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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR A PROPOSED

GRANT

IN THE AMOUNT OF SDR 4.2 MILLION (US\$6 MILLION EQUIVALENT) TO

THE DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

FOR THE

SECOND STRENGTHENING GROWTH AND FISCAL POLICY DEVELOPMENT POLICY FINANCING

April 19, 2018

Macroeconomics, Trade and Investment Global Practice
Africa Region

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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE - GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of February 28, 2018)

Currency Unit = São Tomé and Príncipe Dobras (STD)

STD 20.07 = US\$1

SDR 0.6916155 = US\$1

ABBREVIATIONS AND ACRONYMS

AGER	General Regulatory Authority (<i>Autoridade Geral de Regulação</i>)
AQR	Asset Quality Review
ASA	Advisory Services and Analytics
BCSTP	Central Bank of São Tomé and Príncipe (<i>Banco Central de São Tomé e Príncipe</i>)
BISTP	International Bank of São Tomé and Príncipe (<i>Banco Internacional de São Tomé e Príncipe</i>)
CAR	Capital Adequacy Ratio
COSSIL	Coordination and Assistance Procurement Cabinet
CPI	Consumer Price Index
CPS	Country Partnership Strategy
CST	Santomean Telecommunications Company (<i>Companhia Santomense de Telecomunicações</i>)
DPF	Development Policy Financing
DSA	Debt Sustainability Analysis
ECF	Extended Credit Facility
EIA	Environmental Impact Assessment
EMAE	Water and Electricity Company (<i>Empresa de Água e Electricidade</i>)
ENASA	National Enterprise of Airports and Air Safety (<i>Empresa Nacional de Aeroportos e Segurança Aérea</i>)
ENCO	National Oil and Fuel Company (<i>Empresa Nacional de Combustível e Óleo</i>)
FDI	Foreign Direct Investment
FSDIP	Financial Sector Development Implementation Plan
FY	Fiscal Year
GDP	Gross Domestic Product
GoSTP	Government of São Tomé and Príncipe (<i>Governo de São Tomé e Príncipe</i>)
HIPC	Heavily Indebted Poor Countries
IDA	International Development Association
IMF	International Monetary Fund
kWh	Kilowatt Hours
LCPDP	Least Cost Power Development Plan
MTEF	Medium-Term Expenditure Framework
MW	Megawatt
NAP	Permanent Rules (<i>Normas de Aplicação Permanente</i>)
NDP	National Development Plan
NPL	Non-Performing Loans
PEFA	Public Expenditure and Financial Accountability
PENPS	National Policy and Strategy for Social Protection (<i>Política e Estratégia Nacional de Proteção Social</i>)
PFM	Public Financial Management
PIM	Public Investment Management
PPP	Purchase Power Parity
PSRP	Power Sector Recovery Project
SDR	Special Drawing Rights
STD	São Tomé and Príncipe Dobras
SNP	National Planning System
SOE	State-Owned Enterprise
STP	São Tomé And Príncipe
VAT	Value-added Tax

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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

SECOND STRENGTHENING GROWTH AND FISCAL POLICY DEVELOPMENT POLICY FINANCING

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SUMMARY OF PROPOSED GRANT AND PROGRAM
DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE
SECOND STRENGTHENING GROWTH AND FISCAL POLICY DEVELOPMENT POLICY FINANCING

Borrower	Democratic Republic of São Tomé and Príncipe
Implementation Agency	Ministry of Finance, Trade and Blue Economy
Financing Data	IDA Grant. Terms: Standard International Development Association Terms Amount: SDR 4.2 million (US\$6 million equivalent)
Operation Type	Second in a programmatic series of three operations
Pillars of the Operation and Program Development Objective	<p>The objective of this operation is to help the government introduce growth-enabling reforms in the financial sector, business environment, and infrastructure; generate fiscal resources and savings; and improve the quality of expenditures.</p> <p>Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure</p> <p>Pillar B: Generate fiscal resources and savings and improve the quality of public expenditures</p>
Result Indicators	<p>Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure</p> <p>Number of banks below the central bank's minimum Capital Adequacy Ratio (12%). Baseline (2015): 3; Target (2020): 0.</p> <p>Score on Doing Business indicator "Getting Credit". Baseline (2015): 0 out of 20; Target (2020): 10 out of 20.</p> <p>Share of the population with access to formal financial services (e.g. bank accounts). Baseline (2015): 53 percent; Target (2020): 65 percent.</p> <p>Share of real estate properties and mortgages registered and digitized in the Public Notary Registry. Baseline (2015): 0; Target (2020): 90 percent.</p> <p>EMAE's non-technical losses. Baseline (2015): 26.4 percent; Target (2020): 23.8 percent.</p> <p>Amount of public sector arrears to EMAE. Baseline (2015): 36.4 billion STD; Target (2020): 12 billion STD.</p> <p>Energy cost of production. Baseline (2015): 8,545.22 STD/Kwh; Target (2020): 8,300.00 STD/Kwh.</p> <p>Number of complaints received by EMAE. Baseline (2015): 6,542; Target (2020): 3,000.</p> <p>Pillar B: Generate fiscal resources and savings and improve the quality of public expenditures</p> <p>Tax revenues (as a share of GDP). Baseline (2015): 14.3 percent; Target (2020): 15.8 percent.</p> <p>Percentage of performance targets achieved – average for SOEs. Baseline (2015): N.A.; Target (2020): 50 percent.</p> <p>Share of ongoing and finalized projects with basic information included in the National Investment Portfolio Database. Baseline (2015): 0; Target (2020): 100%.</p> <p>Number of beneficiaries enrolled in the three core social protection programs and receiving regular payments as set in law. Baseline (2015): 0; Target (2020): 4,000 (out of which, 50 percent has received payments through the formal financial system)</p>
Overall Risk Rating	Substantial
Climate and Disaster Risks	There are no short- or long-term climate and disaster risks to the operation
Operation ID	P161707

**IDA PROGRAM DOCUMENT FOR A PROPOSED
GRANT
TO THE DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE**

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Second Strengthening Growth and Fiscal Policy Development Policy Financing aims to support São Tomé and Príncipe (STP) implement reforms to foster private-sector growth, make growth more inclusive, and address risks to growth resulting from banking sector weaknesses, external imbalances, and the fragile fiscal position.** This proposed operation, in the amount of SDR 4.2 million (equivalent to US\$6 million), is the second in a programmatic series of three development policy operation (DPO) operations. The first operation (P159010), in an amount of US\$5 million, was approved by the Board on November 30, 2016. The objective of this operation is to help the government support the country's growth drivers – the agriculture and tourism sectors – by introducing reforms focused on key enabling factors in the financial sector, the business environment, and the infrastructure sector; by generating fiscal resources and savings; and by improving the quality of public expenditures. The reforms in the proposed operation are aligned with the ongoing International Monetary Fund's (IMF) Extended Credit Facility (ECF), which recently underwent its fourth review. Reforms build on the current state of Bank knowledge of this small- island economy, which focuses on the cross-cutting areas that enable growth. As the country is benefiting from a more than fourfold increase in its International Development Association (IDA) allocation, the Bank is undertaking a county economic memorandum that will focus more on the growth drivers: agriculture and tourism, while this DPO supports foundational reforms needed for these growth drivers to thrive.

2. **STP is a low middle-income and small-island country that faces challenges typical of small states.** The country is a multiparty democracy and a unitary state with a population of nearly 200,000 people. It is divided into six districts and the Autonomous Region of Príncipe (*Região Autónoma do Príncipe*). STP's per-capita gross national income is estimated at US\$3,250 in purchasing power parity (PPP), and its per-capita gross domestic product (GDP) is US\$1,714 in 2016. The country faces challenges that are typical of small states and affect its ability to deal with shocks and achieve a balanced budget. The limited number of people and workers in the country often prevent the efficient production of goods and services at the scale needed to meet the demand of both local and export markets. Its remoteness and insularity increase export costs, and the limited availability of land and small workforce prevent the country from diversifying its economy, making it more vulnerable to terms-of-trade shocks. The indivisibility in the production of public goods, and the difficulty of providing services to a scattered population imply a high cost of public goods and a high level of public expenditures. Coupled with a limited tax base, the high cost of public goods makes it more challenging for small states to balance their budgets.

3. **GDP growth has been relatively steady since 2009, but growth is heavily reliant on government spending and has not significantly contributed to poverty alleviation.** GDP grew at an average rate of 4.5 percent between 2009 to 2016, with a mild deceleration since 2014. Agriculture production has declined since independence in 1975, and is no longer the main driver of economic growth. However, agricultural goods, especially cocoa, constitute the bulk of the country's exports. Also, tourism is a natural comparative advantage for STP and already constitutes an important economic activity, although the country is far from becoming a tourism-dependent economy. Even though there has been oil exploration since 2013, commercial activity is not expected before 2020. Since only a few goods are produced locally, STP is heavily dependent on imports, including oil for power generation. Despite methodological issues, there is a consensus that poverty incidence has not changed significantly between the last two household surveys

(2000 and 2010).¹ According to recent World Bank estimates, around one-third of the population lived on less than US\$1.9 PPP per day, and more than two-thirds of the population was poor, using a poverty line of US\$3.2 PPP per day.² Urban areas and southern districts such as Caué and Lembá have higher levels of poverty incidence. Finally, income concentration, as measured by the Gini index, was 30.8 in 2010, and the unemployment rate was 13.6 percent in 2012.

4. **In order to achieve higher levels of development, STP must promote more inclusive and private sector-led growth, and address the macroeconomic risks resulting from banking sector weaknesses, external imbalances, and fiscal fragility.** The country's economic growth has not been pro-poor because most of its vulnerable population lacks the necessary skills to access economic opportunities. Social protection policies have not been able to alleviate poverty and provide a path for vulnerable households to graduate out of poverty. Moreover, growth has been over-reliant on government spending, as STP lacks buoyant private economic activities to drive economic growth. The government spends around 38 percent of GDP, owns four state-owned enterprises (SOEs), invests in eight other companies, and employs around 11,000 people. Even maintaining the country's current growth levels is at jeopardy because of (i) the government's fragile fiscal position, consisting of a high fiscal deficit and a low level of domestic resource mobilization; (ii) a banking sector with a high level of non-performing loans (NPLs) and capital adequacy on the low side; and (iii) external imbalances.

5. **The Government of São Tomé and Príncipe (GoSTP) wants to adopt a more inclusive, private-sector driven growth model and has been addressing the risks to growth.** Public authorities are aware that long-run economic growth cannot rely on government spending. Also, government resources are insufficient to maintain a large payroll, carry out and maintain public investments, and provide quality public services. The GoSTP has been implementing several reforms to improve the business environment. It is currently carrying out investment promotion activities that are expected to attract new private ventures, foster new sources of growth and foreign exchange, and contribute to balancing its external accounts. It is cognizant that it has to resolve infrastructure bottlenecks in the energy and transportation sectors and facilitate access to credit to achieve a more vibrant private sector. Public authorities are also addressing fiscal and banking sector risks to reduce risks to sustainable growth. Finally, the GoSTP has revamped its social protection policy and is expanding education opportunities to allow the benefits of economic growth to reach a wider share of the population.

6. **The two pillars supported by this operation are self-reinforcing and will help the GoSTP to address both the development challenges and the growth risks facing the country.** Reforms aimed at the credit market and the energy sector will address the lack of private-sector growth drivers in STP's economy. Furthermore, the implementation of the new Social Protection Strategy and measures to increase access to finance will address the low inclusiveness of growth. Finally, bank supervision reforms will address the risks from the banking sector, while reforms of the tax policy and SOE management and control will aim to improve the country's fiscal position. The proposed operation is organized around two pillars. The first supports policies aimed at reducing risks from the financial sector through improved bank supervision and fostering private sector-led growth through an improvement in access to credit and energy. The second pillar focuses on the risks from fiscal fragility and the challenges of low inclusiveness of growth. Despite being organized in pillars and around specific sectors and themes; the policy operation is multi-sectoral and the two pillars reinforce each other.

7. **STP's macroeconomic policy framework is adequate for the proposed DPO operation.** The

¹ A new household survey will be released in 2018.

² World Development Indicators.

framework is consistent with price stability due to the credible exchange rate peg that has been in place for the past eight years. The Central Bank of São Tomé and Príncipe (*Banco Central de São Tomé e Príncipe*, BCSTP) has been undertaking efforts to improve its monetary policy tools and support solid credit growth. The GoSTP is addressing fiscal imbalances through improving domestic revenue mobilization, controlling expenditure and achieving a better management and control of SOEs. Moreover, public authorities are taking measures to secure external financing in the short term through grants and concessional loans and support economic activities, which can increase export earnings. Key downside fiscal risks include spending pressures from the upcoming elections in 2018, a sudden reversal in external finance, and a lack of capacity to implement crucial reforms such as the roll-out of the value-added tax (VAT).

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

8. **While the country's economic growth has been positive, it has recently slowed due to lower levels of government spending.** GDP growth rates averaged 4.5 percent between 2009 and 2016. GDP growth peaked in 2014 at 6.6 percent, before moderating to an average 4 percent in 2015-16. Government spending – the main growth driver – has declined since 2015 due to lower public investment, as a result of lower levels of concessional loans and external aid. Public investment fell from 15.5 percent of GDP in 2015 to 10.1 percent in 2017, while recurrent expenditures declined from 18.2 percent of GDP to 16.2 percent in the same period. The key sectoral drivers of growth were tourism and agriculture. The tourism sector grew consistently until 2016, with international tourist arrivals increasing by 59 percent between 2014 and 2016, before stagnating in 2017, according to provisional data. Also, growth in the agriculture sector suffered from a drop in world cocoa prices and the presence of two large pests affecting the country's main subsistence crop – corn.

9. **A revenue shortfall in 2016 led to a worsening of the fiscal balances, despite some cuts in public expenditure.** The domestic primary deficit increased from 2.9 percent of GDP in 2015 to 4 percent in 2016. Moreover, domestic revenue decreased from 15.8 percent of GDP in 2015 to 13.6 percent in 2016, while tax revenue decreased from 14.3 percent of GDP to 12.2 in the same period. The main cause for the decrease in public revenue was a 1.7 percentage-point drop in customs revenue from 2015 to 2016, as oil prices fell. Constrained by the smaller resource envelope, public expenditures declined in 2016. Primary (non-financial expenditures) expenditures decreased from 33.5 percent of GDP in 2015 to 31.6 percent in 2016, mainly due to lower public investment, while current expenditures decreased from 18.2 percent of GDP in 2015 to 17.1 percent in 2016. Payroll – the second largest public expenditure after public investment – remained stable in 2016 at 8.8 percent of GDP. Low domestic resource mobilization – a common phenomenon of small island states due to their limited economic base – is the root cause of the STP's fiscal fragility and represents a risk to growth, as government spending is the country's main driver of economic growth. Public expenditure levels also tend to be higher in small island states due to their higher fixed government costs and the indivisibility of some of their public goods.

10. **Public authorities have taken rapid actions to rebalance the public budget and put the IMF's ECF program back on track.** After the revenue shortfall in 2016, the GoSTP approved 12 legal changes to increase public revenue, including increase in tax rates on imported and locally produced goods, as well as changes in procedures to improve tax collection. These measures were followed by the adoption of a revised 2017 budget that included new revenue measures, but also measures to contain public expenditures on goods and services and, with SOEs. The above measures yielded results, as current revenues grew by 5.2 percent between January and September 2017, while primary expenditures grew by 3.8 percent in the same period. After these changes, the GoSTP was able to meet the mid-2017 primary deficit target of the ECF program,

which was adopted in 2015, after missing the December 2016 targets.

11. The GoSTP has made modest progress in resolving cross-arrears between the government, SOEs, and public suppliers, but planned structural adjustments are expected to yield results in the medium term.

The government is in arrears with its telecommunications, water, and energy suppliers, and it has accumulated years of unpaid fuel subsidies to the fuel importer *Empresa Nacional de Combustíveis e Oleos* (ENCO). In turn, the water and electricity SOE (*Empresa de Água e Electricidade*, EMAE) has arrears with ENCO, its main supplier. The GoSTP sought to address these arrears with support from the ECF program. By the end of 2015, the government had settled its arrears with EMAE and agreed on an arrears settlement plan. It had also implemented a fuel price adjustment mechanism, in which domestic prices were set above international fuel prices, resulting in a difference that was used to reduce the unpaid subsidies bill to ENCO. However, the revenue shortfall in 2016 led the GoSTP to once again generate arrears with EMAE, amounting to €4.2 million as of September 2017. Nevertheless, the arrears for the unpaid fuel subsidies were reduced from €38 million in 2014 to €31.4 million in 2016, and there are no reported public arrears or NPLs in the banking sector. The government never addressed its arrears with the Santomean Telecommunications Company (*Companhia Santomense de Telecomunicações*, CST), which totaled €4.9 million as of September 2017. Total arrears from the government summed up to 30.5 percent of GDP as of September 2017. Ongoing tax reforms are expected to generate the additional resources needed for the GoSTP to settle its arrears with its utility providers. The situation in EMAE is more complex since it is a loss-making company, and the increase in its stock of arrears reflects a public policy to expand the power supply network at loss-making prices. An effort to balance EMAE's accounts in the short term would require a more than doubling of the already high energy tariff. Therefore, public authorities need to adopt more structural solutions and implement projects with longer maturity, which the World Bank supports through its Power Sector Recovery Project (PSRP – P157096).

12. Debt levels have increased due to a recognition of domestic arrears and an increase in concessional borrowing.

STP's debt-to-GDP ratios have increased by all measures since reached the Heavily Indebted Poor Countries (HIPC) completion in 2007. The country's total public and publicly guaranteed debt, including domestic arrears to suppliers, but excluding pre-HIPC legacy debt, a disputed debt with Nigeria, and EMAE's arrears with ENCO, has increased from 30.7 percent of GDP in 2012 to an estimated 59 percent of GDP (US\$225.4 million) as of June 2017. When all debt and arrears are included, this figure grows to US\$386.3 million (108.8 percent of GDP) as of September 2017. 77 percent of its total debt (excluding arrears) was accumulated after completing the HIPC program and is held with bilateral creditors such as Angola and Portugal. Seventy-seven percent of the debt is also held in U.S. dollars, while only 21 percent is held in euros. The weighted average interest rate on the debt is low – 1.08 percent – and the average time to maturity is long – 14.8 years, reflecting the (mostly) concessional terms of the country's debts. Although the debt service is low, it is growing and is expected to increase more rapidly once the grace period of recent loans ends. The GoSTP is in high risk of debt distress and is addressing its high debts by limiting its borrowing to only concessional loans with average yearly disbursements not exceeding 4 percent of GDP. It is also receiving technical assistance on debt management from the World Bank and the IMF.

