PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

May 2, 2017
Report No.: AB7885

Operation Name	2nd Strengthening Growth & Building Foundations for Poverty Reduction
Region	AFRICA
Country	Sao Tome and Principe
Sector	
Operation ID	P161707
Lending Instrument	Development Policy Lending
Borrower(s)	DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE
	Democratic Republic of São Tomé and Príncipe São Tomé and Príncipe
Implementing Agency	
	Ministry of Finance and Public Administration Largo das Alfândegas Caixa Postal 168 Sao Tomé and Príncipe Tel: 2221083
Date PID Prepared	April 25, 2017
Estimated Date of Appraisal	
Estimated Date of Board Approval	July 31, 2017
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

STP is a democratic, low-middle-income country with a high poverty rate. STP is a multiparty democracy and unitary state with a population of nearly 200,000 people. It is divided into six districts plus the Autonomous Region of Príncipe (Região Autónoma do Príncipe - RAP). Gross national income per capita is estimated at US$3,250 in purchasing power parity (PPP) terms; gross domestic product (GDP) per capita is US$1,669. Around one-third of the population lives on less than US$1.9 PPP per day, and more than two-thirds of the population is poor, using a poverty line of US$3.1 PPP per day1. Poverty is widespread in the country, but some districts such as Caué and Lembá have higher poverty incidence. Poverty is more of an urban phenomenon since many families migrated to the cities after independence and nationalization of the agricultural enterprises (roças). Unemployment was at 13.6 percent in 2012, last data available. Two sectors—agricultural and retail—generate 50 percent of all jobs in the country.

GDP growth has been stable, but it is heavily reliant on government spending, and it has not been able to reduce poverty. STP has grown at an average rate of 4.5 percent from 2009 to 2016, with no recessions and little fluctuation. It is, however, susceptible to macroeconomic risks coming from its fiscally fragile

[1] Source: World Development Indicators. Data is for 2015.

position, banking sector, and external deficits. Growth is driven largely by government spending. While agriculture has been explored on a commercial basis since colonial times, production has declined since independence and agriculture is not the main growth driver in STP anymore. However, agricultural goods, especially cocoa, constitute the bulk of STP's exports. Tourism is a natural comparative advantage, and is already an important economic activity, but STP is far from the characterization of a tourism-dependent economy. Oil exploration has taken place since 2013, but commercial activity is not expected before 2020. Few goods are produced locally, leaving STP very dependent on imports, including the oil needed to generate power. Growth has not been pro-poor because the most vulnerable population lacks the skills to access economic opportunities. Social protection (SP) policies have not been able to alleviate poverty and provide a path for the vulnerable population to grow out of poverty.

The Government of São Tomé and Príncipe (GoSTP) wants to move to a more inclusive, private-sector driven and sustainable growth model. The GoSTP is aware that being the main driver of the economy is not sustainable in the long run. Government resources are insufficient to maintain a large payroll, carry out and maintain public investments, and provide quality public services to the population. This arrangement is at the core of the country's fiscal fragility and is a serious threat – together with banking sector stability – to macroeconomic stability and growth. The GoSTP has been implementing several reforms to improve the business environment and is carrying out investment promotion activities, which are expected to attract new private ventures, bringing foreign exchange and balancing its external accounts. It is also cognizant that to have a more vibrant private sector, it has to resolve infrastructure bottlenecks – namely energy and transportation – and access to credit. It is also acting on the fiscal and banking sector macro risks to guarantee a faster and more sustainable growth path. Finally, it has revamped its social policy and it is expanding education opportunities to allow the benefits of growth to reach a wider share of the population.

II. Proposed Objective(s)

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 quality of expenditures. The first operation in this series laid the foundation for policy reforms that will be supported in the second and third operations. For example, the creation of a new directory in the BCSTP in charge of payment systems is what is allowing the revision of the payments system in the second DPO. This operation will help facilitate the shift in growth model by supporting policies that aim to: (i) reduce the risks to growth; (ii) soften the developmental bottlenecks; and (iii) share the benefits of growth more widely. This will be done by supporting policy reforms on credit markets, bank supervision, domestic revenue mobilization and energy sector. The operation will also support the implementation of a new SP policy framework.

