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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A PROPOSED DEVELOPMENT POLICY GRANT

IN THE AMOUNT OF SDR 3.6 MILLION (US$5 MILLION EQUIVALENT)

TO THE

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

FOR THE

STRENGTHENING GROWTH AND FISCAL POLICY DEVELOPMENT POLICY FINANCING

November 1, 2016

Macroeconomic and Fiscal Management Global Practice
Africa Region

**DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE - GOVERNMENT FISCAL YEAR**
January 1 – December 31

**CURRENCY EQUIVALENTS**
(Exchange Rate Effective as of September 30, 2016)

| | | |
|---|---|---|
| Currency Unit | = | São Tomé and Príncipe dobras (STD) |
| STD 21,990 | = | US$1 |
| SDR 0.71642989 | = | US$1 |

**ABBREVIATIONS AND ACRONYMS**

| | |
|---|---|
| AGER | General Regulatory Authority (*Autoridade Geral de Regulação*) |
| ASYCUDA | Automated System for Customs Data |
| BCSTP | Central Bank of São Tomé and Príncipe (*Banco Central de São Tomé e Príncipe*) |
| BISTP | International Bank of São Tomé and Príncipe (*Banco Internacional de São Tomé e Príncipe*) |
| CPI | Consumer Price Index |
| CPS | Country Partnership Strategy |
| DPF | Development Policy Financing |
| DPO | Development Policy Operation |
| ECF | Extended Credit Facility |
| EMAE | Water and Electricity Company (*Empresa de Água e Electricidade*) |
| ENCO | National Oil and Fuel Company (*Empresa Nacional de Combustível e Óleo*) |
| FDI | Foreign Direct Investment |
| FY | Fiscal Year |
| GDP | Gross Domestic Product |
| GoSTP | Government of São Tomé and Príncipe (*Governo de São Tomé e Príncipe*) |
| HIPC | Heavily Indebted Poor Countries |
| IDA | International Development Association |
| IMF | International Monetary Fund |
| NCBP | Non-Concessional Borrowing Policy (*Política de Endividamento Não-Concessional*) |
| NPL | Non-Performing Loans |
| PCA | Prompt Corrective Action |
| PEFA | Public Expenditure and Financial Accountability |
| PENPS | National Policy and Strategy for Social Protection (*Política e Estratégia Nacional de Proteção Social*) |
| PFM | Public Financial Management |
| PIM | Public Investment Management |
| PIT | Personal Income Tax |
| PPP | Purchase Power Parity |
| PRSP-II | Second Poverty Reduction Strategy Paper |
| SDR | Special Drawing Rights |
| SOE | State Owned Enterprise |
| SP | Social Protection |
| SSIL | Coordination and Assistance Procurement Cabinet |
| STP | São Tomé and Príncipe |
| VAT | Value Added Tax |

| | |
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**DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE**

**STRENGTHENING GROWTH AND FISCAL POLICY DEVELOPMENT POLICY FINANCING**

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**SUMMARY OF PROPOSED OPERATION AND PROGRAM**
**DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE**
**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<br>Terms: Standard International Development Association Terms<br>Amount: SDR 3.6 million (US$5 million equivalent) |
| Operation Type | First operation in a programmatic series of three operations |
| Pillars of the Operation and Program Development Objective | 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.<br>Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure<br>Pillar B: Generate fiscal resources and savings and improve the quality of expenditures |
| Result Indicators | **Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure**<br>Number of banks below the Central Bank's minimum Capital Adequacy Ratio. Baseline (2015): 3; Target (2018): 0<br>Credit registry coverage. Baseline (2015): 90%; Target (2018): 100%<br>Number of transactions settled through the national payment system (switch). Baseline (2015): 0%; Target (2018): 30%<br>Number of real estate properties and mortgages registered in the Public Notary Registry. Baseline (2015): 216; Target (2018): 280<br>EMAE's non-technical losses. Baseline (2015): 26.4%; Target (2018): 24%<br>Number of complaints received by EMAE. Baseline (2015): 6,542; Target (2018): 3,000<br><br>**Pillar B: Generate fiscal resources and savings and improve the quality of expenditures**<br>Tax revenues (as a share of GDP). Baseline (2015): 14.3%; Target (2018): 15.5%<br>Government revenues from SOE dividends (as a share of GDP). Baseline (2015): 0.18%; Target (2018): 0.30%<br>Estimate of multiyear borrowing plan included in the budget. Baseline (2015): No; Target (2018): Yes<br>Number of beneficiaries enrolled in the three core SP programs and receiving regular payments. Baseline (2015): 0; Target (2018): 4,000 |
| Overall Risk Rating | Substantial |
| Climate and Disaster Risks | There are no short and long term climate and disaster risks to the operation |
| Operation ID | P159010 |