13. STP's large structural external deficit narrowed in recent years due to lower oil prices.

The country is highly dependent on imports and runs large structural external deficits³ because of its small production base. Its current-account deficit (excluding official transfers) declined from 25.2 percent of GDP in 2015 to 20.8 percent in 2016. The main contributing factor to the improvement in the external accounts was a decline in oil imports from 9.8 percent of GDP in 2015 to 6.2 percent in 2016 due to lower oil prices. During

³ The large and recurrent current-account deficit in STP is similar to other small and small island countries. According to IMF data (World Economic Outlook Database Oct 2017), all of the peer countries used in the STP PER – Cabo Verde, Honduras, Nicaragua, Jamaica and Mauritius – had recurrent current-account deficits between 2013 and 2015.

the same period, exports of goods increased from 3.6 percent of GDP to 3.9 percent, while tourism exports grew by only 0.1 percentage points of GDP. STP's exports are highly concentrated in one single good – cocoa, another characteristic of small island states due to their small domestic markets and endowment of production factors. Income from migrant remittances decreased from 5.7 percent of GDP in 2015 to 4.6 percent in 2016, as economic growth slowed in Portugal and stagnated in Angola. STP's gross international reserves declined slightly and amounted to US\$55.9 million in December 2016, which is equivalent to 4 months' worth of imports.⁴

14. The current-account deficit has been financed by external aid, but the GoSTP is taking measures to foster export-oriented activities to increase exports, especially in the agriculture and tourism sectors. Foreign aid, foreign direct investment (FDI), and public-sector borrowing have mainly financed STP's current-account deficits. Grants were historically the largest source of financing, averaging 11.8 percent of GDP between 2013 and 2015, before reaching 14.8 percent of GDP in 2016. FDI more than doubled between 2013 and 2015. Since then, fluctuations in FDI have been associated with oil investments. Despite recent improvements to the country's external position, it remains vulnerable to internal and external economic shocks, such as a disruption of foreign currency inflows that decreases tourism receipts, remittances, or exports, which could affect the financing of the current-account deficit. Exchange rate adjustments have not played any role in reducing the current-account deficit, as it has been fixed at the same rate since 2010. The GoSTP has taken steps to attract foreign private investment through fostering a more business-friendly environment by reforming key legislation and simplifying business procedures. For example, it has removed most visa requirements and implemented a one-stop shop for foreign trade and business registration. It has also set up a private investment promotion agency, devised export promotion and tourism strategies. The GoSTP's goal is to attract private businesses that could play a significant role in boosting growth in the agriculture and tourism sectors – the country's main growth drivers – and help balance the external accounts by generating exports of goods and services.

15. The BCSTP has succeeded in keeping inflation low and monetary aggregates in check. STP's decision to peg its currency to the euro decreased its inflation rate substantially from 10.4 percent in 2012 to 4 percent in 2015.⁵ The inflation rate was broadly kept in check even though it fluctuated around its trend due to external shocks (agricultural pest and drought) and extraordinary changes in Consumer Price Index (CPI) methodology and increase in tax rates). Given the country's fixed exchange-rate regime and its underdeveloped interbank market, the ability of the BCSTP to conduct independent monetary policy is extremely limited. The recent reduction in the central bank interest rates is not a sign of monetary policy easing. On the contrary, the BCSTP maintains a conservative policy stance by requiring high levels of mandatory reserves – 18 and 21 percent on local and foreign currency deposits, respectively. After controlling inflation for several years, the BCSTP was able to cut three zeros from the currency on January 1, 2018 in an attempt to reduce transaction costs and show confidence in the stability of the currency.

16. STP's banking sector came under pressure following a rapid expansion in the number of banks, but the BCSTP is quickly implementing bank supervision measures. The prospects of oil discoveries, higher

⁴ According to the IMF methodology used in the ECF program: gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP to meet reserve requirements, for new licensing, and meet capital requirements. Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

⁵ Despite the currency peg, the inflation rate has not converged fully to the euro area. The reason for the non-convergence are threefold: (i) large structural differences between the economies such as STP's remoteness and the development of the non-tradable sector that reflect different composition of CPI baskets; (ii) policy differences in the labor market (i.e., existence of wage indexation), differences in tax policy (i.e., different tax rates), barriers to trade (including tariff and non-tariff barriers), and transportation costs or price indexation; and (iii) differences in the external environment, such as oil price fluctuations and its transmission process to the local economy.

levels of FDI, and industry deregulation led to a rapid expansion of the banking sector. However, banks came gradually under pressure as FDI inflows reversed when prospects for commercial oil activity declined. As a result, many of STP's banks suffer from a high level of NPL, a decreasing capital adequacy ratio (CAR), and low profitability, which could have large fiscal costs⁶ and threaten GDP growth if not addressed properly. To help distressed financial institutions, the BCSTP has taken measures to more effectively supervise the banking sector. For example, it has increased the number of staff and on-site inspections, requested problematic banks to increase capital reserves, and revised the legal framework relating to bank supervision. These measures have yielded results, as the CAR for the entire banking system increased from 24.1 percent in 2015 to 32.7 percent as of September 2017, and the share of NPLs to total credit decreased from 29.8 percent in 2015 to 23.9 percent as of September 2017.

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

17. **The GDP growth rate is expected to remain between 4 and 5 percent in the medium term in line with recent performance.** Government spending, agriculture, and tourism are still expected to drive the country's economic growth – in line with the experience of small island countries with specialized development. STP's tourism sector will gain momentum, as it will benefit from the country's connection to the international credit card system, new hotel openings, and increased flight connectivity. Also, public investment is expected to rebound in 2018 due to delayed loan disbursements, a higher IDA allocation, and the upcoming legislative elections. Oil production is still uncertain, and commercial activity is not expected before 2020. In sum, the main risks to growth come from the fiscal, banking, and external sectors. If the GoSTP addresses these risks along with the country's long-term development challenges, economic growth can leap to higher levels.

18. **Fiscal accounts should show gradual improvement, despite serious challenges.** STP's strict public expenditure cuts and aggressive tax changes helped reduce the fiscal deficit in 2017. The sustainability of the consolidation hinges on the country's ability to mobilize more domestic resources, especially through the VAT. The baseline fiscal projections incorporate an increase in tax revenue of 2.4 percentage points of GDP starting in 2019 as a result of the implementation of the VAT and improvements in tax administration. This increase in public revenue should allow STP to pay off its stock of arrears, increase the share of public investment financed by domestic resources, and provide better public services. However, to achieve this the GoSTP will have to control expenditures on a sustained way and improve control over expenditure commitments, modernize tax administration and provide it with the support needed to implement the VAT, and implement reforms of SOEs and public investment management (PIM).

19. **A recent Debt Sustainability Analysis (DSA)⁷ found that the trajectory of the public debt under baseline assumptions is sustainable, although the STP remains at a high risk of debt distress.** This assessment is unchanged from the previous DSA completed in May 2016. Three out of five ratios, including the present value of debt to GDP, exports, and revenue, breached the relevant thresholds. All ratios are projected to fall below the thresholds in the medium term under a baseline scenario that is underpinned by fiscal consolidation. Under the historical scenario, STP would remain at high risk of debt distress for the whole projection horizon. The DSA assesses the largest risks, including a depreciation of the exchange rate and a decrease in exports, to be manageable over the medium term if the country remains committed to the exchange-rate peg and maintains fiscal prudence and international reserves. The main non-market risk, which is not included in the DSA, is contracting debt or quasi-debt in breach of IDA's Non-Concessional

⁶ Fiscal costs could come from the need to compensate depositors or recapitalize banks. However, STP does not have a deposit insurance fund. The BCSTP has been exploring the feasibility and requirement for implementing a deposit insurance scheme, but such a feature is uncommon in small financial systems, particularly in those characterized by a high degree of concentration.

⁷ Joint World Bank-IMF staff report for the third review under the ECF-DSA (2017).

Borrowing Policy (NCBP). This could not only bring the country's debt to unsustainable levels, but also severely restrict access to concessional resources. The recent DSA included domestic arrears (worth 14.8 percent of GDP) for the first time, but it excluded a debt contract with Nigeria that is under dispute. STP is also in arrears with some small bilateral loans, but it is actively seeking restructuring, which led staff to conclude that the qualification of a high risk of debt distress is still adequate. Nevertheless, the permanence of a positive fuel price differential will accelerate the amortization of the government's arrears.

20. **Price stability will be maintained, and the current-account deficit will improve slightly.** Inflation is expected to decrease over the medium term after the current price shocks run their course, although it is expected to remain higher than in the euro area given the STP's remoteness and the large weight of food products in its CPI. The current account deficit will be slightly reduced due to stable oil prices, a reduced dependence on fossil fuels, and higher tourism exports. Despite imbalances in the external accounts and their risk to macroeconomic stability, a devaluation of the currency is not expected, as devaluations are not effective to address external-account imbalances in small countries like the STP.⁸ External financing should be secured from a combination of FDI and external aid. Financial soundness indicators are expected to continue to improve slowly, as authorities increase their supervision of the country's banks (which will significantly reduce the risks to growth from the banking sector) and lending activity increases slowly (which will help to foster private-sector growth drivers).

21. **On balance, STP's macroeconomic framework is adequate for DFP operations.** The framework is consistent with price stability due to the credible exchange-rate peg that has been place for the past eight years, and the BCSTP's commitment to the exchange-rate regime is evident by the evolution of monetary aggregates. The BCSTP has also been undertaking efforts to improve its monetary policy tools and support solid credit growth. Weak fiscal policy, which has produced persistent budget deficits, is the main fragility of the macroeconomic framework. Public authorities are addressing this through improving domestic revenue mobilization, controlling discipline, and achieving a better management and control of SOEs. Also, the GoSTP has committed to only borrow on concessional terms and keep annual borrowing levels in check to reduce debt ratios and address the high risk of debt distress. Even though the funding needs of STP's external accounts are structural – like in other small island countries – public authorities have been taking measures to secure external financing in the short term through grants and concessional loans and support economic activities, especially in agriculture and tourism, which can increase export earnings. Exchange rate devaluations are usually ineffective to deal with external imbalances in small countries. STP's macroeconomic risks include the government's inability to sustain fiscal consolidation and a sudden reversal in external financing flows. However, the GoSTP's macroeconomic policy is deemed adequate, as risks to growth are diminishing and are expected to be reduced further in the short to medium term.

⁸ *Open and Nimble: Finding Stable Growth in Small Economies* (WB) summarizes the discussion on the choice of exchange-rate regimes for small economies (pages 61-64). It explains the theoretical and empirical arguments that favor fixed exchange rate regimes in small countries.

Table 1. Selected Economic Indicators

	2015	2016	2017	2018	2019	2020
	Projected					
Real Economy	Annual Percentage Change					
GDP at constant prices	4.0	4.1	4.0	4.5	5.0	5.0
Imports of goods and nonfactor services	-18.6	-0.4	8.4	5.4	6.3	5.3
Exports of goods and nonfactor services	1.7	7.4	2.7	7.6	7.3	6.3
CPI (end of period)	4.0	6.0	6.3	5.0	4.0	4.0
Fiscal Accounts	Percentage of GDP					
Total revenue	28.0	29.4	24.6	28.0	29.6	30.4
Tax Revenue	14.3	12.2	13.0	13.4	15.0	15.8
Nontax revenue (exc. Oil)	1.5	1.4	1.5	1.6	1.6	1.6
Grants	11.5	14.8	10.1	13.0	13.0	13.0
Total expenditure	34.3	32.0	26.5	31.4	31.3	32.0
Current Expenditure	18.2	17.1	16.2	15.7	17.0	17.1
Of which: personnel costs	8.9	8.8	8.5	8.4	8.4	8.4
Interest due	0.8	0.4	0.7	0.5	0.7	0.7
Goods and services	3.4	3.2	2.8	2.7	3.0	3.0
Transfers	3.5	3.6	3.0	3.2	3.5	3.5
Other	1.6	1.1	1.2	0.9	1.4	1.5
Capital expenditure	15.5	14.7	10.1	15.1	13.8	14.2
Of which: financed by the Treasury	0.7	0.6	0.6	0.5	0.8	1.2
Financed by external sources	14.8	14.1	9.5	14.6	13.0	13.0
HIPC Initiative-related social expenditures	0.6	0.2	0.2	0.6	0.5	0.7
Domestic primary balance	-2.9	-4.0	-1.8	-1.3	-1.0	-0.9
Overall balance (commitment basis)	-6.3	-2.6	-1.9	-3.5	-1.7	-1.6
Selected Monetary Accounts	Annual Percentage Change					
Base money	37.5	5.0	-14.6	5.1	3.5	3.5
Credit to the economy	3.8	6.1	2.6	5.8	9.2	8.9
Central Bank reference interest rate	10.0	10.0	9.0	N.A.	N.A.	N.A.
Bank deposit rate	6.5	4.3	4.2	N.A.	N.A.	N.A.
Balance of Payments	Percentage of GDP					
Current Account Balance (exclude official transfer)	-25.2	-20.8	-22.3	-20.5	-19.9	-19
Imports	37.4	34	33.8	33.6	32.8	31.9
Exports	3.6	3.9	3.1	3.2	3.2	3.1
Foreign direct investments	8.1	5.9	11.6	2.7	2.7	2.7
Gross reserves (in millions of US\$)	61.9	55.9	58.7	64.4	67.1	68.5
Gross reserves (in months of imports)	4.8	4.0	4.0	4.2	4.1	3.9
Exchange rate (dobras per US\$, end of period)	22,424	23,614	20,684			
External debt	65.4	53	49.9	49.7	48	45.9
Other memo items:						
GDP nominal in US\$ (millions)	318.2	349.2	375.0	371.2	396	429
GDP (billions of dobras)	7,018	7,769	8,300	8,287	8,839	9,533

Source: São Tomé and Príncipe Authorities and IMF and WB staff estimates and projections (Jan/2018).

Table 2. Balance of Payment Financing Requirements and Sources

<i>US\$ Million</i>	2015	2016	2017	2018	2019	2020
				Projected		
Gross financing requirements						
Current account, excluding official transfers	-80	-72.9	-83.6	-85.7	-91.5	-95.8
Financial account	-2.4	-1.1	-4.2	-4.4	-4.1	-4.4
Scheduled amortization	-1.4	-1.2	-2.4	-2.6	-4.1	-4.4
IMF repayments	-0.9	-0.9	-0.2	-0.4	-0.3	-0.3
Other public sector flows (net)	-0.1	1.0	-1.6	-1.4	0.3	0.3
Change in external reserves (-ve=increase)	-18.2	4.9	-0.3	-5.2	-3.2	-2.0
Available funding	80	72.9	83.6	85.7	91.5	95.8
National Oil Fund (net)	2.0	-1.3	-0.2	1.1	1.7	1.4
Oil signature bonuses	2.4	0.0	0.0	0.0	0.0	0.0
Saving (-ve=accumulation of oil reserve fund)	-0.4	-1.3	-0.2	1.1	1.7	1.4
Expected disbursements	73.6	58.3	56.8	73.0	76.8	79.1
Multilateral HIPC interim assistance	6.0	2.9	3.7	3.8	4.4	4.6
Capital transfers	0.0	0.0	0.0	0.0	0.0	0.0
Grants	34.0	49	34	51.6	54.8	60
Concessional loans	33.6	6.4	19.1	17.6	17.6	14.5
Private sector (net)	24.1	10.1	29.5	19.4	14.9	14.8
IMF	0.9	1.8	1.8	1.8	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	4.2	6.5
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	0.0	0.0	4.2	6.5

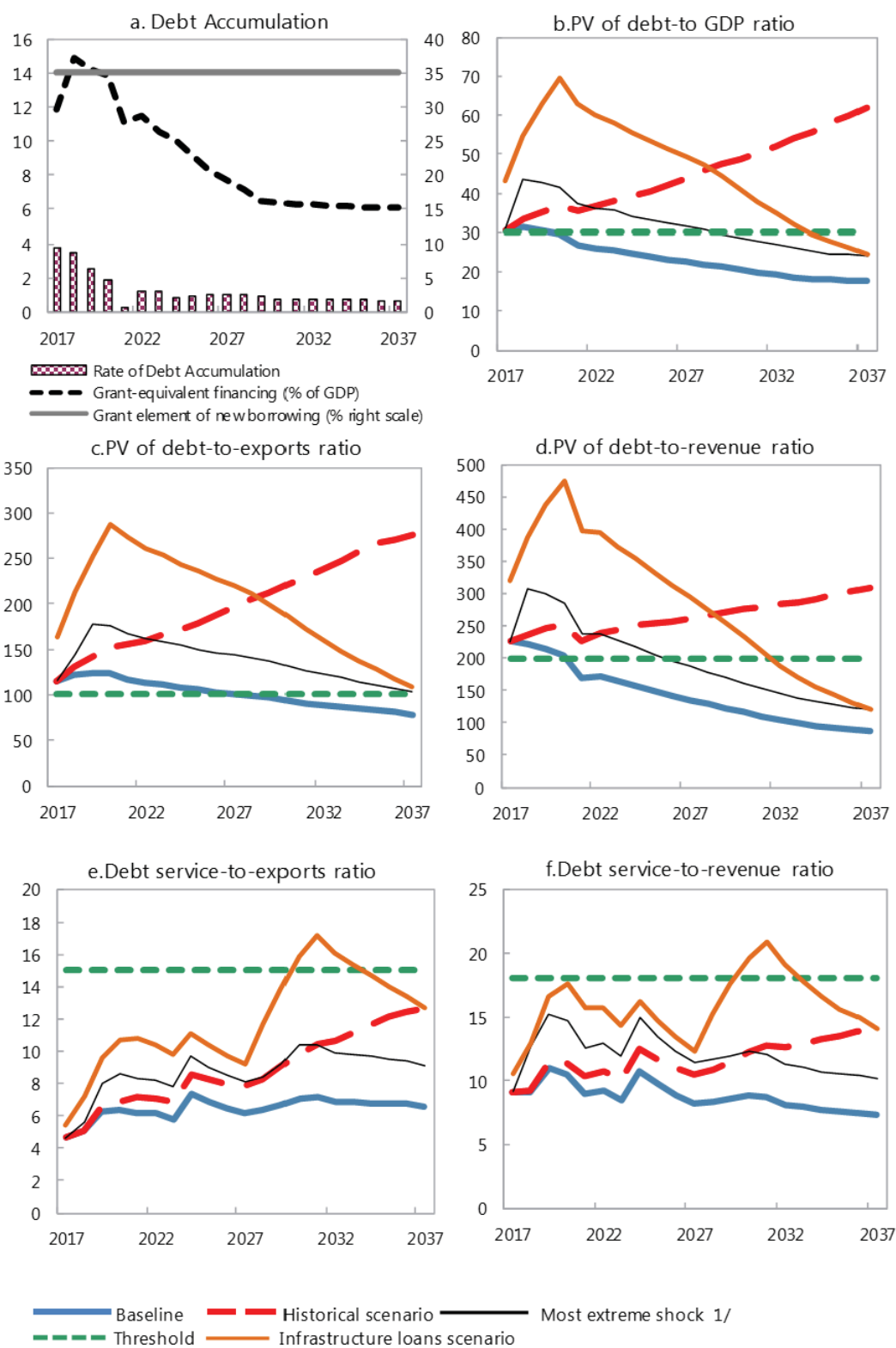
Sources: São Tomé and Príncipe Authorities and WB and IMF staff estimates and projections (Jan/2018)

Table 3. Central Government Operations and Financing Needs

<i>% of GDP</i>	2015	2016	2017	2018	2019	2020
				Projected		
Overall fiscal balance (commitment basis)	-6.3	-2.6	-1.9	-3.5	-1.7	-1.6
Grants	11.5	14.8	10.1	13.0	13.0	13.0
Overall fiscal balance (cash basis)	-7.2	0.2	-2.9	-3.5	-3.1	-3.0
Financing	7.2	-0.1	2.9	3.5	2.9	2.1
Net External	8.2	0.8	0.3	2.4	3.0	2.6
of which project and program loans	10.9	2.2	1.8	3.7	3.9	3.5
of which scheduled amortization	-2.7	-1.4	-1.5	-1.3	-0.9	-0.9
Net domestic	-1.0	-0.9	2.6	1.1	-0.1	-0.5
Net bank credit to the government	-1.0	-0.9	2.6	1.1	-0.1	-0.5
of which banking system credit (excl. NOA)	-0.9	-0.6	1.9	0.6	-0.5	-0.8
of which National Oil Account (NOA)	-0.1	-0.3	0.7	0.5	0.4	0.3
of which nonbank financing	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.1	0.0	0.0	-0.2	-0.9

Sources: São Tomé and Príncipe Authorities and WB and IMF staff estimates and projections (Jan/2018)

Figure 1. Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios



Sources: São Tomé and Príncipe's authorities, and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027.

