing documents at the initial submission.
20. A system providing more user-friendly access to the range of modules required by a cash transfer system has been developed. The Government also aims to streamline and tighten disability benefits and reduce incentives to remain listed as disabled. For children with disabilities, the Government wants to ensure educational inclusion to enable their labor force participation in adulthood.

21. In our effort to ensure social and economic inclusiveness for all members of our society, the Government has undertaken a review of the disability assessment criteria and has decided to move away from an assessment based on incapacity to work, to one based on the functioning capacity of the person (Prior action DPL 2) in line with WHO standards and international best practices. In this regard, the certification process for disability and sickness benefits including roles and responsibilities of the Medical Board has been revised.

22. The current system of domicile care in Seychelles consists of the Home Care Programme and the Family Support Programme. However recently there has been a noticeable shift from the Family Support Programme to the Home Care Programme. To ensure the targeted nature of the assistance, the Government has decided to consolidate the Home Care Programme and the Family Support Programme into one means tested program with clearly defined eligibility rules (Prior action DPL 2). In addition to the decision to consolidate the two Programmes, the Agency of Social Protection has also carried out a survey of the Home Care Programme so as to have a comprehensive picture of the programme and make necessary adjustments to improve efficiency of the programme moving forward.

23. The Government also intends to tackle the long-term fiscal risks of Seychelles’ pension system, which are related to the system’s generous benefits and limited contributions. The Pension system in Seychelles is comprised of the universal pension managed by the ASP and a contributory defined benefit scheme by the Seychelles Pension Fund. Following a Pension Study undertaken as part of technical assistance from the World Bank, Government recognizes the need to improve fiscal sustainability through increase in contribution rates and other parametric reforms. In his budget speech for 2013, the Minister of Finance announced that as from 2014 the contribution rate will be increased by 1% (indicative trigger for DPL3). An amendment to the SPF Benefits Regulations (S.I 3 of 2013 SPF (Benefits) (Amendments) Regulations) has been made to
introduce the element of indexation and increase of pension (*Prior action DPL 2*).

5. **Private Sector Developments**

24. The Government remains committed to the improvement of the business environment in line with its policy of being a facilitator rather than a provider in the economy. We remain focused on creating an enabling business environment by ensuring that the necessary legal framework is in place to enable a private-sector led growth. The Government has identified a series of other measures to be implemented in the medium term. They include improving the framework for foreclosure; making the process of obtaining a construction permit faster and cheaper; making the transfer and registration of property titles more efficient and less costly; introducing online land registration and online planning permission applications by linking all relevant agencies; improving access to credit by allowing more flexibility in the use of collateral to secure loans; enhancing efficiency in paying taxes by reducing the administrative burden on companies to comply with tax requirements; introducing electronic payment facilities for government services; enhancing trade by reducing the number of documents and time to trade; and streamlining the time, costs, and procedures involved in enforcing a contract.

25. The introduction of the virtual one stop shop for business registration has addressed some of the weaknesses in the business entry; however we recognize that there is still the need to modernize legal frameworks so that the business community can benefit fully from a virtual system. A number of sections/provisions of the Companies Act, 1972 has been revised and modernized in line with the international best practices. The revised bill was submitted to the Parliament on 01st July (*Prior action DPL 2*). To further improve the business environment, the government has introduced e-filing for business taxes and intends to introduce e-payment of taxes (*indicative trigger for DPL 3*).

26. The Commercial Division at the Supreme Court continues to play its role in improving the business environment. As of 31 December 2012, 30 civil suits had been registered on the Commercial List, and 5 of those cases had been disposed of. The rest of the cases on the Commercial List are at different stages
including pleadings, pretrial proceedings, pending trial and part-heard. Closing
down a business has been one of the sub-indexes where Seychelles had fared
very weakly, but with assistance from the World Bank, we have submitted to the
Parliament for their approval a modern insolvency law (Prior action DPL 2).
The Insolvency Act will allow us to address the current shortcomings in the
business rescue and bankruptcy area. My Government intends to further
improve the system for business exit by providing operators with mechanisms
for alternative dispute resolutions (indicative trigger for DPL3)

6. Governance of Key Economic Sectors

27. The Government remains committed to ensuring that good governance and
transparency exist in areas which are potential sources of public revenues.

28. The fisheries sector remains an important source of public revenue and financial
transfers. In line with our efforts for better transparency and accountability in
that sector the Government has taken steps to disclose all existing fishing
agreements, fishing and aquaculture licenses (but without infringing any
confidentiality clause by disclosing) and has mandated the Seychelles Fishing
Authority to include a full mandatory disclosure on all new agreements in the
future (Prior action DPL 2). Disclosure of the fishing agreements follows the
publishing of all Seychelles-flagged fishing vessels (Prior action for DPL1).

29. The petroleum sector is another important sector whereby the government is
keen to strengthen governance given the potential economic impact any future
discoveries may have. Following the incorporation of PetroSeychelles last year
(Prior action for DPL1), Government is now committed to ensuring that the
necessary legal framework in the petroleum sector is a reflection of international
best practices especially in regards to the legal and fiscal framework for the
awarding and administration of Petroleum Agreements. Cabinet has approved
revised petroleum legislation to that effect, taking into account operational
standards as well as fiscal terms (Prior action DPL 2).

30. The Government is committed to strengthen transparency in financial reporting
in the petroleum sector by adopting Extractive Industry Transparency Initiative
(EITI) principles (indicative trigger for DPL3). To embark in the process of
becoming EITI compliant, my Government has already made a public statement
to that effect and established a multi-stakeholder group to oversee the
implementation of the EITI. Given the nature and extent of the EITI validation process, we plan to gain recognition as an EITI Compliant Country by mid-2014. The multi-stakeholder group has been called to work with relevant partners and publish a fully costed work plan, containing measurable targets and a timetable for implementation of EITI. The group should also provide an assessment of capacity constraints so that we can seek assistance from our development partners in order to complete the EITI validation process.

Conclusion

31. As the above indicate, the Government of the Republic of Seychelles is strongly committed to undertaking necessary reforms to promote economic growth and modernize our country. In this context, the support of The World Bank through approval of the Development Policy Loan would be important to successful implementation of the government’s continued reform and debt sustainability agenda.

32. Accordingly, the Government of the Republic of Seychelles requests that Development Policy Loan be approved.

Yours Sincerely

James Alix Michel