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

## 1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed operation in the amount SDR 3.6 million (equivalent to US$5 million) is the first one in a Development Policy Financing (DPF) series of three operations for São Tomé and Príncipe (STP).** The previous programmatic series was interrupted due to a breach of the International Development Association (IDA) Non-Concessional Borrowing Policy (NCBP).[1] STP has addressed this problem by changing the terms of the loan it contracted with Angola to comply with the NCBP. The previous series, however, could not be resumed since more than 24 months had elapsed after Board approval of the last operation. A stand-alone development policy operation (DPO) was attempted in 2015, but a potential debt arising from a Memorandum of Understanding signed with a Chinese company prevented the World Bank from going forward. This issue has also been satisfactorily resolved. During this period, the country also signed a revised Extended Credit Facility (ECF) with the International Monetary Fund (IMF) in July 2015, which anchors the short-term fiscal consolidation efforts and includes structural benchmarks on financial stability and measures to address the fiscal imbalance coming from the energy sector.

2. **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*). Gross national income per capita is estimated at US$3,160 in purchasing power parity (PPP) terms; gross domestic product (GDP) per capita is US$1,811. 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 day. 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—provide for 50 percent of all jobs in the country.

3. **GDP growth has been stable, but it is heavily reliant on government spending and imports.** STP has grown at an average rate of 4.4 percent from 2009 to 2014.[2] Growth is driven largely by government spending, agriculture, and tourism. Agriculture is the traditional and long-standing economic activity in the country. While it has been explored on a commercial basis since colonial times, production has declined since independence and agriculture has not been a growth driver in STP, even though agricultural products, 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.

4. **Moreover, growth is vulnerable to several risk factors.** Apart from the inherent fragility that

[1] STP is subject to IDA's NCBP given that it has received debt relief and also given its high debt distress risk rating under the joint World Bank-IMF Fund Debt Sustainability Framework.
[2] The analysis contained in this Program Document is based on STP's current national account data. The National Statistics Office is currently rebasing and revising the data sources, which will likely change the figures reported here. However, early indications show that the main stylized facts presented here will not be affected.

results from its small size, a number of risk factors create additional vulnerabilities. These include high risk of debt distress, recurrent fiscal deficits, low domestic resource mobilization, high current account deficits, banking sector problems, fiscal risks from state-owned enterprises (SOEs), inadequate public investment practices, costly and unreliable energy supply, and an inadequate framework for credit

5. **Progress on poverty reduction has been limited and poverty remains widespread in STP.** 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. Current programs are fragmented and underfunded and suffer from design and control issues. In this current scenario, it is unlikely that acceleration in growth will bring a significant reduction in poverty and boost shared prosperity.

6. **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.** A key focus of government policy is to reduce the dependence on government spending and facilitate the development of alternative growth drivers. This operation will help facilitate this shift by supporting policies that are aimed to address the risks to growth both directly and indirectly. The first pillar of the operation focuses on policies aimed to deal with direct risks to growth such as inadequate frameworks for credit operations and unreliable energy supply. The second pillar brings together policies that will indirectly help mitigate risks to growth. For example, by supporting better SOE surveillance, it is expected that the management of the energy company will improve and thus reduce energy cost and increase reliability of supply.