2.3 IMF RELATIONS

22. **The proposed operation builds on collaboration with the IMF.** This programmatic series was conceived and is implemented along with the current IMF ECF program. The ECF was approved in July 2015 and will be implemented until the end of 2018, with semi-annual reviews. It supports fiscal consolidation and sustainable debt management and aims to create fiscal space for growth-enhancing capital spending. Moreover, it supports policy measures for clearing domestic arrears, enhancing domestic revenue mobilization, and implementing public financial management (PFM) and financial sector reforms.

3. THE GOVERNMENT'S PROGRAM

23. **The GoSTP's program is built around three strategy documents: a long-term development plan (Vision 2030), the Program of the current government, and the recently completed National Development Plan for 2017-2021 (Plano Nacional de Desenvolvimento, PND).** The long-term plan, entitled "Vision São Tomé e Príncipe 2030: The country we need to build," lays out broad strategic guidance for the country's development and is structured around: (a) the rule of law; (b) sustainable growth; (c) human development; and (d) shared development policies. The Program of the current government provides the GoSTP with practical guidance to implement its program over the 2015-2018 period. Finally, the 2017-2021 PND's overarching objective is to accelerate economic growth, poverty reduction, and environmental protection. It provides: (i) a framework for medium-term social and economic development policies; (ii) a way to coordinate the work of development partners; and (iii) a tool to mobilize resources to finance development efforts. It includes five thematic areas: (i) economic, (ii) social, (iii) institutional, (iv) infrastructure, and (v) environment. The GoSTP aims to achieve the PND's objectives through implementing several programs and two large public-private partnership infrastructure projects: an airport hub and a transshipment deep-sea port. Moreover, the PND is comprised of policies that address the country's most pressing developmental challenges, acknowledges the need for fiscal consolidation, and includes education and health policies that are conducive to poverty reduction. It also includes much needed infrastructure projects that can spur growth and reduce poverty if implemented following proper appraisal and prioritization procedures. This may not be the case of two flagship projects – the airport hub and the deep-sea port – which do not seem to be viable in social, economic, and environmental terms. The risks to the successful completion of the PND are related to the plan's ambitiousness, the country's implementation capacity, and its funding.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

24. **The proposed operation is aligned with the GoSTP's program and objectives.** The operation will mainly support the second and fourth axis of the government's strategy: sustainable growth for Pillar A and shared development policies for Pillar B. The reforms supported by this operation are foreseen in the seventh and eighth objectives of STP's Vision 2030: *"Simplify the legislation and improve the business climate; and Implement programs of infrastructure to support growth."* Fiscal and PFM reforms envisaged under Pillar B are echoed in the fourth and fifth objectives of the Vision 2030: *"Strengthen public and administrative management tool; and Promote transparency and accountability in public affairs."* The long-term development plan also dedicates a full chapter (i.e., Chapter 6 of Vision 2030) to priority projects for the implementation of the STP's agenda for transformation by 2030, which is supported by the second pillar of the development policy financing (DPF). DPF-supported reforms are aligned with the PND's social, institutional, and economic infrastructure thematic areas. Finally, the ultimate objective of both the DPF series and the government strategies is to reduce poverty and promote shared prosperity, which is reflected in the first pillar of the Program of the current government: the *"Acceleration of sustainable growth,*

employment-creating and reducing poverty and promoting food security,” or in the list of projects at the end of the Vision 2030 that is clearly linked to the challenge of reducing poverty (e.g., in rural or coastal communities) or promoting shared prosperity (e.g., promoting national and social cohesion).

25. **The proposed operation incorporates the lessons learned from previous World Bank operations in STP.** The key constraint faced by previous operations was the government’s relatively weak implementation capacity. As a result, the proposed operation strikes a balance ambition and feasibility when setting the expected results. The operation is supported by technical assistance, previous analytical work, and other current and prospective World Bank engagements. Legal changes that require parliament approval are included only when a law is already approved or after a careful assessment between the importance to the operation’s objective and its political economy feasibility.

4.2 PRIOR ACTIONS, RESULTS, AND ANALYTICAL UNDERPINNINGS

26. **The objective of this proposed operation is to help the government introduce growth-enabling reforms in the financial sector, business environment, and infrastructure; generate fiscal resources and savings; and improve the quality of public expenditures.** These reforms will address the causes of STP’s development challenges and risks to growth. The operation is structured around two pillars. The first one supports policies aimed at reducing risks from the financial sector through improving bank supervision and fostering private sector-led growth by improving access to credit and energy, which are foundational steps for developing STP’s tourism and agriculture sectors – the country’s main comparative advantages. The second pillar deals with the risk of fiscal fragility and the challenges of low inclusiveness of growth. Despite being organized in pillars around specific sectors and themes, the operation is multi-sectoral, and there are synergies between policy actions and triggers across the two pillars. For example, reforms of the property and mortgage registry will also benefit tax collection and will facilitate loan collateralization by the banking system. Another example is the complementarity between financial inclusion and social protection. Agent banking and mobile finance will allow more people to access the financial system, which in turn will make room for social protection payments to be made through the banking system, allowing for better control and auditing of payments and beneficiaries.

27. **The lack of private-sector growth drivers, the low inclusiveness of growth, and the risks to growth (i.e., from fiscal fragility, the banking sector, and the external sector) have several causes.** For example, the low inclusiveness of growth can be traced to low levels of education, poor access to finance, and inadequate social protection. The lack of private-led growth drivers can be ascribed to poor infrastructure, lack of credit, an inefficient judicial sector, and a cumbersome business environment. Moreover, risks to growth come from: (i) poor bank supervision and inadequate resolution of NPLs in the banking sector; (ii) low domestic resource mobilization, a high risk of debt distress, and the low quality of public expenditures; and (iii) a high current-account deficit, over-reliance on grants, and concentrated exports. Since the DPF series cannot address all causes of growth risk, some filters – such as complementarity with other operations and Advisory Services and Analytics (ASA), client demand, and World Bank expertise - were applied to select the government policies to be supported by this series. As a result, the DPF series is supporting measures to address nine causes of the country’s development challenges and risks to growth.

28. **The policy matrix supported by this programmatic series has been modified from the first DPO to sharpen the focus on growth-enhancing reforms and strengthen the links between this proposed DPO and the WB’s support to the energy sector.** All prior actions were reviewed to incorporate the knowledge gained from the completion of the country’s Public Expenditure Review (PER, 2018). Prior actions and indicators were revised to ensure the critical nature of the supported policies and better link them, such as prior action 1 and results indicators 2 and 3. One new action was included in the energy sector to make sure that more

immediate actions are taken to reduce the fiscal burden of EMAE while more structural measures will yield results in the long term. Finally, some prior actions were adjusted to reflect the updated timeframe of the policy reforms. For example, the draft microfinance law was brought forward from the third operation, while the adoption of the Least Cost Power Development Plan (LCPDP) was moved to the third operation, as there is a need for broader government consultation and ownership.

Table 4. Summary of Changes in Prior Actions from DPO 1 to DPO 2

Trigger	Prior Action	Explanation for Change
The Recipient's Central Bank has established a Prompt Corrective Action (PCA) framework to address events of noncompliance with banking sector regulation.	#1 - In order to strengthen the bank resolution framework, the Recipient, through its BCSTP, has adopted regulations implementing the Recipient's financial institutions resolution law, which set out (i) the measures to be applied by the BCSTP in the resolution of distressed financial institutions; and (ii) the requirements for the elaboration and adoption of recovery and resolution plans.	The World Bank team opted to support the operationalization of the law. This support was deemed more critical to the operation's outcome.
(From DPF3) The Recipient has submitted to the parliament a draft law on microfinance.	#2 - In order to develop the microfinance sector and promote the offer of microfinance services, the Recipient, through its Council of Ministers, has approved and submitted to the Parliament a draft law on microfinance.	This was a trigger for DPF3, which is brought forward to DPF2 due to its completion ahead of schedule.
The Recipient's Central Bank has issued regulation on modern payment methods including agent banking, mobile money, and electronic payments.	#3 - In order to expand the outreach of the banking system and support financial inclusion through the usage of mobile financial services, the Recipient, through its Council of Ministers, has submitted to Parliament the proposed National Payment Systems Law, which sets forth the statutory level principles for regulation on modern payment methods, such as agent banking, mobile money, and electronic payments.	The prior action was changed to reflect the correct legal instrument to be used.
(From DPF3) The Recipient has revised the property registration and public notary code to reduce costs and simplify procedures to register property.	#4 - In order to reduce costs and simplify procedures to register property, therefore improving its ability to serve as loan collateral and foster access to finance, the Recipient, through the Council of Ministers, has submitted to the Parliament (i) proposed Property Registration Code, and (ii) and the proposed Public Notary Code.	This was a trigger for DPF3, which is brought forward to DPF2 due to its completion ahead of schedule.
	#5- In order to promote transparency and incentivize timely payments, the Recipient, through EMAE, has published its policy to improve billing collection and launched a public awareness campaign through public TV and radio.	New prior action. Prior action included supporting an improvement of commercial practices at EMAE due to the large share of energy that is not billed or paid.
The Recipient has adopted an integrated Least Cost Power	#6 - In order to structurally reduce the cost of energy, increase the share of	The procurement and carry-out of the LCPDP could not be anticipated in

Development Plan.	renewable sources, and promote long-term private investment, the Recipient, through its Council of Ministers, has ruled that any capacity expansion in the power sector will have to follow the prescriptions of the integrated Least-Cost Power Development Plan, and that any exceptions would need to obtain the approval of the Recipient's Minister of Infrastructure, who shall have to provide the rationale for such exemption and publish said decision.	relation to the original calendar foreseen in the PSRP. In addition, given the need and importance of broad stakeholder consultation for the LCPDP, the World Bank team judged to be more appropriate to have the plan approved for the third operation, but have the government committed to it by issuing a regulation binding any decision on energy expansion to the forthcoming plan.
AGER has published the minimum quality criteria for energy service to improve the reliability of the energy supply.	#7 - In order to improve the reliability of energy supply, the Recipient, through AGER, had published the minimum quality criteria for the provision of energy service.	No significant changes
The Recipient has mandated companies to issue fiscal invoices and to provide the associated fiscal and accounting information.	#8 - In order to generate the tax and accounting information needed to implement the VAT, the Recipient, through its Council of Ministers, has adopted the legal framework for fiscal invoices and similar documentation, whereby it legally mandated companies to issue fiscal invoices, set out said invoice's minimum content and time requirements for storing them.	No significant changes
The Recipient has put in place a medium and long-term strategy to improve management and control of SOEs and has published accounts audited by an external and independent auditing company of at least two fully public owned SOEs.	#9 - In order to improve SOE's financial and non-financial performance, the Recipient, through its Council of Ministers, has approved an SOE reform plan that established a performance monitoring system with financial and non-financial targets for all SOEs and incentives to ensure compliance. .	The team decided to unbundle the prior action for the sake of clarity and to highlight the relevance and scope of the SOE reform plan. In addition, external auditors are performing a "pre-audit" in the SOEs, whose recommendations will be incorporated in the reform plan.
The Recipient has included in the budget law a list of all public investment projects in the pipeline including the respective financing source.	#10 - In order to improve the efficiency and value for money of public investment, the Recipient's Parliament has enacted a National Planning System Law that harmonizes planning and budget tools and lays the foundation for the appraisal and selection of public investment projects.	The new prior action reflects the better knowledge of the issue brought by the initial analysis for the PER and the structured approached that is being proposed to support PIM reforms in STP.
The Recipient has registered all beneficiaries of the three core SP programs defined by the Social Protection Policy and Strategy in the Social Registry.	#11 - In order to coordinate and harmonize social protection and poverty reduction policies, the Recipient has registered in the Recipient's social registry all beneficiaries of the three core social protection programs defined in the Recipient's Social Protection Policy and Strategy.	No changes

29. **This operation builds on the good progress made in implementing reforms under the first DPO in**

this programmatic series. Provisional banking sector data shows that only one bank is currently below the minimum CAR. The new BCSTP directorate on payment systems has moved forward with the procurement process to upgrade and connect the national payment systems to the international network. EMAE has reported a significant increase in the adoption of prepaid meters,⁹ which has led it to plan for a new purchase of prepaid meters. Staff from the General Regulatory Authority (*Autoridade Geral de Regulação*, AGER) and EMAE received training in a customer complaint redress system, and tax revenue increased in 2017. The production-to-sales ratio in the energy sector has also improved since 2014. Finally, the recent decision of the Council of Ministers to freeze personnel hires in SOEs highlights the alignment between government priorities and WB support.

Pillar A: Introduce Growth-enabling Reforms in the Financial Sector, Business Environment, and Infrastructure

30. **The first pillar of this proposed DPO supports GoSTP's growth-enabling reforms.** These reforms address risks to growth, such as inadequate banking sector supervision, and foster private-sector led growth, for instance by improving the credit market and the costly and unreliable energy supply network. These measures are the key enabling factors to boost the country's growth drivers – agriculture and tourism – and correspond to the specialized development patterns typical of small island countries. Financial sector reforms are supported in coordination with the IMF.

Financial Sector

31. **This DPF series supports reforms in critical areas of the financial sector, including banking supervision, credit markets, and financial inclusion.** Supervision of the financial sector is improving but has been a challenge in STP given the structural characteristics of its market and the limited number of supervisory staff with sufficient technical expertise. On-site supervision of financial institutions has been infrequent, and enforcement of remedial measures has occurred with significant delays. Several banks had CARs below the minimum level required and needed additional time to comply, and regulatory forbearance of prudential standards. Moreover, STP's credit market is not efficient, as traditional collaterals such as real estate or land are limited, and the country lacks a modern and functional system for secured transactions, which would allow movable property to be used as collateral for loans. The BCSTP maintains a credit registry of active loans above a certain threshold, but the registry is incomplete and is seldom used by lenders for assessing credit risk. Also, insolvency laws do not reflect international best practices, and the judicial system has limited experience in resolving NPL cases brought by creditors. Access to finance remains one of the main constraints for private sector development, with demand-side data indicating that only 14.4 percent of business and/or adults have an active loan. To address these challenges, the government adopted the Financial Sector Development Implementation Plan (FSDIP) in September 2016, with support from the WB, and its priority action areas include financial sector supervision, financial inclusion, and financial infrastructure. After the launch of the FSDIP, the BCSTP set up a steering committee, which is leading the implementation. The most significant reforms identified in the FSDIP are supported in this DPF series.

32. **Distress in the STP's banking sector, most recently evidenced by the BCSTP's intervention and liquidation of the country's fourth largest bank by assets, carries contingent economic and fiscal impacts.** The rapid expansion of the banking sector during the period of oil exploration in the early 2000s was challenging for the BCSTP, which did not have the necessary processes nor staff to review requests for licensing and authorization of new banks and could not effectively supervise the industry. As a percentage of gross loans, NPLs were high at 27.1 percent of all loans in 2016. This reduced the profitability of the sector,

⁹ The number of prepaid meters increased by 23 percent – from 1,496 in 2015 to 1,851 in 2016, but they only represent 2 percent of EMAE's revenue, reflecting that the project is in its pilot stage.

which was negative from 2012 to 2015, and the return on assets and equity - only 0.5 percent and 2.2 percent, respectively, as of September 2017. High asset impairment is leading to significant losses across the financial sector, while low-to-negative profitability is expected to erode capital even further.

33. **The BCSTP is aware of the challenges facing the banking sector and has taken measures to improve financial sector supervision.** It has increased the number of staff members that supervise banks and has successfully convinced the management of some banks to increase capital reserves. The BCSTP has also requested support from both the IMF and the WB to revise key financial sector regulations, including the framework for bank resolution, which the WB has been supporting with technical assistance. Finally, the BCSTP wants to revise the central bank law and has been implementing an ambitious strategic plan.

34. **Both this proposed and the upcoming operations support efforts to enhance financial sector supervision and regulation, addressing the risks to growth from potential instability in the banking sector.** STP's bank resolution law provides the legal basis to deal with troubled banks in a manner that safeguards financial stability and depositor savings. The operationalization of the resolution law is a critical element in enabling the BCSTP to adequately resolve troubled banks. **The operationalization of the bank resolution law is a prior action for this second operation and consists of two lower level regulations (*Normas de Aplicação Permanente, NAPs*) included in the new law.** The first NAP details the bank resolution measures available to the BCSTP such as bank recapitalization, partial or full divestiture of bank assets, transfer of assets to third parties, and unilateral bank mergers. The second NAP establishes the contents of the bank recovery and reorganization plans. These plans must contain measures to reestablish the bank's soundness, including the sale of assets, the closing of loss-making units, and the maintenance of essential functions, and must be approved by the BCSTP. The third DPF operation includes a trigger on asset quality review (AQR), which is an exercise wherein a bank's loan portfolio will be reviewed for proper valuation of assets. The policy reforms will be monitored by the compliance of private commercial banks with the minimum CAR required by the BCSTP.