The proposed operation is aligned with the Government's program and objectives. The operation supports mainly the second and fourth axis of the government's strategy – namely, sustainable growth for Pillar A and shared development policies for Pillar B. The growth-enabling reforms supported by this DPF are foreseen in the seventh and eighth Transformation Agenda Objectives of the Government strategy: *Simplify the legislation and improve the business climate*; and *Implement programs of infrastructure to support growth*. Fiscal and Public Finance Management Reforms envisaged under Pillar B are echoed in the fourth and fifth Transformation Agenda Objectives of the Vision 2030: *Strengthen public and administrative management tool*; and *Promote transparency and accountability in public affairs*. The Government document also dedicates a full chapter (chapter 6 of the Vision) to priority projects for the implementation of the STP agenda for transformation by 2030, which is supported by the second pillar of the DPF. Finally, both the DPF series and the government strategy have the ultimate objective of reducing poverty and promoting shared prosperity, which is reflected for instance in the first pillar of the Program of the 16th Constitutional Government, namely 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

Government’s strategy document, where some projects are 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).

III. Preliminary Description

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 quality of expenditures. It is structured in two pillars. The first one supports policies aimed at reducing obstacles to growth, while the second puts together measures to generate fiscal space and increase quality of expenditures. Both pillars are divided into two components. Despite the organization of the operation in pillars and components around specific sectors and themes, it is of a multisectoral nature and there are synergies between policy actions and triggers across the two pillars. For example, the support to reform on the property and mortgage registry will also benefit tax collection and the effort to improve loan collateral. Another example is the complementarity between financial inclusion and SP measures. Agent banking and mobile finance will allow more people to access the financial system, which in turn will make room for SP payments to be made through the banking system, allowing for better control and auditing of payments and beneficiaries.

The first pillar of this operation supports policy reforms aimed to introduce growth-enabling reforms. These reforms aim to address obstacles to growth such as inadequate banking sector supervision, poor framework for the credit market, and costly and unreliable energy supply. Since this operation cannot support all growth-enabling reforms, it has opted to focus on the ones that are most critical, fall within the World Bank expertise in STP, have a time line compatible with the DPF series, and are supported by analytical work. All financial sector reforms are being supported in coordination with the IMF.

The second pillar groups all policies aimed at generating fiscal resources and savings, and improving the quality of public expenditure. STP has a fragile fiscal position, evidenced by recurrent unbalanced budgets and a long-standing high risk of debt distress. Several factors are at its root: poor debt management practices, low domestic revenue mobilization, and inadequate surveillance of SOEs. The low level of revenues collected imposes a limit on expenditures financed by own sources, leaving large parts of the budget to be funded externally and thus subject to more volatility. One example is the SP policy. Not only does it suffer from lack of funding, but the resources spent on the past programs were not directed to the most vulnerable. In addition, poor Public Investment Management (PIM) practices have prevented the country from taking full advantage of the growth leveraging potential of capital expenditures. The IMF program addresses short-term fiscal challenges, while the DPF focus more on structural measures.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The proposed DPF series will have a positive social impact on poverty reduction. This DPF series have some positive and direct effect on poverty reduction, but most of the effects are indirect. The direct effects come from the support to the new SP policy that will better target and expand the coverage of the SP programs. Indirect impacts include greater access to finance, and access to energy, and a more stable economy - through improved bank supervision and a more robust fiscal position.

Environment Aspects

The proposed DPF series has neutral environmental impacts. The policies supported in the financial sector, business regulation, and fiscal tend to have very small and indirect impacts on the environment, leading to an overall neutral impact. Support to the SP policy can have a small indirect positive impact to the extent that it moves vulnerable population away from economic practices that are harmful to the environment. The same can be said for the policy support to the energy sector to the extent that the population not previously covered by the energy grid will stop using fuels such as wood that are harmful to the environment. The regulatory framework foresees the need for environmental impact assessments and strategic environmental assessments, but limited capacity prevents the country to reap the full benefits of the framework.

V. Tentative financing

Source:	($m.)
BORROWER/RECIPIENT	0.00
IDA Grant	5.00
Borrower/Recipient	
IBRD	
Others (specifiy)	
Total	

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