## 2. MACROECONOMIC POLICY FRAMEWORK

### 2.1 RECENT ECONOMIC DEVELOPMENTS

7. **GDP growth slowed down in 2015 due to negative developments in the country's main growth drivers: government expenditures, agriculture, and tourism.** São Tomé and Príncipe is a small and open economy, driven by agriculture and tourism, with a large footprint of the public sector in the economy. Government expenditure, particularly capital expenditure, was reduced in the first half of the year due to the late approval of the budget. Activity in the agricultural and tourism sector decelerated on the back of lower cocoa and tourism exports. Since STP lacks frequent and reliable economic activity data,[3] economic activity is tracked indirectly through government spending and trade balance data. Public investments declined by 51 percent in the first half of 2015 compared to the same period in 2014. Public investment improved eventually in the second half of 2015, ending the year with a 29.4 percent nominal increase. Cocoa exports and tourism receipts fell by 13.7 percent and 7.3 percent, respectively, in 2015. The overall drop in economic activity in 2015 was also apparent from the drop in consumer and capital goods imports—20.9 and 8 percent, respectively, in 2015 (

8. Table 1).

9. **Improvements in the above mentioned growth drivers point to increased economic activity in 2016.** In agriculture, cocoa exports increased by 43 percent in the first half of 2016. Imports of goods, except oil, increased by 31 percent. Capital goods imports rose by 42 percent, an encouraging signal of increased investment. Government spending rose in the first quarter of 2016. Current expenditure

[3] STP does not have high-frequency indicators of economic activity. There are no quarterly GDP figures or monthly surveys of sales or production. Energy consumption is constrained by the insufficient supply and thus is not a reliable indicator for economic activity.

increased by 14.8 percent, while investments grew almost 70 percent. This is a reflection of the timely approval of the 2016 budget, which allowed capital expenditures to be executed since the beginning of the year. Tourism receipts were up by 27.4 percent in the first half of 2016.

**External Sector**

10. **In line with economic activity, trade deficit decreased in 2015, but it is rebounding in 2016.** The trade balance deficit was reduced from US$127.4 million in 2014 to US$107.6 million in 2015. The improvement was achieved despite a reduction in exports – in particular cocoa exports - (US$5.9 million or 34 percent), since imports showed a larger decline in absolute terms (US$26.6 million or 18 percent). The fall in imports was registered in all categories of goods but was more marked in fuels (24 percent) and consumer goods (21 percent). Provisional data for the first half of 2016 show a rebound in both exports (36 percent) and imports (12 percent). Overall, trade deficit increased by 11 percent in the first half of 2016. The expansion of exports was led by cocoa, which grew by 43 percent, and coconut (12 percent). The growth in imports was led by capital goods, which posted an increase of 42 percent, reflecting the timely approval of the budget and higher imports by the Water and Electricity Company (*Empresa de Água e Electricidade*, EMAE). Fuel imports declined in value due to lower oil price.

11. **The slowdown in economic activity in 2015 translated into a lower current account deficit, which has not gone up so far in 2016 due to better than expected results on service exports.** The current account deficit was reduced from 32.6 percent of GDP in 2014 to 28.2 percent of GDP in 2015. This improvement was obtained on the back of reduced deficit on goods and services and improvements on the capital and financial accounts. The surplus in the income transactions was reduced significantly due to lower migrant remittances. Saotomean workers living abroad were already suffering with the faltering Portuguese economy and are now facing the effects of the drop in oil prices in the Angolan economy. Improvements in the service balance were obtained due to lower imports from banks. Foreign direct investments (FDIs) by oil companies more than doubled—from US$11 million to US$24 million—supporting the larger financial account surplus. Oil companies are the largest source of FDI in STP. Despite the increased trade deficit in the first half of 2016, the current account deficit showed improvements on the back of higher tourism receipts, external aid, and migrants' remittances. Net international reserves ended in 2015 at US$56.3 million and are now at US$54.1 million in July 2016.