Prior action 1 (DPF1): *The Recipient, through its National Assembly, has approved a banking resolution law (Medidas Especiais de Saneamento, Resolução e Liquidação de Instituições Bancárias) that provides the BCSTP with the power and authority necessary to deal effectively with distressed financial institutions by facilitating early intervention and providing additional policy instruments to address vulnerabilities.*

Prior action 1 (DPF2): *In order to strengthen the bank resolution framework, the Recipient, through its Central Bank, has adopted regulations implementing Recipient's financial institutions resolution law, which set out (i) the measures to be applied by the BCSTP in the resolution of distressed financial institutions; and (ii) the requirements for the elaboration and adoption of recovery and resolution plans.*

Trigger 1 (DPF3): *In order to obtain more reliable information on banks' financial soundness, the Recipient, through its Central Bank, has carried out a review of the quality of banking sector assets (Asset Quality Review- AQR) and mandated banks to adjust Non-Performing Loans classification and provision accordingly.*

Result Indicator 1: *Number of banks below the Central Bank's minimum Capital Adequacy Ratio (12%). Baseline (2015): 3; Target (2020): 0*

35. **The difficulty to offer loan guarantees and enforce loan contracts in STP is preventing its credit markets from functioning efficiently and hindering the growth of credit to private businesses.** The lack of access to credit reduces the capacity of individuals and micro, small, and medium enterprises to supplement their income and smooth consumption. The country has a credit registry, but few lenders refer to it for lending decisions, as data are incomplete. The ability to pledge assets or rights as collateral is limited, as this involves changing the ownership of the property and paying high fees. Moreover, movable assets are not registered, and fixed assets tend to be registered with a lower value. The GoSTP and the private sector agree that the institutional setup is not conducive to functional credit markets. Therefore, the government is taking policy measures to address this problem such as reducing the cost of registering property and mortgages

and revising key legislation. The private sector, in particular banks, has recently showed greater compliance with the requirements of the credit registry.

36. **This DPO series support measures to strengthen the credit market by introducing a new guarantee law with a framework for secured transactions and increasing available information on loans and borrowers.** Secured transaction systems (the use of movable property as collateral for a loan) enable businesses and consumers to use their assets and rights - in addition to traditional collateral such as land and real estate - as security to generate capital. The new guarantee law will be drafted along the lines of the United Nations Commission on International Trade Law's model law, allowing all guarantees to be treated uniformly (functional approach), creating a non-possessory pledge, and allowing for the creation of a movable collateral registry that serves two functions: (i) notifies third parties of the existence of the security interest and (ii) establishes the priority status of a security interest based on the date of registration. This new guarantee law, which is a trigger for the third operation, will be a real innovation for STP and for Portuguese-speaking countries in general, as it will make the country the first Lusophone country to adopt a more modern functional approach to guarantees. The third indicative trigger for the third operation – upgrade of the credit registry – will address the information and coverage gaps in the existing credit information system and encourage its use. The potential of credit reporting data is largely underexploited in STP due to: (i) imperfect quality of information; (ii) a lack of some relevant data; (iii) the absence of functions/reports in the platform; (iv) incomplete coverage (i.e., microfinance institutions and some banks do not contribute to the Credit Registry Central; and (v) high operational risk (e.g., there no disaster/recovery procedures and the servers are becoming obsolete). The achievement of these reforms will be measured by the WB's Doing Business indicator "Getting Access to Credit," which measures the legal rights of borrowers and lenders in secured transactions and bankruptcy laws, and the coverage, scope, and quality of credit information available through credit registries and bureaus.

Trigger 2 (DPF3): *In order to expand the range of assets that can be pledged by borrowers and strengthen the quality of collaterals, thereby improving access to credit, the Recipient has submitted to the parliament a new law on guarantees that: (i) introduces the concept of a functional approach to secured transactions; (ii) widens the range of assets that can be used as collateral; and (iii) allows for the establishment of a movable collateral registry.*

Trigger 3 (DPF3): *In order to increase the information available to lenders for assessing borrower's creditworthiness, which would improve access to credit, the Recipient, through its Central Bank, has improved the Public Credit Registry by: (i) instituting back-up procedures; (ii) instituting real-time update procedures; and (iii) expanding the scope of information.*

Result Indicator 2: *Score on Doing Business indicator "Getting Credit". Baseline (2015): 0 out of 20; Target (2020): 10 out of 20.*

37. **Limited access to finance is one of the reasons behind STP's low inclusiveness of growth.** Although 48 percent of the population has a savings account, few individuals regularly use financial services. Only 7 percent of micro, small, and medium enterprises have a bank loan, less than 5 percent of adults are clients of consumer finance firms, and a mere 4.3 percent of adults have some form of private insurance. Financial inclusion is hindered by outdated payment systems, limited physical access to banks, a lack of alternatives to banks, the limited offer of credit instruments, and the informal sector. Most bank branches are concentrated in the capital city, and there are two districts with no bank branches. When present outside of the capital city, banks are located only in the district capital, as lack of scale prevents branch expansion into unserved areas. Moreover, the legal and regulatory frameworks for more cost-effective alternatives, such as agent banking and mobile money, are still being developed. The banking sector represents 96 percent of STP's financial sector, and alternatives such as microfinance, micro insurance, and firms specializing in leasing and factoring are either nonexistent or unregulated.

38. **The proposed DPO supports the strengthening of the legal and regulatory framework to**

modernize the payment system and foster non-bank financial institutions, underpinning increased access to finance, which will make growth more inclusive. The second operation supports two prior actions on access to finance. **The first prior action is the submission to parliament of the draft national payment systems law that aims to strengthen the overall system for payments and transactions in the country.** Currently, there is no adequate legal safeguard for electronic transactions and more cost-effective banking methods such as agent banking and digital financial services. The adoption of these regulations will lay the foundation for financial inclusion by providing the legal framework for mobile and agent banking. The new law will also facilitate links to international credit card services, which should help the tourism sector and reduce current-account deficits. **The second prior action is the submission of the draft law on microfinance to Parliament.** This law will (i) incentivize the microfinance sector, which is practically nonexistent, and put it under the BCSTP's regulatory oversight; and (ii) increase competition by allowing the creation of alternative financial institutions. Once the law is passed, the next step will be for the BCSTP to develop a microfinance regulatory framework, which is a trigger for the third operation. This will focus on prudential regulation, mainly for microcredits. Moreover, it will be necessary to establish regulations for the creation, licensing, and operation of new institutions created by the law such as microcredit societies, microbanks, microinsurance companies, and financial cooperatives. There will also be a need to create specialized expertise in microfinance through trainings and possibly the dedication of staff. The microfinance draft law was originally a trigger for the third operation; however, it has been brought forward as a prior action of the second operation due to early completion. Conversely, the establishment of a legal framework for secured transactions, which was a trigger for the second operation, has been moved to the third operation. This set of reforms on financial inclusion will be evaluated by the share of population with access to formal financial services.

Prior action 2 (DPF1): *The Recipient, through its Central Bank, has created, operationalized and staffed a new directorate (Direcção de Sistemas de Pagamentos) to consolidate in the same unit all responsibilities related to oversight, policy formulation and development of the national payment system.*

Prior action 2 (DPF2): *In order to develop the microfinance sector and promote the offer of microfinance services, the Recipient, through its Council of Ministers, has approved and submitted to Recipient's Parliament a draft law on microfinance.*

Prior action 3 (DPF2): *In order to expand the outreach of the banking system and support financial inclusion through the usage of mobile financial services, the Recipient, through its Council of Ministers, has approved and submitted to Parliament the proposed National Payment Systems Law, which sets forth the statutory level principles for regulation on modern payment methods, such as agent banking, mobile money, and electronic payments.*

Trigger 4 (DPF3): *In order to implement the key provisions of the microfinance law, the Recipient, through its Central Bank, has passed the regulations, which establish the supervisory and reporting procedures for microfinance institutions.*

Result Indicator 3: *Share of the population with access to formal financial services (e.g. bank accounts). Baseline (2015): 53%; Target (2020): 65%.*

39. **A property registry is a cornerstone of a well-functioning economy, with positive spillovers to credit markets.** It secures property rights and allows for the development of a real estate and housing market. A proper registry of properties and related transactions, such as mortgages, allows assets to be safely pledged as collateral. A well-functioning mortgage registry would enable the expansion of credit to firms and households, easing an important constraint to growth in STP (i.e., its underdeveloped credit markets) and fostering private-sector growth drivers. Furthermore, efficient property registries are essential for property tax collection.

40. **STP's property registry policies and procedures are from colonial times, although the GoSTP has recently initiated changes.** Most registry services are only offered in the country's capital city. Moreover, registry procedures are mostly manual, and the system relies on paper files that are inadequately stored and not backed-up electronically. A large share of properties is either not registered or registered at a lower

value, as until recently hefty fees were imposed on the registration of properties and mortgages. However, the government has appointed a new management team at the property registry who is advancing a modernization plan. In July 2016, the Council of Ministers reduced the cost of registering mortgages by half and determined that fees should be levied only on the initial registration and not on mortgage cancellations as it was done previously.¹⁰ This reform was the third prior action of the first DPF operation. Currently, the cost of registering property is at 10.2 percent of the property value, which is still above the Sub-Saharan African average of 7.8 percent and above other Lusophone African countries such as Cabo Verde (2.3 percent) and Mozambique (5.1 percent). The transfer tax (SISA), which is set at 8 percent of the property value, is the main hindrance to further reducing the cost.

41. **The GoSTP is undertaking a full-fledged revision of property and business-related legislation.** In January 2017, public authorities made further changes to the prices and procedures of the property registry. Most services are now charged a reduced flat fee or the value of the fee (expressed as a percentage of the underlying object) when a flat fee is not possible due to tax issues. In the case of mortgages, the fee is now calculated as a fraction of the interest due in the first year as opposed to the value of the mortgage. Fees for expedited service were also reduced and are now refundable if the service is not delivered within 48 hours, and the registry was moved to a new and improved building. The next step in the reform process is a revision of the property registration and notary codes. The revision of these codes, which has gained momentum with the appointment of a new minister of justice, will further reduce the cost to users and result in more modern and simplified processes, with the implementation of information-technology tools. A committee of legal experts drafted a proposal for the revised codes, which received input from WB experts. The judicial and commercial codes are undergoing the same revision process. **The revision of the notary and property registration codes was originally an indicative trigger for the third operation, but it has been brought forward as a prior action for this proposed operation due to early completion.** These reforms will be evaluated by the number of properties and mortgages registered and digitized in the public notary. Cost reductions and the simplification of procedures are also expected to encourage people and firms to register their properties and mortgages, with positive spillovers to credit markets and tax collection.

Prior action 3 (DPF1): *The Recipient, through its Council of Ministers (Conselho de Ministros), has reduced legal fees (i.e. taxes and registry fees) associated with the registry of mortgages.*

Prior Action 4 (DPF2): *In order to reduce costs and simplify procedures to register property, therefore improving its ability to serve as loan collateral and foster access to finance, the Recipient, through the Council of Ministers, has approved and submitted to Recipient's Parliament (i) the proposed Property Registration Code; and (ii) the proposed Public Notary Code.*

Result Indicator 4: *Share of real estate properties and mortgages registered and digitized in the Public Notary Registry. Baseline (2015): 0; Target (2020): 90 percent.*

Energy Sector

42. **STP's energy supply is costly and unreliable, reaches only about half of the population, and is predominantly generated by nonrenewable sources.** Similar to other small island countries, STP's energy costs are structurally high, as its small scale and insularity hinders interconnectivity between systems.¹¹ The country's average retail tariff is US\$0.21 per kWh, one of the highest in the region. Renewable energy sources are restricted to a single functioning hydroelectric power plant, which is currently producing less

¹⁰ The mortgage cancellation fee was later changed to a flat fee of €20.

¹¹ Trimble, Chris et al. "Financial Viability of Electricity Sectors in Sub-Saharan Africa: Quasi-Fiscal Deficits and Hidden Costs" World Bank Policy Research Working Paper 7788, The World Bank Group, Washington D.C: 2016 shows that operating costs of power utilities in SSA are 20 times higher in island countries than in non-island countries, and that operating costs for small systems (less than 150 MW) are six times higher than for larger systems (>1000 MW).

than 1 MW.¹² The rest of the energy is provided by low-efficiency thermal generators, leading to high fuel consumption. In addition, years of underinvestment have left energy assets and the electricity grid in poor condition and highly vulnerable to failure. As a result, extensive outages are frequent, especially during periods of peak demand.¹³ This limited and unreliable power supply leaves privately-owned diesel or gasoline generators as the only reliable way to access electricity in STP, even for households connected to the energy grid. This has also resulted in a costly and unsustainable situation for household budgets and a challenge for private-sector growth drivers to flourish.

43. **Apart from its technical problems, EMAE also faces challenges related to management and commercial viability.** Two-thirds of the company's estimated 40 percent losses in 2015 were non-technical, and these alone were estimated to have increased the overall cost of electricity production by more than 33 percent. Therefore, EMAE is not able to recover its costs, despite its high energy tariffs. In 2016, EMAE's cost exceeded its revenue by €11.2 million, equivalent to 3.5 percent of GDP. As a result, EMAE has accumulated arrears with the government and suppliers in the amount of €57.3 million, equivalent to 18 percent of GDP. It has also underinvested in maintenance, leading to low-quality services and high customer dissatisfaction. The major commercial challenges faced by EMAE include improper metering and billing and overdue bills from public and private clients. Client arrears reached €7.8 million in 2016, equivalent to 72 percent of EMAE's annual revenue in the same year. Not all clients have meters, and those who have are not measuring electricity consumption properly because of the meters' old age. Reports of incorrect metering and billing as well as energy theft are not uncommon, contributing to an alienation of the customer base.

44. **The GoSTP is implementing a comprehensive reform of the energy sector, encompassing infrastructure, planning, regulation, and management of EMAE.** The government has recently expanded the power grid to the center of the island and installed more generators. It plans to rehabilitate the main hydropower plant and critical components of the grid in the medium term. In the long run, the GoSTP aims to generate at least half of its energy supply from renewable sources.¹⁴ The Bank's PSRP is also supporting the government to upgrade and update its planning instruments. Within the next two years, the GoSTP plans to develop an LCPDP, create electricity demand forecast models, and revise energy tariffs and subsidies. In the recent past, the government reformed the regulatory framework by adopting a new energy sector law and creating an energy regulator, and it is currently implementing the new framework, albeit slowly. The proposed DPF operation supports measures to improve EMAE's commercial management and improve the planning and regulation of the energy sector.

45. **EMAE is reforming its commercial practices to introduce good industry practices.** A successful utility company measures and bills all the energy supplied to its clients and receives most of the payments in a timely manner. In addition, clients with payments in arrears should be actively and quickly pursued. However, this has not been the case at EMAE, as it collects around 60 percent of the energy billed and has large client arrears that stretch far back in time. EMAE has revamped the pre-paid energy system as an initial step to address the metering and billing issues, which allowed the company to resume the offer of pre-paid energy services. This reform, which was supported in the first operation, allowed EMAE to install new meters and reduce the non-payment of bills. A review of the expansion of the pre-paid service was conducted in 2017. While the overall result was positive, some adjustments were made to improve control. New measures were also put in place to deal with the non-payment of clients with non-prepaid meters. Moreover, a unit was created in the commercial department with dedicated staff to handle large private clients. As a result,

¹² The total nominal installed capacity in the country is 30 MW, out of which 1.9 MW is from HPP. However, the effective capacity is around 60 percent, yielding 16 MW.

¹³ There are no available statistics on standard industry measures for energy interruptions, but the index on reliability of supply and transparency of tariff from the Doing Business survey is zero in STP.

¹⁴ The main renewable resources identified so far are hydropower with 60 MW potential. The ongoing LCPDP is identifying other sources such as solar and wind.

SOEs were invited to negotiate a payment plan for their arrears, and a letter was sent to the government asking for the settlement of arrears. For all other private clients, mostly residential and small firms, **EMAE implemented a new policy, which is a prior action to this operation, consisting of a formal decision to cut energy supply after 100 days of non-payment.** It could do this based on a legal provision that was never implemented but gave the company more autonomy to its commercial managers to renegotiate client arrears. Also, EMAE launched a public awareness campaign to sensitize its clients about the need to pay their bills and the schedule of power cuts. Currently, EMAE is implementing a significant change in policy that is expected to lead to a critical change in the attitude of the population toward paying energy bills. Moreover, the PSRP will allow EMAE to rehabilitate key power lines and replace old conventional meters with new meters that work remotely and are connected to a new metering system, which is a trigger for the third operation. This set of reforms will be evaluated by the level of EMAE's non-technical losses. This indicator is in alignment with the results indicator of the PSRP, which includes an indicator on combined losses.

Prior action 4 (DPF1): *The Recipient, through EMAE, has introduced a revised system of pre-paid energy services that will allow for accurate consumption metering and invoicing, as well as eliminating the risk of non-payment.*

Prior action 5 (DPF2): *In order to promote transparency and incentivize timely payments, the Recipient, through EMAE, has published its policy to improve billing collection and launched a public awareness campaign through public TV and radio.*

Trigger 5 (DPF3): *In order to allow for a more efficient and accurate billing and reduce potential for underreporting of consumption, the Recipient, through EMAE, has introduced a new remote metering system connected to the management system that will allow for automated metering and billing.*

Result Indicator 5: *EMAE's non-technical losses. Baseline (2015): 26.4 percent; Target (2020): 23.8 percent.*

46. **The public sector is the largest client in arrears with EMAE.** The central and local governments represented 23 percent of all its client arrears at the end of 2016, and this share increases to 47 percent when all SOEs are included. Payment arrears from the GoSTP to EMAE have been a recurrent issue, but the current administration reduced government arrears (excluding SOEs) by 85 percent in 2015. However, the GoSTP's 2016 and 2017 revenue shortfall led it to generate new arrears with EMAE. On the contrary, the National Enterprise of Airports and Air Safety (*Empresa Nacional de Aeroportos e Segurança Área*, ENASA), the most indebted SOE, has resumed its payments to EMAE and signaled its intention to sign a payment plan for its overdue bills. In order to sustainably reduce its energy bill and make arrears less likely, the GoSTP has decided to carry out a full inventory of its energy and water bills. Until recently, the government paid the bills it received without inspecting their accuracy. The inventory process enables the government to inspect each bill and ensure that the building is a government building, the bills refers to only government activities, and the amount billed is commensurate with the government activity, which will allow the GoSTP to reduce its energy bills. A lower public energy bill will be more fiscally sustainable and allow public authorities to promote and enforce reforms to reduce the stock of arrears and prevent the generation of new arrears. The trigger for the third operation is a series of PFM improvements to ensure the timely payment of the government's energy bills. This reform will be evaluated by the amount of public-sector arrears with EMAE.

