# Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: February 28, 2018 | Report No: 124348

## BASIC INFORMATION

### A. Basic Project Data

| Country | Project ID | Project Name | Parent Project ID (if any) |
|---|---|---|---|
| Democratic Republic of São Tomé and Príncipe | P161707 | Second Strengthening Growth and Fiscal Policy Development Policy Financing | First Strengthening Growth and Fiscal Policy Development Policy Financing |
| **Region** | **Estimated Board Date** | **Practice Area (Lead)(s)** | **Financing Instrument** |
| Africa | April 30, 2018 | Macroeconomics, Trade and Investment (MTI) Global Practice | Development Policy Financing |
| **Borrower(s)** | **Implementing Agency** | | |
| Democratic Republic of São Tomé and Príncipe | Ministry of Finance, Trade and Blue Economy | | |

**Proposed Development 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 the quality of expenditures.
Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure.
Pillar B: Generate fiscal resources and savings and improve the quality of expenditures.

**Financing (in US$, Millions)**

SDR 4.2 million (US$6 million equivalent)

**SUMMARY**

| | |
|---|---|
| **Total Financing** | US$6 million equivalent |

**DETAILS**

Source:
IDA Grant.
Terms: Standard International Development Association Terms.

Decision

Following the corporate review, the decision was taken to proceed with the preparation of the operation.

## B. Introduction and Context

### Country Context

**STP is a low-middle-income, small-island country that faces problems typical of small states.** 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$1,714. STP faces problems typical of small states that affect its ability to deal with shocks and achieve a balanced budget. The limited number of people and workers normally prevent production for both export and local markets to be done at an efficient scale. Remoteness and insularity increases export costs. Land and workforce size prevent the country to diversify its economy, making the country more vulnerable to terms of trade shocks. The indivisibility in the production of public goods, the high fixed costs associated with some of them, and the difficulty of providing services to scattered population imply a high cost of public goods and a higher level of public expenditures. This high cost coupled with limited tax base make it more challenging for small states to balance their budgets.

**In order to achieve higher levels of development, STP must face two challenges: (i) the low inclusiveness of growth, and (ii) the lack of private-led growth drivers; and address three risks to growth coming from fiscal fragility, the banking sector, and external imbalances.** 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. Growth has been over-reliant on government spending because STP lacks buoyant private economic activities to drive growth. The government spends around 38 percent of GDP, owns four State-Owned Enterprises (SOEs), invest 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 situation – high fiscal deficit, low level of domestic resource mobilization; (ii) a banking sector that requires caution with high level of non-performing loans and borderline capital adequacy; and (iii) and external imbalances.

**The Government of São Tomé and Príncipe (GoSTP) wants to move to a more inclusive, private-sector driven growth model and has been addressing the risks to growth.** The GoSTP is aware that economic growth cannot rely on government spending in the long run. 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 and is carrying out investment promotion activities, which are expected to attract new private ventures that are expected to foster new sources of growth and foreign exchange and contribute to 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 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.

**The macroeconomic framework in STP is adequate for development policy operations.** The macroeconomic policy framework is consistent with price stability due to the credible exchange rate peg in place for eight years. The BCSTP has been undertaking efforts to improve monetary policy tools and support solid credit growth. Fiscal imbalance is being addressed through improved domestic revenue mobilization, disciplined expenditure and better management and control of SOEs. The GoSTP has been taking measures to secure external financing in the short term through grants and concessional loans and by supporting economic activities, which can increase export earnings. Key downside risks include spending pressures from elections in 2018, sudden reversal in external finance and lack of capacity to implement crucial reforms such as the roll-out of Value Added Taxation.

### Relationship to CPF

**The proposed operation supports both themes of the current Country Partnership Strategy (CPS) FY14-FY18 (Report number 83144), discussed by the Board in July 2014.** An extension of the CPS until FY19 is being sought, which would fully align the timeframe of the CPS and the operation. The first pillar of the operation contributes to the first CPS theme: Supporting Macroeconomic Stability and National Competitiveness. The DPF support to financial sector supervision activities will help reduce the risks of a more serious banking problem and the corresponding output and fiscal implications. The 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 second pillar contributes to the advancement of the second theme of the CPS. It will do so by streamlining Social Protection programs, expanding the coverage, and improving the target of the Social Protection policy framework.

**This operation will contribute directly and indirectly to the World Bank Group's twin goals.** The revision of the SP policy framework and the expansion of the fiscal space will allow a better targeting and increased coverage of the SP programs. This will be done through measures to increase domestic mobilization of revenues. As a result, it is expected that extreme poverty will be reduced. The supported policies will also concur to boost shared prosperity. The revised SP policy will focus not only on the extreme poor but also on the poor and other vulnerable people. Policy changes to improve the credit market and will help increase access to credit and market opportunities for the people in the bottom part of the income distribution. Finally, affordable and greater access to energy are also associated with reduced poverty and greater shared prosperity.