12. **Current account deficits are a structural characteristic of the country, but the Government of STP (GoSTP) is taking measures to address it and boost growth.** External accounts are in deficit much more as a reflection of structural characteristics of the country such as its small size and insularity, rather than exchange rate misalignment. In fact, the IMF assesses the currency to be moderately overvalued – less than 10 percent – and there is ample literature that backs pegged exchange rate regimes for small island countries. This small overvaluation does not seem to have affected exports substantially since: (i) the currency is pegged to the euro and most of the exports are to Europe; (ii) exports are mostly commodities; and (iii) tourism arrivals in small islands are not affected by real exchange rate movements[4]. The authorities rely on foreign grants and concessional loans to close the gap in the short and medium-term, but are working towards attracting private investors to activities that will generate foreign exchange revenues in the long-term like agricultural products and tourism. It was able to attract French investors to revive coffee production for export. It has also set a private investment promotion agency and has eliminated visa requirements from most tourists and businessmen. This operation will also support policy reforms that will alleviate the constraints to growth such as energy supply and

[4] (Culic, 2014)

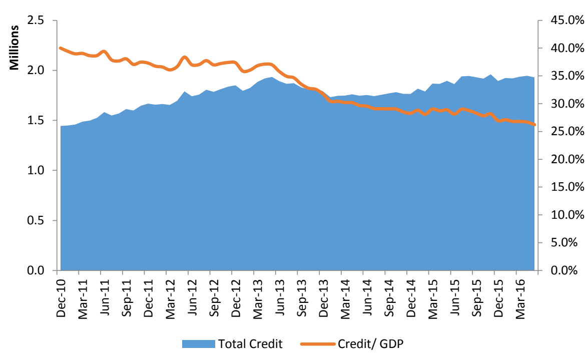
underdeveloped banking and credit market, helping to attract foreign private investment and contributing to balance the external accounts.

**Monetary Policy and Inflation**

13. **The main tool of the Central Bank of STP (*Banco Central de São Tomé e Príncipe,* BCSTP) to fight inflation has been the currency peg.** STP operates under a fixed exchange rate regime, with the local currency—São Tomé and Príncipe dobras—pegged to the euro since 2010, which limits monetary policy tools. The compulsory reserve rate, another monetary policy tool available, has not been used as it has remained unchanged since 2011 - 18 percent for deposits in national currency and 21 percent for deposits in foreign currency. Despite the creation of other monetary policy tools by BCSTP, such as an open market and an interbank borrowing market, both tools are not being used. Interbank borrowing is not occurring because liquid banks feel that borrowing needs from other banks are more of a structural nature rather than a temporary situation. Thus, they do not lend to each other. This perception arises from the fact that many banks have negative profitability, high volume of nonperforming loans (NPLs), and declining Capital Adequacy Ratios. Against this landscape, the most solid banks have preferred to retain liquid assets, generating excessive liquidity in the system, which cannot be moped solely through open market operations.

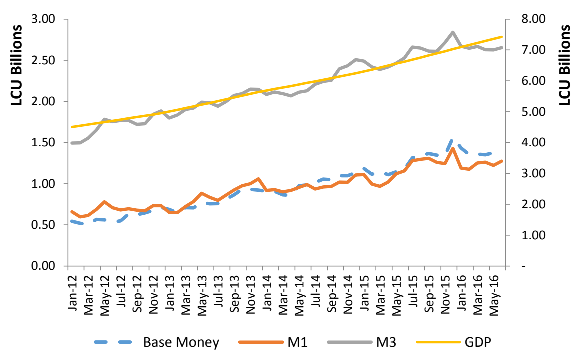
14. **Despite the limitations on the monetary policy, the BCSTP has succeeded in keeping inflation low and monetary aggregates in check.** The growth rate of monetary aggregates has slowed down in 2016**.** Base money and M3 grew by 18.8 and 5 percent, respectively, until July 2016, a decline from the rates registered in 2015 (37.5 and 17.4 percent, respectively). Moreover, monetary aggregates have grown in line with nominal GDP as can be seen in Figure 2, which reduces the probability that inflation was caused by monetary factors and reinforces the BCSTP sound monetary policy.

**Figure 1. Nominal Credit Stock (LHS) and Credit to GDP Ratio (RHS): December 2010–March 2016**




*Source:* BCSTP.

**Figure 2. Evolution of Monetary Aggregates and Nominal GDP**




*Source:* BCSTP.