Trigger 6 (DPF3): *In order to reduce arrears from the government to EMAE, the Recipient has taken the following actions: (i) condition the budget transfer to autonomous institutes on the timely payment of energy bills; (ii) agree on payment plans for overdue energy bills for each autonomous agency; and (iii) give priority to energy bill payments just after payroll and debt service.*

Result Indicator 6: *Amount of Public Sector Arrears to EMAE. Baseline (2015): 36.4 billion STD; Target (2020): 12 billion STD.*

47. **This operation supports government reforms to improve planning in the energy sector.** STP currently lacks consistent energy data and a master plan for the sector. The WB is supporting the application of the Global Energy Access Household Survey, which is a comprehensive survey that measures access to energy as a continuum of services and if energy services are reliable, affordable, safe, and of adequate

quality. The survey will be an input to the sectorial planning instruments and allow the benchmarking of access to energy, as it will be conducted with a standardized methodology. The LCPDP will address the lack of plans in the energy sector and identify the optimum set of ongoing and future projects and related time schedules to increase the installed generation capacity and expand transmission and distribution facilities over a 20-year period. The basic criteria for optimization include the minimum net present value (NPV) of investment, operating costs, and cost of unserved energy over a certain period. The optimization process will explicitly take into account applicable rules and standards on environmental protection, land availability, and land use policies. The LCPDP will also take into consideration the government's commitment to generate at least 50 percent of the country's power from renewable energy by 2030. As the projects will be ranked by their minimum NPV, it is expected that future energy generation will be less costly (and more environmental friendly) than the current fuel-powered thermal plants, reducing the overall cost of energy and fostering private-sector growth drivers. The LCPDP involves a long process that includes intensive technical work but also an extensive consultation process. Because the plan will rank power generation projects according to their long-run marginal cost, the commitment of the government to follow this ranking for energy expansion is critical to reduce the cost of energy in STP. Thus, the conclusion and approval of the LCPDP is a trigger for the third operation. **To demonstrate its commitment to the outcome of the plan, the GoSTP has issued a resolution binding any expansion of power sector generation to the LCPDP, which is a prior action to the second DPF operation.** This set of reforms will be evaluated by the energy cost of production.

Prior action 6 (DPF2): *In order to structurally reduce the cost of energy, increase the share of renewable sources, and promote long-term private investment, the Recipient, through its Council of Ministers, has ruled that any capacity expansion in the power sector will have to mandatorily follow the prescriptions of the integrated Least-Cost Power Development Plan, and that any exceptions would need to obtain the approval of the Recipient's Minister of Infrastructure, who shall have to provide the rationale for such exemption and publish said decision.*

Trigger 7 (DPF3): *In order to structurally reduce the cost of energy, increase the share of renewable sources and promote long-term private investment, the Recipient, through its Council of Ministers, has approved the Least-Cost Power Development Plan.*

Result Indicator 7: Energy cost of production. Baseline (2015): 8,545.22 STD/Kwh; Target (2020): 8,300.00 STD/Kwh.

48. **Regulatory and planning capacity is inadequate.** The regulatory agency, *Autoridade Geral de Regulação* (AGER), has insufficient capacity to fulfill its role in the energy sector, resulting in little monitoring of service quality or auditing of EMAE's accounts to assess revenue requirements and set tariffs. The energy regulation law, approved in 2014, calls for several pieces of regulation to be issued as well as the establishment of a concession contract between the government and EMAE. As a result, AGER has mapped all the pending regulations that need to be issued. AGER also receives technical support through the PSRP, which has a specific component for regulatory strengthening. Moreover, both EMAE and AGER have received hands-on training on customer complaint redress.

49. **This DPF series support AGER to take the steps needed to effectively regulate the energy sector.** The first operation supported the issuance of an ordinance to EMAE, mandating it to have a comprehensive customer complaint redress system and send monthly reports to AGER on customer complaints. **The second DPF operation supports the establishment of minimum quality requirements for energy services.** The regulation that sets the minimum quality criteria for energy services is extensive, covering technical definitions and methodology of quality indicators, the obligation of both clients and energy companies, incentive mechanisms to improve services, deadlines to respond to client inquiries, and compensation to clients for poor service. The third operation foresees a trigger to establish a concession contract with EMAE, which encompasses all aspects of the relation between EMAE and AGER such as tariffs, quality criteria, and sanctions. Both policies are foreseen in the legislation. Given that energy distribution in STP is a monopoly, improving regulatory efficiency is critical to ensure better service quality and lower tariffs. These policy

actions will be evaluated by the number of customer complaints, which will be monitored to avoid perverse incentives and assessed whether a more effective resolution system leads to an increase in the number of complaints.

Prior action 5 (DPF1): *The Recipient, through AGER, has mandated EMAE to: (i) establish a comprehensive customer complaint redress system, for the mediation of conflicts between citizens and EMAE, as well as representing the interests of the public, receiving feedback, complaints, information requests and suggestions for improvement of service; and (ii) send to AGER monthly reports of complaints received from customers.*

Prior action 7 (DPF2): *In order to improve the reliability of energy supply, the Recipient, through AGER, had published the minimum quality criteria for the provision of energy service.*

Trigger 8 (DPF3): *In order to improve the quality of service, the Recipient, through AGER, has signed a concession contract with EMAE including all the company's obligations including rules on tariffs and sanctions.*

Result Indicator 8: *Number of complaints received by EMAE. Baseline (2015): 6,542; Target (2020): 3,000.*

Pillar B: Generate Fiscal Resources and Savings and Improve the Quality of Public Expenditures

50. **The second pillar supports policies aimed at generating fiscal resources and savings and improving the quality of public expenditure to address the country's fiscal fragility and make growth more inclusive.** STP's fragile fiscal position, evidenced by recurrent budget deficits and a long-standing high risk of debt distress, is primarily caused by low domestic revenue mobilization and weak control of public expenditures. In addition, SOEs are a significant source of fiscal pressures. Like many other small island countries, STP's small economic base translates into a small tax base, although its tax burden is lower than that of its peers, as shown in the PER. The low level of revenue collected imposes a limit on expenditures financed by own sources, leaving large parts of the budget to be funded by external sources and are thus subject to more volatility. One example is the GoSTP's social protection policy, which not only suffers from a lack of funding, but its programs are not directed to the most vulnerable. In addition, poor PIM practices have prevented the country from taking full advantage of the growth-leveraging potential of capital expenditures.

51. **The country's revenue underperformance is a result of an inefficient tax policy and tax administration.** Its tax revenue comes from mainly customs duties, and a stamp tax is levied on many transactions. There are also several consumption taxes, with many of them overlapping. STP is one of the few countries in Africa that do not have a VAT, and its tax administration practices also fall short of needs. Customs duties and taxes are managed by different offices, which makes coordination difficult and imposes additional administrative costs. Also, the taxpayer cadaster does not include all the citizens and firms in the country, and tax auditing is limited to confirming the consistency of information provided, with no cross-checks with other sources or risk-based selection of taxpayer for audits. Collection of tax arrears is rare, and the enforcement of tax sanctions is a costly and long process, which creates an incentive for not paying taxes.

52. **The government is working to broaden the tax base and reform the tax policy to close the financing gap.** The GoSTP has recently approved several changes in the tax legislation. In the first DPF operation, the tax structure for the personal and corporate income taxes was adjusted and simplified.¹⁵ The amount of the minimum tax paid as a form of presumptive taxation was updated after remaining fixed since 1995, and it was differentiated between personal income and corporate income taxes. Also, the structure with six taxation thresholds was replaced by one single threshold for each tax. Moreover, the GoSTP is preparing to implement a VAT and replace several overlapping taxes on consumption, which is included as an indicative trigger for the third operation. A precondition for the successful introduction of the VAT is the

¹⁵ The personal and corporate income taxes operate on a dual structure in STP. Large taxpayers and higher income individuals pay taxes on an ad-valorem basis and on a progressive schedule.

adoption of the necessary regulations for fiscal invoicing and supporting accounting and tax information from taxpayers. **Thus, the DPF series included the introduction of regulations covering invoicing as a prior action for the second operation.** Given the broad range of the reforms on revenue mobilization, this set of policy actions will be evaluated by the overall tax-to-GDP ratio.

Prior action 6 (DPF1): *The Recipient, through its Council of Ministries, has simplified the tax structure and updated the threshold values of tax brackets for presumptive income taxation.*

Prior action 8 (DPF2): *In order to generate the tax and accounting information needed to implement the VAT, the Recipient, through its Council of Ministers, has adopted the legal framework for fiscal invoices and similar documentation, whereby it legally mandated companies to issue fiscal invoices, set out said invoice's minimum content and time requirements for storing them.*

Trigger 9 (DPF3): *In order to broaden the tax base and generate more own-source revenues, the Recipient has submitted to parliament a draft law to implement a VAT.*

Result Indicator 9: *Tax revenues (as a share of GDP). Baseline (2015): 14.3%; Target (2020): 15.8%.*

53. **The government is the sole owner of four companies that are vital for the competitiveness of the country's economy.** The GoSTP is the sole owner of: EMAE, ENASA, the National Enterprise of Ports (*Empresa Nacional de Portos*), and the Postal Service. These companies exercise a monopoly to provide water, energy, airport, port, and postal services, respectively. There is also government participation in seven other companies, including STP's only oil importer and its largest fuel distribution company (ENCO), its largest bank (*Banco Internacional de São Tomé e Príncipe*, BISTP), the incumbent telecommunications company (CST), and the local airline (STP Airways).

54. **SOEs face a number of challenges related to transparency, efficiency, and financial viability.** The legal and regulatory framework for SOEs is broadly adequate, but there is gap in implementation, and ownership and accountability mechanisms are unclear. The law foresees a nonexecutive administrative board for each SOE, but this has not yet been implemented. The managing directors are appointed formally by the Council of Ministers for a three-year term. The Ministry of Finance nominates an SOE's chief financial officer, while other managers are suggested by the overseeing ministry. Despite being obligated to follow general principles on legality, efficiency, effectiveness, and economy, STP's SOEs are not bound by any specific fiscal or financial outcomes. SOEs are also not transparent, as they lack performance monitoring systems and their managers are hardly held accountable. Finally, they normally exert significant fiscal pressure on the government's budget by imposing high tariffs, forfeiting tax or dividends payments, and missing payments to suppliers or creditors.

55. **The GoSTP is cognizant of the problems posed by its SOEs in relation to its fiscal accounts and private sector-led growth, and it has taken initial steps to address them.** In January 2017, the Council of Ministers recognized that almost all SOEs and other decentralized government agencies were in a state of in or near bankruptcy. It also acknowledged that SOEs are a source of fiscal risk and that they suffer from an excessive wage bill. Therefore, it demanded all SOEs to submit a management improvement plan and prohibited any increase in personnel expenditures until SOEs are financially sound again. The government has also expressed its desire to divest their minority stakes in former SOEs such as the CST and the BISTP.

56. **The WB is supporting SOE reforms through several instruments.** The PSRP provides support to management reforms at EMAE – the largest SOE. The recently concluded PER also carried out a diagnostic of the management and control of SOEs. **This diagnostic formed the basis for the government's SOE reform plan, which was recently approved by the Council of Ministers and is a prior action to this DPF operation.** The objective of the plan is to improve government control and the performance of SOEs. It includes action on performance targets, subsidies, ownership policy, and transparency. The implementation of the SOE reform plan will be supported by the forthcoming Bank-funded São Tomé Institutional Capacity Building

Project (P162129). Following early suggestions by the World Bank to improve management and control of SOEs, the GoSTP has ordered an external pre-audit of the three main SOEs to identify and report on (a) material misstatements in the financial statements that will be subject to review and (b) significant weaknesses in the accounting policies, practices, and procedures and internal control during the preparation of the financial statements. The objective is to provide these companies with a roadmap of improvements needed to issue balance sheets that follow international standards and are externally audited. The decision to commission a pre-audit instead of an actual external audit derives from previous WB experience in similar environments. The recommendations of the pre-audit will be incorporated in the SOE reform plan. The third operation includes a trigger on the adoption of a set of financial and non-financial performance targets for the four SOEs. These prior actions and triggers will be evaluated by the overall achievement of these targets. The program document for the first operation contained an indicator on dividends, which will not be used in this operation since dividends can be increased in the short term despite a weakening of financial soundness.

Prior action 9 (DPF2): *In order to improve SOE's financial and non-financial performance, the Recipient, through its Council of Ministers, has approved an SOE reform plan that established a performance monitoring system with financial and non-financial targets for all SOEs and incentives to ensure compliance.*

Trigger 10 (DPF3): *In order to improve accountability of the SOE management, the Recipient, through its Council of Ministers, has established a performance monitoring system with financial and non-financial targets for all SOEs, with clear incentives for compliance.*

Trigger 11 (DPF3): *In order to increase transparency and ensure accuracy of SOE's financial position, the Recipient has published accounts audited by an external and independent auditing company for its main public owned SOEs (EMAE, ENASA and ENAPORT).*

Result Indicator 10: *Percentage of performance targets achieved – average for SOEs. Baseline (2015): N.A.; Target (2020): 50%.*

57. **STP lacks a structured process to select the investment projects to be implemented.** There are no specific provisions for special PIM procedures in the public finance legislation. Criteria for project selection are unclear, and many decisions are made without a sound and objective technical analysis. Cost and time overruns are also common. The Vision 2030, the PND, and the Government Program all provide strategic guidance for the country's public investments. However, these documents are too broad and fail to provide effective guidance. Also, the Directorate of Planning is not involved in the selection, ranking, or recommendation of investment projects. Moreover, the Directorate of Budget does not have any formal process for selecting projects. Overall, great emphasis is given to the availability of financing and the preference of donors and lenders to finance specific interventions.

58. **This DPF series supports policies that strengthen PIM practices.** The GoSTP has taken the first step to improve PIM by approving the National Planning System Law (SNP), which fills the country's legal vacuum in relation to PIM. The law focuses on: transparency, public consultation, monitoring and evaluation, harmonization between different planning instruments, and the connection between planning and budget instruments through a Medium-term Expenditure Framework (MTEF). **The SNP is a prior action for the second DPF operation.** While the law is a laudable advancement, STP requires technical support to effectively implement it. Through its trust funds and the new Institutional Capacity Building Project, the WB will support the GoSTP to implement a logical sequence of activities, encompassing: (i) the set-up of a comprehensive public investment portfolio database; (ii) the development of a project prioritization and investment programming tool; (iii) the creation of a project management cycle framework; (iv) an improvement of the legal framework; and (v) the set-up of software applications. The set-up of a portfolio database with projects ranked by priority is included as a trigger for the third operation. Support to better PIM in STP is critical due to the large size of the investment budget and the high debt level, which was mostly accumulated due to previous public investment projects. This set of prior actions and triggers will be

evaluated by the number of investment projects included in the public investment database.

Prior action 10 (DPF2): *In order to improve the efficiency and value for money of public investment, the Recipient's parliament has enacted a National Planning System Law that harmonizes planning and budgeting tools and lays the foundation for the appraisal and selection of public investment projects.*

Trigger 12 (DPF3): *In order to improve selection of public investment projects, the Recipient, through its Council of Ministers, has established a National Investment Portfolio Database - NIPD (Carteira Nacional de Projectos) to serve as the single source for public investment projects, from which all public investment projects will have to be sourced to be executed through the Public Investment Program (Programa de Investimentos Públicos).*

Result Indicator 11: *Share of ongoing and finalized projects with basic information included in the National Investment Portfolio Database. Baseline (2015): 0; Target (2020): 100 percent.*

59. **Existing social protection policies are fragmented and cover only a small portion of the population.** Social protection expenditures amounted to 0.4 percent of STP's GDP, including public works programs. There are 11 social programs in the country, excluding higher education scholarships. However, the school feeding program is the only program that covers 100 percent of its target population. The coverage could either not be estimated or did not reach a third of population for all other programs. In addition, several programs have part of their expenditures financed by external aid, which is the case for the school feeding program. Social protection programs also suffer from problems such as a low value of benefits, weak control, and uncertainty in funding, reducing the efficiency of the country's social protection framework.

60. **The GoSTP has devised a new social protection strategy, which is embodied in the National Policy and Strategy for Social Protection (*Política e Estratégia Nacional de Proteção Social*, PENPS), which was approved in 2014.** The PENPS foresees the streamlining of existing social protection programs into three core programs. The first program is a conditional cash transfer for families in extreme poverty. The second program is a non-contributory pension program for the poor elderly, handicapped, and the chronically ill. Finally, the third is a labor-intensive public works and community service program. This DPF series supports the implementation of the social protection policy. An initial step was the development and adoption of an operational manual in 2016 – with a targeting methodology and eligibility criteria – for the new Vulnerable Families Program. **With support from the Bank, the GoSTP has registered all social protection beneficiaries in a single register, which is a prior action for the second DPF operation.** The registry has recorded all current beneficiaries of social protection programs, which already generated savings since 10 percent of them were 'ghost' beneficiaries. Going forward, the government will have to exclude beneficiaries identified as non-poor and registry-eligible beneficiaries based on the new household survey. For the third operation, the trigger is the creation of a formal payment mechanism for social protection programs. Payments will be made preferentially through the banking system, fostering financial inclusion and enabling the tracking and reconciliation of public funds.

61. **The results of this proposed DPO will be evaluated by the number of beneficiaries registered and actually receiving payments from the three core social protection programs.** The creation of an operational manual will enable enrollments, and the payment system will allow for regular payments once resources are guaranteed. Currently, there are around 1,000 registered beneficiaries, but they are not receiving regular payments. The results indicator aims to monitor not only the registry, but also actual and regular benefit payments to ensure the policy's effectiveness. The rationale is that these programs will be more effective in reducing poverty, and their expansion will be an indirect measure of the reduction in the poverty headcount, which is the ultimate objective. New measurements of the poverty headcount are expected in 2018.

Prior action 11 (DPF2): *In order to coordinate and harmonize social protection and poverty reduction policies, the Recipient has registered in the Recipient's social registry all beneficiaries of the three core social protection programs defined in the Recipient's Social Protection Policy and Strategy.*

Trigger 13 (DPF3): In order to allow for tracking and reconciliation of funds allocated to social protection payments, the Recipient has instituted a predominantly financial system-based formal payment mechanism for social protection programs.

Result Indicator 12: Number of beneficiaries enrolled in the three core social protection programs and receiving regular payments as set in law. Baseline (2015): 0; Target (2020): 4,000 (out of which, 50 percent has received payments through the formal financial system).

62. **This proposed operation has been informed by past analytical and field work.** Policy actions supported in component A.1 benefited from the diagnostic performed during the preparation of the FSDIP and follow-up missions supported by the First Trust Fund. Policy reforms in the energy sector are supported by the knowledge obtained through regional analytical work and the PSRP. Support to component B.1 is based on the recently concluded PER, which included specific chapters on SOEs, PIM, tax policy, and tax administration. Support to the Social protection policy is based on extensive analytical work carried out by the WB in 2014 and 2015, which concluded that the inability of the social protection sector to significantly reduce poverty was due to a lack of funding and the multitude of programs.