**This DPF series was designed to complement and leverage current and upcoming World Bank projects in STP.** The rationale is to increase the effectiveness of World Bank support to STP by using different instruments to address different aspects of the development challenges faced by the country. On the energy sector, the World Bank is supporting an investment financing project that will deal with the reliability of the power supply, help reduce the price of energy, and improve the management of the utility company. The DPF will work on the policy side to improve sector regulation, management and oversight of SOEs. The DPF series will also leverage previous Advisory Services and Analytics work on the SP and banking sector, by supporting policy recommendations from these documents. The operation also takes into account the conclusions of the recently concluded PER that focused on tax policy and administration, SOE and PIM.

## C. Proposed Development 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 the quality of expenditures.
Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure.
Pillar B: Generate fiscal resources and savings and improve the quality of expenditures.

The objective is to:

### Key Results

These are the results expected under each pillar

Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure

- Number of banks below the central bank's minimum Capital Adequacy Ratio (12%). Baseline (2015): 3; Target (2020): 0.
- Score on Doing Business indicator "Getting Credit". Baseline (2015): 0 out of 20; Target (2020): 10 out of 20.
- Share of the population with access to formal financial services (e.g. bank accounts). Baseline (2015): 53 percent; Target (2020): 65 percent.
- Number of real estate properties and mortgages registered and digitized in the Public Notary Registry. Baseline (2015): 0; Target (2020): 90 percent.
- EMAE's non-technical losses. Baseline (2015): 26.4 percent; Target (2020): 23.8 percent.
- Amount of public sector arrears to EMAE. Baseline (2015): 36.4 billion LCU; Target (2020): 12 Billion LCU.
- Energy cost of production. Baseline (2015): 8,545.22 LCU/Kwh; Target (2020): 8,300.00 LCU/ Kwh.
- 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 expenditures

- Tax revenues (as a share of GDP). Baseline (2015): 14.3 percent; Target (2020): 15.8 percent.
- Percentage of performance targets achieved – average for SOEs. Baseline (2015): N.A.; Target (2020): 50 percent.
- Share of ongoing and finalized projects with basic information included in the National Investment Portfolio Database. Baseline (2015): 0; Target (2020): 100 percent.
- Number of beneficiaries enrolled in the three core SP programs and receiving regular payments as set in law. Baseline (2015): 0; Target (2020): 4,000.

## D. Program Description

**The proposed operation is the second of a series of three Development Policy Financing.** The first operation (P159010) in the amount equivalent to US$5 million was approved by the Board on November 30, 2016. STP is benefiting from a more than fourfold increase in its IDA allocation. As a result, the World Bank is gradually building up its knowledge and program in this small-island country.

**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.** These reforms address the causes of the development challenges and risks to growth faced by STP. The operation is structured in two pillars. The first one supports policies aimed at reducing risks from financial sector through improved bank supervision, and to foster private sector-led growth by improving access to credit and energy, which are foundational for the development of STP's tourism and agriculture – its 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 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. 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 lack of private-sector growth drivers, the low inclusiveness of growth, and the risks to growth (fiscal fragility,**

**banking sector and external sector) have several causes.** For example, low inclusiveness can be traced to low educational levels, poor access to finance, and an inadequate SP policy. The lack of private-led growth drivers can be credited to poor infrastructure, lack of credit, 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, high risk of debt distress, and low quality of expenditures in the fiscal side; and (iii) high current account deficit, over-reliance on grants, and concentrated exports on the external sector. Since the DPF series cannot address all causes, some filters – such as complementarity with other operations and Advisory Services and Analytics, client demand, and WB expertise - were applied to select the government policies to be supported by this series. As a result, this series is supporting measures to address nine causes behind the development challenges and the risks to growth.

**Prior Actions under DPF 2**

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 Central Bank, has issued regulations on two key provisions of the new banking resolution law to: (i) detail bank resolution measures (bank sale, recapitalization, and unilateral merger); and (ii) lay out the minimum content of the bank recovery and reorganization plan.
- Prior action 2: In order to develop the microfinance sector and promote the offer of microfinance services, the Recipient has submitted to 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 adopted a new National Payment Systems Law, establishing 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 has submitted to parliament revised Property Registration and Public Notary Codes.
- 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.
- 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 mandatorily follow the prescriptions of an integrated Least-Cost Power Development Plan, and any exception will need the approval of the Minister of Infrastructure, who will have to provide and publish the rationale for the waiver. Ahead the finalization of a Least Cost Power Development Plan, the Minister of Infrastructure will provide and publish the rationale for the approval of any power generation project.
- Prior action 7: In order to improve the reliability of energy supply, the Recipient, through AGER, has published the minimum quality criteria for energy service.

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 has legally mandated companies to issue fiscal invoices and set the invoice’s minimum content and time requirements for storing.
- 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.
- Prior action 10: In order to improve the efficiency and Value for Money of public investment, the Recipient has

enacted a National Planning System Law that harmonizes planning and budgeting tools, and lays the foundation for public investment projects appraisal and selection.
- Prior action 11: In order to coordinate and harmonize Social Protection and poverty reduction policies, the Recipient has registered all beneficiaries of the three core SP programs defined by the Social Protection Policy and Strategy in the Social Registry.