15. **An adequate monetary policy stance allowed inflation to fall to a historical low in 2015, which then showed a slight acceleration in 2016.** STP registered the lowest historical inflation in 2015 with a consumer price index (CPI) increase of 4 percent. An improvement from 2014—6.4 percent—and a substantial improvement compared to 2012, when inflation was in double digits (10.4 percent). Inflation, however, has picked up in 2016 and the 12-month inflation at the end of May was at 6.2 percent. The last CPI readings, though, showed moderation and inflation bottomed to 5.5 percent in August.

16. **The acceleration of inflation in 2016 was temporary and caused by shocks on food prices and a change in the CPI methodology.** Food prices increased by 4.6 percent and contributed with 3.3 percentage points to the CPI. The overall weight of food items in the CPI is 70.2 percent. Increases in food product prices were concentrated in three classes: (a) cereals and bread; (b) vegetables; and (c) fruits. The surge in the cereals and bread price is related to an agricultural pest that inflicted the maize crop, while the other groups suffered from a more rigorous drought. In January 2016, the National Institute of Statistics (*Instituto Nacional de Estatísticas*) revised the CPI methodology. Some products such as bread have begun to be weighted and a standardized price has begun to be calculated.

17. **Lending rates have gone down significantly in 2016, but this has not boosted credit in the economy.** The average lending rate was at 23.2 percent in December 2015, and it is now at 19.2 percent as of June 2016. The spread between deposit and lending rates, although still large[5], has declined as well. It is at 15.3 percentage points as opposed to 18.2 percentage points in December 2015. The declines in rates and spread have not propelled credit in the economy. The nominal stock of credit has grown but below nominal GDP, which had led the credit-to-GDP ratio to decline. It stands now at 26.2 percent of GDP as opposed to 26.9 percent of GDP by the end of 2015. This downward movement is not a short-term one but rather the continuation of a long-term trend as it can be seen in Figure 1.

**Banking Sector**

18. **The banking sector has grown in recent years but remains concentrated and inefficient.** The growth in the banking sector is attributable to (a) the prospects of oil discoveries; (b) larger FDI; and (c) industry deregulation. Total banking sector assets were equivalent to 77 percent of GDP in 2015, up from 26 percent of GDP in 2001. It is also a very concentrated sector despite having six banks operating in the country. The International Bank of STP (*Banco Internacional de São Tomé e Príncipe,* BISTP), which is partially state owned, holds approximately two-thirds of total deposits and half of total assets. STP has a higher spread between lending and deposit rates (13.3 percentage points) than its Sub-Saharan and small island peers.

19. **After some years of rapid growth, the banking sector has started to show troubling signals.** Commercially viable oil production proved more difficult and slower than initially anticipated. The regulatory framework and the BCSTP surveillance capacity proved to be short of the need of a larger banking sector. Private sector credit to GDP fell from a peak of 40 percent in 2010 to 20.8 percent in 2016. At the same time, NPLs have increased from 15.6 percent in 2011 to 29.8 percent in 2015, and provisions, as a percentage of NPLs, increased from 77 percent in 2014 to 90 percent in 2015. High provisioning is an adequate and prudent approach to deal with poor asset quality, but it reduces bank profitability. As a result, banking is largely not a profitable enterprise with the exception of the BISTP. Two banks were put under BCSTP management, leading to one merger and a process of liquidation. If not dealt with adequately and promptly, banking sector problems might impair growth due to an inability to intermediate savings into productive investments and generate economic and fiscal losses due to the cost of recapitalizing banks in the near future. There is a low probability that significant contingent liabilities from the banking sector will materialize. This is due to the small size of the banks in difficulty and the efforts from the BCSTP to address these problems at an early stage.

20. **The BCSTP is moving quickly to improve its capacity.** The BCSTP is making rapid moves to upgrade its capacity to adequately supervise the banking sector and improve the effectiveness of the

[5] The main causes of high spreads are: high overhead cost of small financial systems, high NPL, poor credit information and difficulty to enforce guarantees and loan contracts.

local financial sector. It has developed a strategy to help banks deal with high NPL levels, following the structural benchmark commitment within the IMF program. With support from the World Bank, it has recently concluded a diagnostic of the sector and launched a midterm strategy to develop the financial sector. The strategy already has a steering committee and a dedicated team in charge of implementing. The Central Bank is also revising key legislations such as its founding law to increase its independency and safeguard its autonomy.