Table 5. DPF Prior Actions and Analytical Underpinnings

Prior Actions	Analytical Underpinnings
Operation Pillar 1: Introduce Growth-enabling Reforms in the Financial Sector, Business Environment, and Infrastructure	
Prior action #1 - In order to strengthen the bank resolution framework, the Recipient, through its BCSTP, has adopted regulations implementing the Recipient's financial institutions resolution law, which set out: (i) the measures to be applied by the BCSTP in the resolutions of distressed financial institutions; and (ii) the requirements for the elaboration and adoption of recovery and resolution plans.	The World Bank Group. "Financial Sector Development Implementation Plan: 2016–2020", Washington D.C: self-pub, 2016. The World Bank Group, "Upgrading the Credit Registry Platform in the Republic of São Tomé and Príncipe" (unpublished manuscript, June 2017), Microsoft word file. The World Bank Group. "São Tomé and Príncipe – Secured transactions law and practice: legal and institutional diagnosis study" (unpublished manuscript, July 2017), Microsoft word file. Beck, Thorsten. "Microfinance- A critical literature survey" IEG Working Paper 2015/4, The World Bank Group, Washington D.C: 2015.
Prior action #2 - In order to develop the microfinance sector and promote the offer of microfinance services, the Recipient, through its Council of Ministers, has approved and submitted to the Recipient's Parliament a draft law on microfinance.	
Prior action #3 - In order to expand the outreach of the banking system and support financial inclusion through the usage of mobile financial services, the Recipient, through its Council of Ministers, has approved and submitted to the Parliament the proposed National Payment Systems Law, which sets forth the statutory level principles for regulation on modern payment methods, such as agent banking, mobile money, and electronic payments.	
Prior Action #4: In order to reduce costs and simplify procedures to register property, therefore improving its ability to serve as loan collateral and foster access to finance, the Recipient, through the Council of Ministers, has approved and submitted to the Recipient's Parliament (i) the proposed Property Registration Code; and (ii) the proposed Public Notary Code.	Direcção Geral dos Registos e Notariado. <i>Plano Estratégico dos Registos e Notariado 2017-2019</i> . São Tomé: October 2016.
Prior action #5 - In order to promote transparency and incentivize timely payments, the Recipient, through EMAE, has published its policy to improve billing collection and launched a public awareness campaign through public TV and radio.	International Monetary Fund. "Adopting and Implementing an Automatic Fuel Price Mechanism"- Technical Assistance Report, Washington D.C: self-pub, 2015.

Prior Actions	Analytical Underpinnings
<p>Prior action #6 - In order to structurally reduce the cost of energy, increase the share of renewables, and promote long-term private investment, the Recipient, through its Council of Ministers, has ruled that any capacity expansion in the power sector will have to mandatorily follow the prescriptions of the integrated Least-Cost Power Development Plan, and that any exceptions would need to obtain the approval of the Recipient's Minister of Infrastructure, who shall have to provide the rationale for such exemption and publish said decision.</p> <p>Prior action #7 - In order to improve the reliability of energy supply, the Recipient, through AGER, had published the minimum quality criteria for the provision of service.</p>	<p>The World Bank Group. "Power Sector Recovery Project" Washington D.C: self-pub, 2016.</p> <p>The World Bank Group. "Beyond Connections: Energy Access Redefined" Washington D.C: self-pub, 2015.</p> <p>Trimble, Chris et al., "Financial Viability of Electricity Sectors in Sub-Saharan Africa: Quasi-Fiscal Deficits and Hidden Costs" World Bank Policy Research Working Paper 7788, The World Bank Group, Washington D.C: 2016.</p>
Operation Pillar 2: Generate Fiscal Resources and Savings and Improve the Quality of Public Expenditures	
<p>Prior action #8 - In order to generate the tax and accounting information needed to implement the VAT, the Recipient, through its Council of Ministers, has adopted the legal framework for fiscal invoices and similar documentation, whereby it legally mandated companies to issue fiscal invoices, set out said invoice's minimum content and time requirements for storing them.</p>	<p>The World Bank Group. "São Tomé and Príncipe: Public Expenditure Review", Washington D.C: self-pub, 2018.</p> <p>International Monetary Fund. "São Tomé and Príncipe: Towards a Slim VAT – simple, local and modern", IMF/FAD Technical Assistance Report, Washington D.C: self-pub, 2016</p>
<p>Prior action #9 - In order to improve SOE's financial and non-financial performance, the Recipient, through its Council of Ministers, has approved an SOE reform plan that established a performance monitoring system with financial and non-financial targets for all SOEs and incentives to ensure compliance.</p>	<p>The World Bank Group. "São Tomé and Príncipe: Public Expenditure Review", Washington D.C: self-pub, 2018.</p> <p>The World Bank Group. "Corporate Governance of State-Owned Enterprises: a Toolkit". Washington D.C: self-pub, 2014.</p>
<p>Prior action #10 - In order to improve the efficiency and Value for Money of public investment, the Recipient's Parliament has enacted a National Planning System Law that harmonizes planning and budget tools and lays the foundation for the appraisal and selection of public investment projects.</p>	<p>The World Bank Group. "São Tomé and Príncipe: Public Expenditure Review", Washington D.C: self-pub, 2018.</p>
<p>Prior action #11 - In order to coordinate and harmonize social protection and poverty reduction policies, the Recipient has registered in the Recipient's social registry all beneficiaries of the three social protection programs defined in the Recipient's Social Protection Policy and Strategy.</p>	<p>The World Bank Group. "Building Blocks to the social protection system (P149534)"</p>

4.3 LINK TO CPF, OTHER BANK OPERATIONS, AND THE WORLD BANK GROUP STRATEGY

63. **The proposed operation supports both themes of the Country Partnership Strategy (CPS) FY14-FY18 (report number 83144), discussed by the Board in July 2014.** An extension of the CPS until fiscal year 2019 is being sought, which would fully align its timeframe with that of the operation's timeframe. The operation's first pillar contributes to the first CPS theme: Supporting Macroeconomic Stability and National Competitiveness. DPF support to financial sector supervision activities will help reduce the risks of a serious banking crisis and the corresponding implications on economic output and fiscal stability. Also, its support to domestic revenue mobilization, which is aligned with IDA18's fifth special theme, will help the country achieve a more sustained budget balance position. The proposed operation's second pillar contributes to the advancement of the second theme of the CPS by streamlining social protection programs, expanding

coverage, and improving the target of the social protection policy framework.

64. **The DPO will contribute both directly and indirectly to the twin goals.** The revision of the social protection policy framework and the expansion of fiscal space will allow a better targeting and an increased coverage of social protection programs. This will be done through measures to increase domestic revenue mobilization. As a result, extreme poverty is expected to be reduced. The policies supported by the operation will also boost shared prosperity. The revised social protection policy will focus not only on the extreme poor but also on the poor and other vulnerable groups. Policy changes to improve the credit market are expected to increase access to credit and market opportunities for households in the bottom part of the income distribution. Finally, affordable and increased access to energy are also associated with reduced poverty and greater shared prosperity.

65. **This DPF series was designed to complement and leverage current and upcoming World Bank projects in STP.** The goal is to increase the effectiveness of World Bank support by using different instruments to address different aspects of the development challenges facing the country. In the energy sector, the World Bank is supporting an investment financing project that will increase the reliability of the power supply, help reduce the price of energy, and improve the management of the utility company. Moreover, the DPF operation will work with policymakers to improve sector regulation and the management and oversight of SOEs. The DPF series will also leverage previous ASA reports in the social protection and banking sectors by supporting the policy recommendations outlined in these reports. Finally, the operation takes into account the conclusions of the recently concluded PER that focused on the tax policy, the tax administration, SOEs, and PIM.

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

66. **The government program and the supported policy reforms underwent public consultations.** The GoSTP conducted open consultative meetings in every district in a participatory budget preparation process that informed the 2015 public budget as well as the following budgets. The PND, which is aligned with the reforms supported in this operation, also underwent consultations. Moreover, public consultation with stakeholders in the financial sector was conducted throughout the formulation of the financial sector's development strategy. Similarly, there were various rounds of consultation with stakeholders when the PENPS was formulated, and the PENPS established a formal council on social protection. The reforms of the public notary and property registration codes were created by a committee with members from the country's courts, the public prosecutor, and university law professors. The drafting of the new national planning law was also preceded by consultation with key stakeholders. Both the SOE diagnostic and the reform plan were shared with and presented to the management of all SOEs and high- and mid-level government officials before they were completed and approved.

67. **This DPF series is coordinated with the main developing partners working in STP.** The policies supported by the proposed operation complement and leverage the support provided by development partners. For example, the African Development Bank is providing STP's revenue administration with needed technical assistance, infrastructure, and equipment. Also, the IMF is financing advisors to support the implementation of the VAT. Altogether, this external support helps the country achieve a more balanced budget position. Moreover, Portugal has been providing technical assistance to STP's justice sector, which will help address concerns that the effectiveness of banking and credit reforms might be compromised by the lack of justice reforms.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

68. **The proposed DPO will have an overall positive impact on the country' social development and poverty reduction.** It is expected to have some indirect effects on poverty reduction, mainly through reforms aimed at improving the financial sector, the business environment, and infrastructure (Pillar A).

69. **STP lacks the data required for a more in-depth impact analysis, but three new surveys to be released in 2018 will bridge this gap.** The latest available household-level surveys do not include information on access to finance, titling of residential units, or income received from social protection programs, although there are data on access to energy. According to the 2012 census, 57.9 percent of residential dwellings had access to energy, but this rate was lower in poorer districts such as Caué (35.5 percent). The main reason given for not having access to energy was the inability of the company to provide such a service (76 percent). It is reported that 16.3 percent of the population did not have the ability to pay the energy bill as the main reason for lack of energy access, and this rate was higher in urban (24.2 percent) than in rural (6.9 percent) areas, where poverty rates were also higher. Authorities will soon have access to more in-depth data with the release of three new household surveys in 2018: the National Household Survey, the Access to Finance Survey, and the Global Energy Access Household Survey.

70. **Most prior actions in the financial sector are expected to have positive social and poverty-reducing effects.** The new legislation to strengthen the bank resolution framework will improve the functioning of the banking system, but it will have no clear effects on poverty alleviation. STP's microfinance sector is underdeveloped, but the draft law on microfinance is expected to improve the regulatory framework and foster the development of the sector, benefiting poor households who are the main users of microfinance services. Moreover, the new National Payment System Law, which establishes the statutory level principles for regulating modern payment methods, may have indirect poverty and social impacts through increased security of mobile money transactions. This law will also increase the use of mobile payments, including remittances, which may be beneficial for poor households.¹⁶ Parliamentary approval of the revised property registration law will allow the use of movable property as collateral for a loan, resulting in a larger range of assets that can be used as guarantees for loans, which will be particularly useful for the poor.

71. **Prior actions in the energy sector are also expected to have overall positive social and poverty-reducing effects.** Prior action 5, which supports a policy to improve billing collection at EMAE, could affect the poor negatively, as it includes a formal decision to cut energy supply after 100 days of non-payment. However, most poor households are likely not currently connected to the energy grid¹⁷ and will therefore not be affected. Instead, the policy is more likely to affect middle-income households. The current average tariff of US\$0.21 per kWh is one of the highest in the region and is a burden on the poor. Nevertheless, energy tariffs are unlikely to increase in the future, as prior action 7 aims to improve the financial soundness of EMAE and reduce the cost of energy, which will have a positive impact on the country's population, including the poor. Prior action 8 is expected to improve the quality of energy supply for those connected to the grid. This will also benefit people across the country, including the poor, as a reliable supply of energy

¹⁶ Research on similar policies in Mexico (Aportella, 1999) and India (Burgess and Parde, 2005) demonstrated the importance of geographical barriers to formal banking outlets on savings. These studies showed that government policies that expanded banking services increased the savings rate of low-income households, while no effect was found for high-income households. The use of mobile finance brings substantial benefits to the poor. For instance, a 2010 WB study mentions that the spread of mobile finance increased the volume of remittances, spurred local economies, and boosted local consumption in poor areas of Kenya. Official figures from 2010 indicate that only 53 percent of households in STP use electricity for lighting purposes and the figure drops to 42 percent for the poorest quintile.

can lead to improved earnings, particularly for households with home-based enterprises or small and medium enterprises that require regular access to electricity to function.

72. **Finally, some prior actions under Pillar B, which focuses on generating fiscal resources and savings and improving the quality of public expenditures, are expected to have positive overall social and poverty-reducing effects.** Measures aimed to support the implementation of the VAT will increase the fiscal space for social services to the poor. However, this does not necessarily mean that more funds will be redistributed to the poor, and the introduction of the VAT can raise the price of goods and services, including food, which might be detrimental to the poor. Authorities could implement mitigating measure such as exempt or apply lower VAT rates to food items that are included in the food basket that the poor consume. Moreover, improving the efficiency and value for money of public investments – prior action 10 – has the potential to have an indirect positive impact on the poor if savings are invested in projects that benefit the poor. An overall coordination and harmonization of social protection and poverty reduction policies will also be beneficial to poor households. For example, the registration of the beneficiaries of the three core social protection programs in a single register will improve the targeting of these programs, allowing a larger proportion of the poor to be recruited into the social protection system.

5.2 ENVIRONMENTAL ASPECTS

73. **STP has a legal and institutional framework to manage and respond to environmental challenges, although the implementation and enforcement of policies need to be improved.** The National Environmental Law, approved on December 31, 1999, provides the legal tools to manage the country's environmental and natural resources. Decree-Law No 37/99 defines the rules and principles applicable to an environmental impact assessment (EIA), which requires that all activities that may have a significant impact on the environment (which will depend on the nature, size, or location of the activity) must complete an EIA prior to implementation. The General Directorate of Environment under the Ministry of Infrastructure, Natural Resources and Environment, is the central public institution responsible for environmental issues, and it coordinates and implements environment-related public activities and policies. Despite the country's credible institutional and legal framework, its institutional design and operational efficiency need to be improved. Specifically, environmental monitoring, compliance, and enforcement are of particular concern. Since some prior actions to be implemented under this DPF operation are likely to have an impact on the environment, they need to be closely scrutinized and supervised. Nonetheless, some supported policies under this operation will also have environmental benefits, such as a reduction in the use of certain sources of energy, including wood, diesel, or gasoline, which may contribute to a decrease in greenhouse gas emissions and lower emissions of air pollutants.

74. **Prior action 6 will lead to significant environmental benefits, as the GoSTP's commitment to have at least half of the country's power generated by renewable sources before 2030 is imbedded in the LCPDP.** This plan will guide stakeholders in how the energy sector can cost-effectively meet the needs of the nation without damaging or depleting environmental resources. This will build on Decree-Law n°26/2014, which ensures that there is an adequate, quality, cost-effective, and affordable supply of energy to meet the country's development needs while protecting and conserving the environment through the use of natural energy resources. The decree also stipulates that the environmental safety and protection of people, property, electrical installations, appliances, and equipment shall be governed by the provisions of the law on hazardous, unhealthy, and inconvenient establishments or, where applicable, by the urban planning and construction regulations in force. Moreover, all energy projects need to undergo an EIA, and a compliance monitoring mechanism will be put in place to make sure that investors comply with regulations and properly manage environmental risks and any impact that may occur.

75. **Prior action 10 is likely to have a positive impact on environmental governance and make environmental issues mainstream at the policy, planning, and management levels in the GoSTP.** It could also help reduce the delay in processing EIA reports, manage environmental and social issues associated with public investment projects, and incorporate environmental data in the decision-making process for investment projects. An EIA is required for any investment planning process, but sufficient resources need to be made available for an EIA or a licensing system to make a difference on the ground. This harmonization will enable to secure adequate funding for EIA related tasks in the planning process. As stated in Annex 4, all other prior actions do not have significant environmental effects.

5.3 PFM, DISBURSEMENT, AND AUDITING ASPECTS

76. **PFM practices have continuously improved, and authorities are committed to further implementation of reforms.** The GoSTP's commitment is exemplified by its progress in implementing reforms supported by the last DPF series and the creation of an overall PFM action plan that was published in 2016.¹⁸ PFM reforms have focused on areas related to the comprehensiveness and transparency of budget documents, medium-term fiscal planning, public financial reporting, and external auditing, including the submission of the 2013 public financial statements to the court of accounts. The 2015 financial statements, created by the Public Expenditure and Financial Accountability (PEFA) review in 2013, have also been submitted to the Supreme Audit Institution for audit.

77. **While the PEFA concluded that the GoSTP has made progress on PFM reforms in several areas, there are various challenges that public authorities need to address.** The review noted that the government made improvements in the scoring that demonstrated broad engagement on reforms, and there was a strong public commitment to continue the implementation of reforms. The PEFA also acknowledged advances in PFM performance, including: (i) progress in the orderliness of and participation in the annual budget as well as greater transparency and comprehensiveness of financial information available to the public; (ii) some improvements in the preparation of an MTEF; (iii) the availability of budget documents through the website of the Ministry of Finance and Public Administration; (iv) improvement in the legislative scrutiny of the annual budget law; (v) the establishment of a treasury single account, resulting in greater control over bank accounts and deposits in commercial banks; (vi) the implementation of an integrated financial management information system (IFMIS); and (vii) positive trends in internal controls and tax management. However, the review noted that ongoing reform efforts have not yet addressed the key challenges facing PFM in the STP, including: (i) low budget credibility; (ii) the absence of the structural and institutional reforms needed to strengthen tax management; (iii) a lack of effectiveness of the IFMIS; and (iv) insufficient follow up on the findings of the audit and monitoring process. These challenges and continuing weaknesses in the PFM environment are a result of constraints in technical capacity, human resources, and available skills, affecting the key institutions responsible for all stages of the PFM cycle, including the General Inspectorate of Finance, which is responsible for internal audit functions, and the supreme audit institution (*Tribunal de Contas*). Nevertheless, the GoSTP's PFM action plan appears adequate to address these challenges over the next few years.

78. **The general government budget is made available to the public in printed form and on an external website prior to legislative approval.**

79. **The country's public procurement system is becoming increasingly transparent.** A procurement supervisory body and a coordination and assistance procurement cabinet (COSSIL) were created in 2009 to centralize procurement information, assist decentralized procurement units, and ensure uniformity and

¹⁸ Plano de Ação Para A Reforma Das Finanças Públicas em São Tomé e Príncipe – March 2016.

quality across units. COSSIL may suspend, cancel, or invalidate a particular contractual procedure that is not in accordance with the applicable legislation. Despite legal and institutional improvements, poor practices, such as the non-formal appointment of the members of the Conflict Resolution Commission¹⁹ or general capacity constraints in central government institutions as well as in procurement management units at the sector level, hamper public procurement performance.

80. **The BCSTP is responsible for ensuring a strong foreign exchange control environment in the STP.** The IMF published its second review under the ECF, and a request for waivers for nonobservance of performance criterion and modification of performance criteria was made public in December 2016. These documents indicate that the BCSTP still faces capacity constraints, including in the independent oversight of the audit mechanisms, internal controls, and financial reporting. While external audits conducted by a reputable audit firm continue to serve as a critical safeguard, ongoing institutional development will be needed to strengthen capacity and bolster the safeguard framework. The IMF concluded that the BCSTP is committed to strengthen the control environment.