**Indicative Triggers for DPF 3**

Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure

- 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.
- 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.
- 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.
- 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.
- 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.
- 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.
- Trigger 7: 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.
- 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.

Pillar B: Generate fiscal resources and savings and improve the quality of public expenditures

- 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.
- 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 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).
- 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 (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).

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

## E. Implementation

### Institutional and Implementation Arrangements

**The Ministry of Finance, Trade and the Blue Economy 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 the past operations.

**The results framework is based on standard and widely available indicators.** The results framework was built trying 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 is also being monitored by indicators that are calculated by external sources and allow for international benchmarking such as the Doing Business indicators.

## F. Poverty and Social Impacts and Environment Aspects

### Poverty and Social Impacts

**The proposed DPO will generally have a positive social impact and on poverty reduction.** The DPO has some indirect effects on poverty reduction, coming mainly from Pillar A, on reforms in the financial sector, business environment, and infrastructure. Most prior actions in the financial sector are expected to have positive social and poverty-reducing effects. The draft law on microfinance will improve regulation and foster the development of the microfinance sector, thus benefiting the poor as they are the main users of these services. Further, the new National Payment System Law that establishes the statutory level principles for regulation on modern payment methods may have indirect poverty and social impacts through increased security of mobile money transactions. This will increase the use of mobile payments, including remittances, which may be good for the poor. Prior actions in the energy sector are expected to have overall positive social and poverty-reducing effects. Prior action 5 supporting a policy to improve billing collection at EMAE could affect the poor negatively. The policy contains a formal decision to cut energy supply after 100 days of non-payment. However, the poor are likely not connected to the grid now and therefore will not be affected. Prior action 7 improve the financial soundness of EMAE and reduce the cost of energy. As a result, energy tariffs are unlikely to increase in the future. This will have a positive impact on the STP population, including the poor. Reliable supply of energy can lead to improved earnings, in particular for those households with home-based enterprises and small medium enterprises that need regular electricity supply to function. Some prior actions under Pillar B are expected to have positive overall social and poverty-reducing effects. The coordination and harmonization of social protection and poverty reduction policies will be beneficial to the poor. The registration of beneficiaries of the three core SP programs in a single register will improve targeting of these programs thus allowing a larger proportion of the poor to be selected into the programs.

**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 household-level surveys available do not bring information on access to finance, titling of residential units, and income received from SP programs. There is however, data on access to energy. According to the 2012 census, 57.9 percent of the residential dwellings had access to energy, however, this rate was lower in poorer districts such as

Caué (35.5 percent). The main reason for not having access to energy is the inability of the company to provide such service (76 percent). The inability to pay the energy bill is said to be the main reason for lack of energy access for 16.3 percent of the population, but this rate is higher among urban dwellings (24.2 percent compared to 6.9 percent), where poverty rates are higher. The scarcity of data will likely be overcome soon with the release of three new household-level surveys in 2018: the national household survey, the access to finance survey and the Global Energy Access Household Survey.

### Environmental Aspects

**São Tomé and Príncipe has a general legal and institutional framework to manage and respond to the challenges on environmental issues, however implementation and enforcement need to be further improved**. The National Environmental Law approved on December 31, 1999, provides for the administration of the environment and all the natural resources of STP. Decree-Law No 37/99 defines the rules and principles applicable in the Environmental Impact Assessment (EIA), which requires that all activities due to their nature, size or location that may have significant impacts on the environment, must present an EIA prior to its implementation. The General Directorate of Environment (DGE) under the Ministry of Infrastructure, Natural Resources and Environment (MIRNA), is the central institution responsible for environmental issues; it coordinates and implements government activities and policies in the environmental sector. Despite the credible institutional and legal framework, significant aspects of institutional design and operational efficiency remain to be resolved. Environmental monitoring, compliance and enforcement is of concern and some prior actions to be implemented under this DPF are likely to have environmental effects, and they need to receive scrutiny and close supervision. Nonetheless, the supported policies shall result in environmental benefits: the reduction in the use of other sources of energy such as wood, diesel or gasoline may contribute to a decrease in greenhouse gas emissions and decrease in lower emissions of air pollutants.

## G. Risks and Mitigation

**The overall risk of the 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. The reform program is supported by the highest authorities of the country. However, lack of coordination between ministries and elusive funding promises have led to backtracks 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. Institutional capacity in STP is very low due to a myriad of factors including lack of standard procedures in the public sector, difficulty in inter-agency cooperation and flow of information, and small pool of qualified personnel due to low education levels and migration alike in other small island countries, which are at the core of the substantial institutional risk rating.

**Mitigative risk measures are in place to address the main risks.** Constant dialogue with the country authorities since the workshop held for the Performance Learning Review and the revision of the CPF have increased ownership of the program by the government. The large resource envelope of IDA18 also increased the Bank leverage in the country. Macroeconomic risks are mitigated by the ECF program. Capacity and implementation risks are addressed by technical support provided by the Bank and funded by Trust Funds and the Institutional Capacity Project (P162129), which is in preparation.

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## APPROVAL

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