**Fiscal Policy**

21. **The fiscal stance is characterized by low levels of domestic revenue mobilization, heavy reliance on import duties, and external grants.** Domestic revenues reached 15.8 percent of GDP in 2015, with tax revenues equaling 14.3 percent of GDP.[6] The largest single revenue item is customs revenue—6.5 percent of GDP in 2015. The second largest source of tax revenue is personal income tax (PIT), with revenues worth 3.5 percent of GDP in 2015. Grants accounted for 41 percent of revenues, reaching 11.4 percent of GDP. The main nontax revenue is property income from fishing and non-regular payments from oil companies.[7]

22. **Government revenues have shown a positive evolution in recent times but have been boosted by nonrecurring factors.** Current revenues, excluding oil revenues, grew by 13.5 percent in nominal terms in 2015 and 20.3 percent when considering all revenues. The same positive performance was maintained in the first quarter of 2016. Current revenues were up by 63.5 percent in nominal terms. This high growth rate was helped by extraordinary oil revenues. If this nonrecurrent revenue is excluded, current revenues would still post a growth rate of 22.6 percent. The increase registered in 2015, when current revenues were up by 0.9 percentage points of GDP, was due to an increase of 0.2 percentage points in tax revenues and nonrecurrent revenues from oil of 0.7 percent of GDP. The increase in tax revenues is mainly attributable to PIT. In 2016, the increase in tax revenues comes from a strong rebound in custom revenues, a result of the regularization of payments from the oil-importing company (National Oil and Fuel Company [*Empresa Nacional de Combustível e Óleo,* ENCO]). In the first quarter of 2016, there was again nonrecurrent revenue from oil companies, which boosted revenues. Grant proceeds nearly tripled in the first quarter of 2016, with an increase in project and heavily indebted poor countries (HIPC) grants.

23. **Government expenditure has been high, and public investment is largely externally funded.** STP's primary expenditures reached 33.7 percent of GDP in 2015. Investments accounted for almost half of it—a share of 46.5 percent—reaching 15.5 percent of GDP. The bulk of it—92 percent—is financed by external sources, with 54 percent being financed by grants and 38 percent financed by concessional loans. The second largest expenditure item is payroll. It reached 8.9 percent of GDP in 2015.

24. **In spite of the increase in expenditures in 2015, its composition signals good underlying trends.** Total primary expenditures increased by 3.9 percentage points of GDP, but this was driven by investments (2.1 percentage points of GDP) and payments to settle government arrears (1.2 percentage points of GDP). The growth in public investments was achieved despite the late approval of the budget, which prevented the Government from carrying out almost all capital expenditures in the first six

[6] If oil revenues are excluded, domestic revenues would reach 15.8 percent of GDP. Oil revenues are registered in the budget but are deposited in the National Oil Account and only 20 percent of its balance can be used to finance the next year budget. Thus, fiscal analysis will be done without oil revenues to avoid distortions.

[7] Oil companies pay royalty fees of 2 percent and income tax of 30 percent. Non-regular payments from oil companies include signature bonus and ownership transfer fees.

months of the year.[8] Other current expenditures such as payroll and transfers decreased from 9.1 to 8.9 percent of GDP and from 3.7 to 3.5 percent of GDP, respectively. The same drivers of growth in government expenditures in 2015 remained in effect in 2016. Total primary expenditures grew by 30.4 percent; current expenditures increased 15 percent, while investments increased 70 percent, all in nominal terms. In 2016, the effort to clear the arrears continued, especially with the energy and water company, but unfortunately this came at the expense of generating arrears with the telecom company. Payroll expenditures increased by 8.3 percent in nominal terms, but this figure has not captured yet the effect of the increase in public wages, which became effective in April.[9] The increase in transfers reflects a reclassification of two government agencies as public institutes and the unification of the value of social transfer programs.