81. **The WB concludes that although the fiduciary risk is substantial, the STP's PFM environment is adequate to support the proposed operation if additional risk mitigation measures are implemented.** In addition, the GoSTP's development strategy and its previous actions to implement reforms are a satisfactory reflection of its commitment to improving the PFM environment

82. **SDR 4.2 million (equivalent of US\$6 million) will be disbursed upon grant effectiveness and following the Recipient's request for withdrawal of grant proceeds.** The grant will follow IDA's standard disbursement procedures for DPOs. IDA has informed the GoSTP that there can be no withdrawals unless it is satisfied (a) that the program is being carried out by the recipient; and (b) with the appropriateness of the recipient's macroeconomic policy framework. Once the operation is approved by the WB Board and becomes effective and following the GoSTP's request for withdrawal of proceeds, IDA will disburse the grant to a dedicated foreign currency account at the BCSTP. The proceeds of the grant will then become part of the STP's official reserves. Within 30 days of the receipt of the deposit, the Recipient needs to provide confirmation to IDA that (a) the grant proceeds were received into a public account that is part of the country's foreign exchange reserves (including the date, name, and number of the government's bank account); and (b) an amount equivalent to the grant proceeds has been credited in the Recipient's budget management system within five working days of the receipt, with an indication of the exchange rate applied, where applicable. The conversion from the foreign to the local currency will be based on the prevailing exchange rate on the date that the funds are credited in the budget management system. The BCSTP will not impose any charges or commissions on the Recipient for these transactions.

83. **Based on the level of fiduciary risk associated with this operation, IDA reserves the right to request an audit of the dedicated account on terms of reference acceptable to IDA.** If the right were to be exercised, the GoSTP would have the dedicated account audited by an independent auditor acceptable to IDA, with the audit providing assurance that: (a) the funds have been received and deposited into the account; (b) the funds received in the dedicated account were, within five working days of receipt, converted into local currency and transferred to the consolidated fund account (Treasury Account) of the GoSTP to finance budgetary expenditures; and (c) the amount received have been appropriately accounted for in the government's financial management system. If the proceeds of the grant are used for ineligible purposes as defined in the financing agreement, IDA will require the Recipient to, promptly upon notice from IDA, refund an amount equal to the amount of the payment to IDA. Funds refunded to IDA, upon such request, shall be

¹⁹ As a result of these practices, the country's PEFA score on public procurement indicator (PI 19) was an overall score of C+ and did not improve compared to the 2010 PEFA.

cancelled. The administration of this proposed grant will be the responsibility of the Ministry of Finance.

5.4 MONITORING, EVALUATION, AND ACCOUNTABILITY

84. **The Ministry of Finance will be responsible for the overall implementation of the proposed operation.** It will coordinate actions under the DPF program and report progress to relevant ministries and public agencies. The ministry has experience in coordinating and implementing DPF programs as demonstrated by the successful implementation of past operations.

85. **The results framework is based on standard and widely available indicators.** It was created in an effort to avoid higher outcome indicators that are influenced by factors outside the control of the operation. Preference was given to indicators that are already produced and reported by the authorities using their own proprietary systems. To the extent possible, the operation will also be monitored by indicators that are calculated by external sources and allow for international benchmarking such as the Doing Business indicators.

86. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

87. **The overall risk of the proposed operation is substantial.** The overall rating is derived from the substantial ratings of the main risk categories of the operation, which are: (i) political and governance; (ii) macroeconomic; (iii) fiduciary; and (iv) institutional capacity for implementation and sustainability. While the reform program is supported by the country's highest authorities, lack of coordination between ministries and broken funding promises have led to non-implementation in the past. Macroeconomic risks are substantial due to the recurrent fiscal deficits, high risk of debt distress, structurally unbalanced external accounts, and banking sector risks. Moreover, institutional capacity in the STP is very low due to a myriad of factors that are at the core of its substantial risk rating, including lack of standard procedures in the public sector, difficulty in inter-agency cooperation and flow of information, and a small pool of qualified personnel due to low levels of education and immigration, which are common characteristics of small island countries.

88. **Measures are in place to address the main risks facing the country.** A constant dialogue between the WB and country authorities since the workshop held in 2016 for the Performance and Learning Review and the revision of the CPS has increased government ownership of the program. The large resource envelope of IDA18 also increased the role of the WB in the country. Moreover, macroeconomic risks are mitigated by the IMF's ECF program, and capacity and implementation risks are addressed by technical support provided by the WB with funding from trust funds and the Institutional Capacity Project (P162129), which is in preparation.

Table 6. Summary Risk Ratings

Risk Categories	Rating (H, S, M, or L)
1. Political and Governance	Substantial
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Moderate
8. Stakeholders	Moderate
Overall	Substantial

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions and Indicative Triggers			Results
Prior Actions under DPF 1	Prior Actions under DPF 2	Indicative Triggers for DPF 3	
Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure			
Component A.1: Introduce growth-enabling reforms in the financial sector and business environment			
<p>Prior action 1: The Recipient, through its National Assembly, has approved a banking resolution law (<i>Medidas Especiais de Saneamento, Resolução e Liquidação de Instituições Bancárias</i>) that provides the Central Bank with the power and authority necessary to deal effectively with distressed financial institutions by facilitating early intervention and providing additional policy instruments to address vulnerabilities.</p>	<p>Prior action 1: In order to strengthen the bank resolution framework, the Recipient, through its BCSTP, has adopted regulations implementing the Recipient's financial institutions resolution law, which set out: (i) the measures to be applied by the BCSTP in the resolution of distressed financial institutions; and (ii) the requirements for the elaboration and adoption of recovery and resolution plans.</p>	<p>Trigger 1: In order to obtain more reliable information on banks' financial soundness, the Recipient, through its Central Bank, has carried out a review of the quality of banking sector assets (Asset Quality Review- AQR) and mandated banks to adjust Non-Performing Loans classification and provision accordingly.</p>	<p>Result Indicator 1: Number of banks below the Central Bank's minimum Capital Adequacy Ratio (12%) Baseline (2015): 3 Target (2020): 0</p>
		<p>Trigger 2: In order to expand the range of assets that can be pledged by borrowers and strengthen the quality of collaterals, thereby improving access to credit, the Recipient has submitted to the parliament a new law on guarantees that: (i) introduces the concept of a functional approach to secured transactions; (ii) widens the range of assets that can be used as collateral; and (ii) allows for the establishment of a movable collateral registry.</p>	<p>Result Indicator 2: Score on Doing Business indicator "Getting Credit". Baseline (2015): 0 out of 20 Target (2020): 10 out of 20</p>
		<p>Trigger 3: In order to increase the information available to lenders for assessing borrower's creditworthiness, which would improve access to credit, the Recipient, through its Central Bank, has improved the Public Credit Registry by: (i) instituting back-up procedures; (ii) instituting real-time update procedures; and (iii) expanding the scope of information.</p>	
<p>Prior action 2: The Recipient, through its Central Bank, has created, operationalized and staffed a new directorate (<i>Direção de Sistemas de Pagamentos</i>) to consolidate in the same unit all responsibilities related to oversight, policy formulation and</p>	<p>Prior action 2: In order to develop the microfinance sector and promote the offer of microfinance services, the Recipient, through its Council of Ministers, has approved and submitted to Recipient's Parliament a draft law on</p>	<p>Trigger 4: In order to implement the key provisions of the microfinance law, the Recipient, through its Central Bank, has passed the regulations, which establish the supervisory and reporting procedures for microfinance institutions.</p>	<p>Result Indicator 3: Share of the population with access to formal financial services (e.g. bank accounts). Baseline (2015): 53 percent Target (2020): 65 percent</p>

Prior Actions and Indicative Triggers			Results
Prior Actions under DPF 1	Prior Actions under DPF 2	Indicative Triggers for DPF 3	
development of the national payment system.	microfinance.		
	Prior action 3: In order to expand the outreach of the banking system and support financial inclusion through the usage of mobile financial services, the Recipient, through its Council of Ministers, has approved and submitted to the Parliament the proposed National Payment Systems Law, which sets forth the statutory level principles for regulation on modern payment methods, such as agent banking, mobile money, and electronic payments.		
Prior action 3: The Recipient, through its Council of Ministers (<i>Conselho de Ministros</i>), has reduced legal fees (i.e. taxes and registry fees) associated with the registry of mortgages.	Prior Action 4: In order to reduce costs and simplify procedures to register property, therefore improving its ability to serve as loan collateral and foster access to finance, the Recipient, through the Council of Ministers, has approved and submitted to the recipient's Parliament (i) the proposed Property Registration Code; and (ii) the proposed Public Notary Code.		Result Indicator 4: Share of real estate properties and mortgages registered and digitized in the Public Notary Registry. Baseline (2015): 0 Target (2020): 90 percent.
Component A.2: Introduce growth-enabling reforms in the infrastructure sector			
Prior action 4: The Recipient, through EMAE, has introduced a revised system of pre-paid energy services that will allow for accurate consumption metering and invoicing, as well as eliminating the risk of non-payment	Prior Action 5: In order to promote transparency and incentivize timely payments, the Recipient, through EMAE, has published its policy to improve billing collection and launched a public awareness campaign through public TV and radio.	Trigger 5: In order to allow for a more efficient and accurate billing and reduce potential for underreporting of consumption, the Recipient, through EMAE, has introduced a new remote metering system connected to the management system that will allow for automated metering and billing.	Result Indicator 5: EMAE's non-technical losses. Baseline (2015): 26.4 percent Target (2020): 23.8 percent
		Trigger 6: In order to reduce arrears from the government to EMAE, the Recipient has taken the following actions: (i) condition the budget transfer to autonomous institutes on the timely payment of energy bills; (ii) agree on payment plans for overdue energy bills for each autonomous agency; and (iii) give priority to energy bill payments just after payroll and debt service.	Result Indicator 6: Amount of Public Sector Arrears to EMAE. Baseline (2015): 36.4 billion STD Target (2020): 12 billion STD
	Prior action 6: In order to structurally reduce the cost of energy, increase the	Trigger 7: In order to structurally reduce the cost of energy and promote long-term	Results Indicator 7: Energy cost of production.

Prior Actions and Indicative Triggers			Results
Prior Actions under DPF 1	Prior Actions under DPF 2	Indicative Triggers for DPF 3	
	share of renewable sources, and promote long-term private investment, the Recipient, through its Council of Ministers, has ruled that any capacity expansion of the power sector will have to follow the prescriptions of the integrated Least-Cost Power Development Plan, and that any exception would need to obtain the approval of the Recipient's Minister of Infrastructure, who shall have to provide the rationale for such exemption and publish said decision.	private investment, the Recipient, through its Council of Ministers, has approved the Least-Cost Power Development Plan.	Baseline (2015): 8,545.22 STD/kwh Target (2020): 8,300.00 STD/kwh
Prior action 5: The Recipient, through AGER, has mandated EMAE to: (i) establish a comprehensive customer complaint redress system, for the mediation of conflicts between citizens and EMAE, as well as representing the interests of the public, receiving feedback, complaints, information requests and suggestions for improvement of service; and (ii) send to AGER monthly reports of complaints received from customers.	Prior action 7: In order to improve the reliability of energy supply, the Recipient, through AGER, has published the minimum quality criteria for the provision of services in the electricity sector.	Trigger 8: In order to improve the quality of service, the Recipient, through AGER, has signed a concession contract with EMAE including all the company's obligations including rules on tariffs and sanctions.	Result Indicator 8: Number of complaints received by EMAE Baseline (2015): 6,542 Target (2020): 3,000
Pillar B: Generate fiscal resources and savings and improve the quality of public expenditures			
Component B.1: Generate fiscal resources and savings			
Prior action 6: The Recipient, through its Council of Ministries, has simplified the tax structure and updated the threshold values of tax brackets for presumptive income taxation.	Prior action 8: In order to generate the tax and accounting information needed to implement the VAT, the Recipient, through its Council of Ministers, has adopted the legal framework for fiscal invoices and similar documentation, whereby it legally mandated companies to issue fiscal invoices, set out said invoice's minimum content and time requirements for storing them.	Trigger 9: In order to broaden the tax base and generate more own-source revenues, the Recipient has submitted to parliament a draft law to implement a VAT.	Result Indicator 9: Tax revenues (as a share of GDP) Baseline (2015): 14.3 percent Target (2020): 15.8 percent
	Prior action 9: In order to improve SOE's financial and non-financial performance, the Recipient, through its Council of Ministers, has approved an SOE reform plan that established a performance monitoring system with	Trigger 10: In order to improve accountability of the SOE management, the Recipient, through its Council of Ministers, has established a performance monitoring system with financial and non-financial targets for all SOEs, with clear	Result Indicator 10: Percentage of performance targets achieved – average for SOEs. Baseline (2015): N.A. Target (2020): 50 percent

Prior Actions and Indicative Triggers			Results
Prior Actions under DPF 1	Prior Actions under DPF 2	Indicative Triggers for DPF 3	
	financial and non-financial targets for all SOEs and incentives to ensure compliance.	incentives for compliance.	
		Trigger 11: In order to increase transparency and ensure accuracy of SOE's financial position, the Recipient has published accounts audited by an external and independent auditing company for its main public owned SOEs (EMAE, ENASA and ENAPORT).	
Component B.2: Improve the quality of public expenditures			
	Prior action 10: In order to improve the efficiency and Value for Money of public investment, the Recipient's Parliament has enacted a National Planning System Law that harmonizes planning and budget tools, and lays the foundation for the appraisal and selection of public investment projects.	Trigger 12: In order to improve selection of public investment projects, the Recipient, through its Council of Ministers, has established a National Investment Portfolio Database - NIPD (<i>Carteira Nacional de Projectos</i>) to serve as the single source for public investment projects, from which all public investment projects will have to be sourced to be executed through the Public Investment Program (<i>Programa de Investimentos Públicos</i>).	Result Indicator 11: Share of ongoing and finalized projects with basic information included in the National Investment Portfolio Database. Baseline (2015): 0 Target (2020): 100 percent
	Prior action 11: In order to coordinate and harmonize social protection and poverty reduction policies, the Recipient has registered in the Recipient's social registry all the beneficiaries of the three core social protection programs defined by the Recipient's Social Protection Policy and Strategy.	Trigger 13: In order to allow for tracking and reconciliation of funds allocated to social protection payments, the Recipient has instituted a predominantly financial system-based formal payment mechanism for social protection programs.	Result Indicator 12: Number of beneficiaries enrolled in the three core social protection programs and receiving regular payments as set in law. Baseline (2015): 0 Target (2020): 4,000 (out of which, 50 percent has received payments through the formal financial system).

ANNEX 2: LETTER OF DEVELOPMENT POLICY



Carta de Políticas de Desenvolvimento

Vossa Excelência
Jim Yong Kim
Presidente do Grupo Banco Mundial
1818 H Street, NW
Washington, DC. 20433
EUA

Ref. 645/GM/2018
São Tomé, 28 de Março

Sr. Presidente,

Em nome do Governo da República Democrática de São Tomé e Príncipe, eu tenho o prazer de submeter a vossa elevada consideração o documento da segunda operação do programa em apoio ao fortalecimento do crescimento e política fiscal de São Tomé e Príncipe. Essa operação e seu respectivo donativo dão seguimento ao apoio do Banco aos esforços do país para realizar reformas conducentes ao crescimento económico, geração de recursos próprios para o financiamento do desenvolvimento e a melhoria da qualidade do gasto público. Este último componente abrange também o aprimoramento da política nacional de protecção social, que em conjunto com as medidas para ampliar a mobilização de recursos domésticos, proporcionarão maior eficácia no combate à pobreza. Essas reformas ajudar-nos-ão a mitigar os riscos ao nosso crescimento, advindos dos sectores bancários, externos e fiscais bem como a superar os principais obstáculos ao desenvolvimento, nomeadamente: a ausência de um sector privado forte capaz de liderar o crescimento; e a baixa inclusão do crescimento obtido até ao presente momento.

No ano de 2017, o Governo aprovou um novo Plano Nacional de Desenvolvimento (PND) 2017-2021, alinhado à Agenda de Transformação: Visão São Tomé e Príncipe 2030. O objectivo desse plano é gerar um crescimento acelerado, redutor da pobreza e protector do ambiente. O plano contém nove aspirações, dois pilares e cinco objectivos estratégicos agrupados em cinco áreas temáticas: (i) económica, (ii) social, (iii) institucional, (iv) infra-estrutura; e (v) meio-ambiente. Esses objetivos serão atingidos pelo alcance dos vários programas em cada área temática, mas também pela implementação de dois projectos transformadores: um porto de águas profundas e um aeroporto internacional de classe mundial. É importante ressaltar que esses projetos serão realizados respeitando sempre a capacidade financeira do governo de forma a não gerar riscos fiscais excessivos bem como os compromissos assumidos, como a política de empréstimos não-concessionais.

Nos últimos dois anos, o crescimento da nossa economia desacelerou devido a contenção das despesas correntes e a menor disponibilidade de recursos para financiar os investimentos públicos, evidenciando a excessiva dependência da



economia dos gastos públicos. A queda do preço internacional do cacau também contribuiu para a desaceleração da economia. Por outro lado, o sector de turismo mostrou um crescimento vigoroso. As perspectivas para a economia são positivas na medida que o governo vem trabalhando para afastar os principais riscos ao crescimento: sector bancário, sector externo e política fiscal.

No campo da supervisão bancária, o Banco Central de São Tomé e Príncipe vem conduzindo reformas estruturantes no quadro legal e práticas de supervisão, alinhando-se com as melhores práticas internacionais. Foi com base nesse esforço, que a licença de operação do Banco Equador foi revogada, com o seu consequente encaminhamento para liquidação pelo Poder Judiciário, e mais recentemente o Banco Privado foi submetido ao regime de administração temporária para posterior venda parcial ou total dos seus ativos.

As contas externas de São Tomé e Príncipe são estruturalmente deficitárias devido ao pequeno tamanho do nosso país e da nossa população. Contribuem também para o défice, a nossa insularidade e a ausência de grandes recursos naturais ou vantagens comparativas já estabelecidas. Nesse sentido, os recursos provenientes de donativos e empréstimos externos têm sido essenciais para a sustentabilidade externa da economia. Contudo, nota-se uma ligeira melhoria nas contas externas santomenses, fruto de maior investimento directo por parte das empresas petrolíferas, queda do preço do petróleo e maiores receitas de turismo. O governo tem incessantemente procurado atrair o investimento privado, tendo estabelecido uma agência de promoção das exportações e atracção de investimento, e concluído a estratégia de promoção de investimento e do turismo.

O Ministério das Finanças vem envidando um esforço enorme para promover a consolidação fiscal e equilibrar o orçamento público. Após um incremento do défice em 2016, causado por uma queda na receita de impostos de importação, o governo tomou medidas duras do lado das receitas e das despesas para retomar uma trajectória declinante do défice. Foram aumentadas as taxas, abrangendo diversos impostos, e novas medidas de administração tributária foram implementadas. Pelo lado das despesas, cortaram-se gastos com combustíveis, telecomunicações, e eliminou-se benefícios concedidos aos funcionários das empresas públicas. Como resultado, o défice primário (doméstico) foi reduzido de 4 por cento do PIB em 2016 para 1.8 por cento do PIB no primeiro semestre de 2017, atingindo a meta acordada com o FMI.