25. **Given the size and nature of the expansion in expenditures, the budget balances showed a small improvement from 2014 to 2015.** Domestic primary balance, which takes into account only domestic revenues and investment financed by internal resources and is a better indicator of the underlying fiscal stance, improved slightly from -3.3 to -2.9 percent of GDP. On the other hand, overall balance deteriorated due to increased capital expenditures, reaching 6.2 percent of GDP, but was financed inexpensively with grants and concessional loans. The Government managed the budget more tightly in 2015, promoting cuts after some revenues failed to materialize, to comply with the ECF target on primary balance. Part of the deterioration of the government accounts was prompted by the settlement of arrears with EMAE.

26. **STP has historically registered cross-arrears between the treasury, SOEs, and its suppliers, but the GoSTP is taking measures to resolve this situation.** This is a reflection of poor public financial management (PFM) and SOE management practices. Budgeting and financial execution processes have failed to ensure that budgeted expenditures fit into a realistic resource envelope and that continuous services, whose payments are certain and predictable, get preference over discretionary expenditures. On the other hand, SOEs, especially EMAE, have failed to set tariffs at cost recovery level. EMAE is also not being compensated for activities conducted on behalf of the Government. As a result, today EMAE has arrears with ENCO, its fuel supplier, which in turn does not pay its taxes on time. Since 2015, the GoSTP has been making an effort to solve this problem. First, the amount of cross-arrears between the three parties became known and registered in the balance sheets. As of December 2015, public sector clients owed EMAE €1.4 million, while EMAE owed ENCO €1.4 million. After that, the three parties—EMAE, ENCO, and the treasury—have agreed on a settlement plan, which was one of the structural benchmarks in the IMF program. Thus, as of May 2016, the treasury did not have any outstanding payment with EMAE. In addition, the GoSTP has committed through the IMF program to adjust domestic prices of fuel in line with international prices and is taking advantage of the current higher domestic prices to amortize the debt with ENCO.

27. **The Government has put in place a number of measures to strengthen the fiscal stance and the progress so far is encouraging.** Short-term fiscal consolidation is anchored by the ongoing IMF program. The program has performance criteria which target the domestic primary balance, and limit

[8] The official fiscal reports show investment payments in the first quarter of 2016 since some investment projects, financed by development partners, have their payments made directly by the partner and thus are not subject to the legal restrictions imposed on the 2015 budget execution due to its delayed approval.

[9] The GoSTP set a general minimum wage in the country for the first time in 2015. This policy also applies to the public sector, whose minimum wage was set at €45 per month. This wage not only represents an effective increase in the lowest wage paid by the Government but also triggered an increase in all public sector wages, since by legislation all salaries are indexed to the minimum wage and most top-ups to salaries (*subsídios*) are linked to the base salary. Overall, the expected impact from this measure on payroll is 12 percent.

current expenditures. In addition, the large fiscal pressures that are coming from the energy sector are being addressed by structural measures supported by both the IMF and the World Bank. Possible contingent liabilities from the banking sector are being mitigated through the IMF program and World Bank support to banking supervision. Moreover, this operation and a parallel Public Expenditure Review would help identify supporting measures to address other sources of fiscal imbalances such as low domestic revenue mobilization and budget pressures from SOEs. Finally, the European Union has started to provide support on PFM and fiscal transparency issues recently. On the Government side, the roll-out of a new financial management system called SAFE, and the introduction of good practices recommended by the last Public Expenditure and Financial Accountability (PEFA) report are helping strengthen fiscal management. On the revenue side, the introduction of the Automated System for Customs Data (ASYCUDA) system would streamline customs processes and help enhance revenues.

28. **After benefiting from debt relief, STP's debt ratio has since been showing an increasing trend.** From 2006 to 2008, the debt-to-GDP ratio of STP came down from 257 percent to 57 percent. However, the ratio has since been increasing and it has reached its peak in 2015 at 86 percent of GDP. The debt-to-GDP ratio has shown a small decline in the first half of 2016, reaching 82 percent. Most of the debt is held by bilateral creditors, who are not part of the Paris Club agreement. The recent increase in debt amounts comes from donors such as Nigeria and Angola as well as arrears with external suppliers. In 2016, new debt is being contracted with Kuwait to rehabilitate and expand one public hospital and with Turkey.