No que tange à inflação, eu gostaria de realçar que o aumento registado nos últimos anos, deve-se ao efeito de choques como o excesso de chuvas e pragas agrícolas, e eventos pontuais como a mudança na metodologia do índice e o aumento dos impostos sobre alguns itens como as bebidas alcoólicas. Uma vez ultrapassados esses efeitos, a inflação deve retornar a um patamar mais baixo, devido ao bem-sucedido regime de câmbio fixo estabelecido desde 2010. O corolário dessa bem-sucedida política é a recente reforma monetária, que eliminou três zeros da moeda no intuito de reduzir os custos de transação e eliminar a memória inflacionária.

Não obstante as medidas evidenciadas acima para mitigar os riscos ao crescimento, São Tomé e Príncipe precisa lidar com os desafios de tornar o crescimento económico mais inclusivo e desenvolver o sector privado para que este possa liderar e acelerar o crescimento, e tornar a economia menos



dependente do gasto público. A segunda operação do programa em apoio ao fortalecimento do crescimento e política fiscal de São Tomé e Príncipe e o Plano Nacional de Desenvolvimento alinham-se para lidar com esses desafios e mitigar os riscos ao crescimento económico.

O PND incorpora integralmente a Estratégia de Desenvolvimento do Sector Financeiro, que foi realizada em conjunto com o Banco Mundial, da qual é parte integrante das acções prévias de políticas a serem apoiadas nessa série de operações. O objectivo é melhorar a supervisão bancária, dotar o mercado financeiro de condições para oferecer mais crédito, de forma mais barata e segura, e ampliar o acesso da população aos serviços financeiros com a figura do agente bancário, dinheiro digital e o quadro legal das microfinanças.

O alto custo da energia, a baixa extensão da rede eléctrica e também a intermitência do fornecimento são entraves ao desenvolvimento do sector privado bem como à redução da pobreza. No sector eléctrico, o objectivo geral do PND é aumentar significativamente a oferta de energia e reduzir o seu custo, através de recurso às fontes próprias, para atender às necessidades das empresas e ligar 95 por cento das localidades do país à rede eléctrica. O governo assumiu também o compromisso de ter ao menos 50 por cento da energia gerada por fontes limpas até 2030. Para o efeito, é essencial o apoio ao planeamento do sector por meio da realização e adopção do Plano de Desenvolvimento de Energia de Menor Custo, que guiará a expansão do sector energético do país. Para a sustentabilidade do sector energético, torna-se também necessário a melhoria da gestão da empresa pública de água e energia (EMAE) e a melhoria da regulação do sector, reformas que também constam do PND e da presente operação.

A fragilidade fiscal do nosso país é um risco ao crescimento económico, dada a dependência da economia dos gastos públicos. Uma das razões por trás dessa fragilidade é o baixo nível da receita dos impostos. O nosso país tem um dos menores rácios de receita tributária sobre o PIB. Isso implica uma posição fiscal mais vulnerável com constantes défices e uma dificuldade do governo em prover os serviços públicos necessários à população. Um exemplo dessa dificuldade é a implementação da nova Política e Estratégia Nacional de Protecção Social (PENPS), que foi aprovada pelo Conselho de Ministros em 2015, mas não conta ainda com todos os recursos necessários para sua implementação integral. Nesse sentido, a ampliação das receitas domésticas – por meio da implementação do Imposto sobre Valor Acrescentado – é uma condição necessária para a implementação da PENPS.

As reformas previstas não se restringem apenas as receitas, mas abrangem também as despesas. Os investimentos públicos representam a maior despesa do nosso país, que são financiados na sua maioria por donativos e empréstimos concessionais. Esses investimentos exercem grande influência na actividade económica do país, porém, seu impacto está aquém do potencial. Nesse sentido, São Tomé e Príncipe compromete-se com um programa de reformas na gestão de investimentos públicos. Por último, o governo reconhece a necessidade de reformar a gestão e controle das empresas públicas. Nesse sentido, agradecemos o apoio do Banco na elaboração de um diagnóstico e um plano de reforma das empresas públicas, cuja adopção e implementação estão sendo apoiados por essa operação. A reforma das empresas públicas é vital para reduzir os riscos fiscais,



fomentar o sector privado e reduzir a pobreza, uma vez que essas empresas detêm o monopólio em sectores cruciais como energia, águas, portos e aeroportos.

Em síntese, são essas as reformas para as quais gostaríamos de contar com o apoio do Banco Mundial. Acredito que os resultados já alcançados pelo nosso país, bem como a adequação da nossa situação macroeconómica e os compromissos assumidos e implementados por esse governo desde o seu início, fornecem a confiança necessária à execução das políticas e ao alcance dos resultados propostos. Renovo também o meu compromisso de manter-lhe informado sobre qualquer acção do governo que possa interferir no programa ou no nosso compromisso junto as instituições multilaterais.

Ciente da sua atenção, renovo os meus protestos de elevada estima e distinta consideração.

O Ministro,


Américo d'Oliveira dos Ramos

Your Honor
Jim Yong Kim
President of the World Bank Group
1818 H Street, NW
Washington, DC. 20433
USA

Ref. 645 / GM / 201 8
Sao Tomé, March 29, 2018

Mr. President,

On behalf of the Government of the Democratic Republic of São Tomé and Príncipe, I have the pleasure of submitting to your high consideration the document of the second operation of the program in support of São Tomé and Príncipe's growth and fiscal policy. This operation and its respective grant continue the Bank's support to the country's efforts to carry out reforms conducive to economic growth, generation of own resources for development financing, and improving the quality of public spending. The latter component also covers the improvement of the national policy on social protection, which together with measures to increase the mobilization of domestic resources, will provide greater efficiency in reducing poverty. These reforms will help us mitigate the risks to growth, coming from the banking, external and fiscal sectors as well as to overcome the main development challenges, namely: the absence of a strong private sector capable of leading growth; and the low inclusiveness of the growth registered so far.

In the year 2017, the government approved a new National Development Plan (PND) 2017-2021, aligned to the Transformation Agenda: Vision São Tomé and Príncipe 2030. The purpose of this plan is to generate an accelerated, poverty-reducing, and environmental-protective growth. The plan contains nine aspirations, two pillars, and five strategic objectives grouped into five thematic areas: (i) economic, (ii) social, (iii) institutional, (iv) infrastructure; and (v) the environment. These objectives will be achieved by the completion of the various programs in each thematic area, but also through the implementation of two transformative projects: a deep-sea port and a world-class international airport. It is worth noting that these projects will be carried out while respecting the financial capacity of the government so as not to generate excessive fiscal risks and risks to our commitments, such as the non-concessional borrowing policy.

In the last two years, our economy growth has slowed due to the curtailment of current expenditures and reduced availability of resources to finance public investments, evidencing the excessive dependence of the economy on public expenditures. The fall in the international price of cocoa also contributed to the slowdown of the economy. On the other hand, the tourism sector has shown a vigorous growth. The outlook for the economy is positive as the government has been working to address the main risks to growth: banking sector, external sector, and fiscal policy.

In the area of banking supervision, the Central Bank of São Tomé and Príncipe has been conducting structural reforms in the legal framework and supervisory practices, in line with best international practices. It was based on this effort that the operating license of Banco Ecuador was revoked, with its consequent submission to liquidation by the Judiciary, and more recently the Private Bank was subject to a temporary administration regime for subsequent sale of part or the totality of its assets.

São Tomé and Príncipe's external accounts are structurally in deficit due to the small size of our country and our population. Our insularity and the absence of major natural resources or established comparative advantages also

contribute to the deficit. In this sense, the proceeds of grants and foreign loans have been essential to the external sustainability of the economy. Nonetheless, there has been a slight improvement in the external accounts, due to higher direct investment from oil companies, the oil price decline, and increased tourism revenue. The government has incessantly sought to attract private investment, having established an agency in charge of promoting exports and attracting investment, and having completed the investment promotion and tourism strategy.

The Ministry of Finance has been making a huge effort to promote fiscal consolidation and balance the budget. After a deficit increase in 2016, caused by a drop in customs revenue, the government took tough measures on the revenue and the expenditure side to resume a downward trajectory of the deficit. Tax rates were increased, and new tax administration measures were implemented. On the expenditure side, spending on fuels and telecommunications was cut, and fringe benefits granted to public company employees were eliminated. As a result, the primary (domestic) deficit was reduced from 4 percent of GDP in 2016 to 1.8 percent of GDP in the first half of 2017, reaching the goal agreed with the IMF.

With regards to inflation, I would like to highlight that the increase registered in the last couple years is due to the effect of shocks such as excessive rainfall and agricultural pests, and specific events, such as the change in the index methodology and the increase in taxes on some items such as alcoholic beverages. Once these effects wane out, inflation should return to a lower level because of the successful fixed exchange rate regime established since 2010. The corollary of this successful policy is the recent monetary reform, which has eliminated three zeros of the currency to reduce transaction costs and eliminate inflationary memory.

Despite the measures highlighted above to mitigate the risks to growth, São Tomé and Príncipe needs to deal with the challenges of turning growth more inclusive and to develop the private sector so that it can lead and accelerate growth, in order for the country to become less dependent on public expenditure. The second operation of the program in support of São Tomé and Príncipe's growth and fiscal policy and the National Development Plan are aligned to address these challenges and mitigate the risks to economic growth.

The National Development Plan (NDP) fully incorporates the Financial Sector Development Strategy, carried out jointly with the World Bank, which is an integral part of the policy matrix to be supported in this series of operations. The objective is to improve banking supervision, to provide the financial market with the conditions to offer more credit, in a cheaper and safer way, and to increase the population's access to financial services with the figure of the banking agent, digital money and the legal framework for microfinance.

The high cost of energy, low extension of the electricity grid, and the intermittent supply are obstacles for the development of the private sector as well as for the reduction of poverty. On the electric sector, the general objective of the NDP is to increase significantly the supply of energy and reduce its cost through use of own sources, to meet the needs of companies, and connect 95 percent of the country to the network. The government also made a commitment to have at least 50 percent of the energy generated by renewable sources by 2030. To this end, it is essential to support the planning of the sector through the implementation and adoption of the Least Cost Power Development Plan, which will guide the expansion of the country's energy sector. For the sustainability of the energy sector, it is also necessary to improve the management of State-Owned Enterprise of water and energy (EMAE) and to improve the regulation of the sector, reforms which are also part of the NDP and the present operation.

The fiscal fragility of our country is a risk to economic growth, given the economy's dependence on public spending. One of the reasons behind this fragility is the low level of tax revenue. Our country has one of the lowest tax revenue ratio to GDP. This implies a more vulnerable fiscal position with constant deficits and a difficulty of the government to provide the necessary public services to the population. An example of this difficulty is the implementation of the new National Policy and Strategy for Social Protection (PENPS), which was approved by the Council of Ministers in 2015, but still doesn't have all the necessary resources for its full implementation. In this sense, increasing domestic revenue - through the implementation of the Value Added Tax - is a necessary condition for the implementation of the PENPS.

The reforms envisaged are not only restricted to revenue, but also encompass public expenditure. Public investments represent the biggest expenditure of our country, which are funded mostly by grants and concessional loans. These investments exert great influence on the economic activity of the country, but their impact is below

potential. In this sense, São Tomé and Príncipe is committed to reforming public investment management. Finally, the government recognizes the need to reform the management and control of State-Owned Enterprises. In this regard, we are grateful for the Bank's support in preparing a diagnosis and a plan for the reform of State-Owned Enterprises, whose adoption and implementation are being supported by this operation. Reform of State-Owned Enterprises is vital to reducing fiscal risks, boosting the private sector and reducing poverty, as these companies have a monopoly on crucial sectors such as energy, water, ports and airports.

In summary, these are the reforms we would like the support of the World Bank. I believe that the results already achieved by our country, as well as the adequacy of our macroeconomic situation and the commitments assumed and implemented by this government since its inception provide the necessary confidence to the implementation of policies and to achieving the proposed results. I hereby renew my commitment to keep you informed of any action of the government that might affect the program or our commitments with multilateral institutions.

Very truly yours,

The Minister
Américo D'Oliveira Ramos

ANNEX 3: IMF RELATIONS ANNEX

IMF Executive Board Concludes Third and Fourth Reviews of the Program Supported by the Extended Credit Facility (ECF) Arrangement with São Tomé and Príncipe

December 11, 2017

- The program's success hinges on closely monitoring budget execution to ensure that expenditures are limited to realized resources, while safeguarding macroeconomic stability and debt sustainability.
- Efforts to reduce contingent liabilities and rehabilitate the financial system continue, and structural reforms are advancing, albeit with delay.
- The authorities' development strategy to promote more inclusive and sustained growth by boosting investment in infrastructure and human capital, increasing social spending, and advancing structural reforms is appropriate.

The Executive Board of the International Monetary Fund (IMF) today completed the third and fourth reviews of the arrangement under the Extended Credit Facility (ECF) [\[1\]](#) for São Tomé and Príncipe. The Board's decision enables the immediate disbursement of SDR 1,268,570 (about US\$1.8 million), bringing total disbursements under the arrangement to roughly SDR 3.17 million (about US\$4.5 million).

In completing the review, the Executive Board granted the authorities' request for waivers for nonobservance of the end-December 2016 performance criteria on the domestic primary balance and changes in net bank financing of the central government, based on the corrective measures introduced by the authorities. In addition, the Executive Board established targets and structural benchmarks for 2018. The ECF arrangement for São Tomé and Príncipe in the amount of SDR 4.44 million (about US\$6.2 million or 60 percent of the country's quota at the time of approval) was approved on July 13, 2015 (see [Press Release No. 15/336](#)) to support the government's economic reform program for stronger and more inclusive growth.

Following the Executive Board's discussion, Mr. Tao Zhang, Deputy Managing Director and Acting Chair, said:

"São Tomé and Príncipe's economy continues to grow steadily and the outlook is favorable. However, implementing sound policies to bring the fiscal deficit and public debt to sustainable levels will be key to achieving sustained, robust growth and reducing poverty. In this context, the 2017-21 National Development Plan is expected to help diversify the economy and improve the business environment.

"The authorities have taken decisive action to bring the program back on track. Program targets have been met and good progress was made on structural reforms, including the planned adoption of a VAT. Measures have been taken to meet the end-2017 fiscal targets. In addition, the 2018 budget appropriately targets further consolidation to lower the domestic primary deficit.

"The authorities aim to strengthen public financial management. Efforts will be made to prevent new domestic arrears, reduce the current stock of arrears, and tackle fiscal risks posed by the large operational losses at the state-owned electricity and water enterprise. To ensure debt sustainability while meeting the large investment needs, external borrowing should be at concessional terms.

"In the financial sector, banking supervision has been strengthened and financial soundness indicators have improved. The liquidation of Banco Equador has resumed. Steps will be taken to reduce the stock of non-performing loans and further enhance financial stability."

[1] The [ECF](#) is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted balance of payments problems.

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ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure		
Prior action 1: In order to strengthen the bank resolution framework, the Recipient, through its BCSTP, has adopted regulations implementing the Recipient's financial institutions resolution law, which set out: (i) the measures to be applied by the BCSTP in the resolution on distressed financial institutions; and (ii) the requirements for the elaboration and adoption of recovery and resolution plans.	No	No, there is no clear direct or indirect distributional effect of this policy.
Prior action 2: In order to develop the microfinance sector and promote the offer of microfinance services, the Recipient, through its Council of Ministers, has approved and submitted to Recipient's Parliament a draft law on microfinance.	No	Yes, positive poverty-reducing, social or distributional effects are expected. The draft law will contribute to the expansion of the microfinance sector in STP. This will allow larger proportion of the poor to access finance.
Prior action 3: In order to expand the outreach of the banking system and support financial inclusion through the usage of mobile financial services the Recipient, through its Council of Ministers, has approved and submitted to Parliament the proposed National Payment Systems Law, which sets forth the statutory level principles for regulation on modern payment methods, such as agent banking, mobile money, and electronic payments.	No	Yes, positive poverty-reducing, social or distributional indirect effects are expected. The poor may benefit indirectly through increased security in mobile money transactions.
Prior action 4: In order to reduce costs and simplify procedures to register property, therefore improving its ability to serve as loan collateral and foster access to finance, the Recipient, through the Council of Ministers, has approved and submitted to the Recipient's Parliament (i) the proposed Property Registration Code; and (ii) the proposed Public Notary Code.	No	Yes. This will have positive social and poverty-reducing effects. This will increase access to finance by the poor which can be used in income generating activities.
Prior action 5: In order to promote transparency and incentivize timely payments, the Recipient, through EMAE, has published its policy to improve billing collection and launched a public awareness campaign through public TV and radio.	No	No. Cutting electricity supply after 100 days of non-payment could have a negative impact on the poor, but only if these are connected to the grid, which is unlikely to be the case.
Prior action 6: In order to structurally reduce the cost of energy, increase the share of renewable sources, and promote long-term private investment, the Recipient, through its Council of Ministers, has ruled that any capacity expansion of the power sector will have to follow the prescriptions of the integrated Least-Cost Power Development Plan, and that any exception would need to obtain the approval of the Recipient's Minister of Infrastructure,	Yes. Positive effect	Yes. Positive distributional impacts are expected. The reduction in the cost of energy will allow energy tariffs to be kept unchanged for a longer period or even be reduced.

Prior actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
who shall have to provide the rationale for the such exemption and publish said decision.		
Prior action 7: In order to improve the reliability of energy supply, the Recipient, through AGER, has published the minimum quality criteria for the provision of services in the electricity sector.	No	Yes, positive poverty-reducing, social or distributional effects are expected. This will benefit particularly households with home-based enterprises and small and medium enterprises that need regular electricity to stay in business.
Pillar B: Generate fiscal resources and savings and improve the quality of public expenditures		
Prior action 8: In order to generate the tax and accounting information needed to implement the VAT, the Recipient, through its Council of Ministers, has adopted the legal framework for fiscal invoices and similar documentation, whereby it legally mandated companies to issues fiscal invoice's minimum content and time requirements for storing them.	No	Yes. The introduction of VAT may have detrimental effects on the poor, in particular with respect to food items.
Prior action 9: In order to improve SOE's financial and non-financial performance, the Recipient, through its Council of Ministers, has approved an SOE reform plan that established a performance monitoring system with financial and non-financial targets for all SOEs and incentives to ensure compliance.	No	No poverty and social impact is expected from this prior action.
Prior action 10: In order to improve the efficiency and Value for Money of public investment, the Recipient's Parliament has enacted a National Planning System Law that harmonizes planning and budget tools, and lays the foundation for the appraisal and selection of public investment projects.	Yes. Positive effect	No poverty and social impact is expected from this prior action. There is now way to guarantee that the funds saved from the increased efficiency will be used in productive programs that benefit the poor.
Prior action 11: In order to coordinate and harmonize social protection and poverty reduction policies, the Recipient has registered in the Recipient's social registry all the beneficiaries of the three core social protection programs defined in the Recipient's Social Protection Policy and Strategy.	No	Yes. This has a potential positive impact. It will lead to better targeting and increase in coverage.