29. **Notwithstanding the increase in debt, STP has made some progress on debt management.** It revised the debt framework law; it devised a medium-term debt management strategy and issued domestic government bonds for the first time in 2015. Notwithstanding these advances, STP needs to strengthen its information technology and human resources capacity as well as to ensure better connection between technical analysis and political decisions. The Government is reflecting on the need and convenience of establishing a legal limit on the debt stock. The debt management office is also making efforts to equate debts before the Paris Club agreements that were not settled yet, such as debts with Angola and Nigeria.

**Box 1. Prospects for Growth in STP**

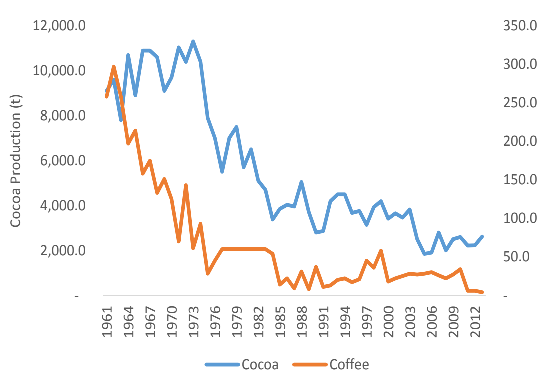
**Agriculture is a traditional and relevant economic activity in STP but is not a dynamic growth driver.** In fact, the main crops have seen a continuous decline after independence (see Figure 3). Agriculture accounted for 15.1 percent of GDP in 2014, and it is the largest employer in the country, accounting for 23.2 percent of all jobs. From 2002 to 2014, it showed a lower growth rate (2.2 percent) than the rest of the economy (5.2 percent). Agricultural products are STP's main export goods, cocoa being the single largest export good. In 2015, it generated US$7.9 million, accounting for 70 percent of all goods exported. The main crops are of export-oriented products: cocoa, coffee, coconut, and pepper. Subsistence agricultural products include roots, fruits, and some livestock. Production is done not only by private firms in large areas but also by small producers organized in cooperatives.

**Tourism is a relevant economic activity in STP, but it is still below its potential and therefore is not the major growth driver of the country.** Tourism services are already the main export of the country. In 2015, it generated revenues of US$52 million. The number of tourist arrivals has also increased (see Figure 4)—61.5 percent compared to 2013. However, when compared to other small island countries, STP receives less tourists, and tourism contribution to GDP is also smaller. In 2014, tourist arrivals represented 9.8 percent of the country population, a low ratio when compared to that of Cabo Verde (96.1 percent) and Seychelles (254.9 percent). Tourism total contribution to GDP is less than 10 percent in STP, while in Cabo Verde it accounts for roughly half of GDP and reaches almost 60 percent in Seychelles.

**Prospects for oil production are good, but actual production is expected only in the long term.** Preparation for oil activity has been undertaken since early 2000s. The first competitive bid for oil areas took place in 2010 and the first contracts were signed in 2012. Currently, there are six signed contracts, all of them in the exclusive economic zone. Based on the geological studies undertaken, which showed a similar profile to Gabon and Equatorial Guinea, there is a good probability of finding commercial oil discoveries in STP. However, given the time needed before asserting the commercial viability of the oil field, no exploitation is expected before 2020.

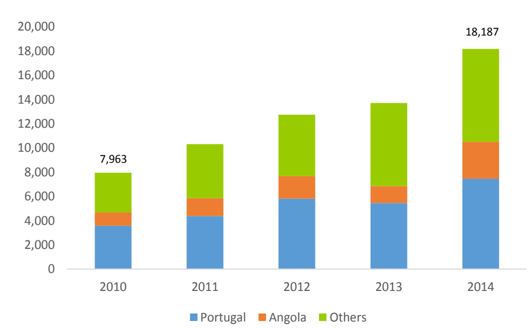
**The envisioned development path includes a renewed bet on agriculture and tourism and less reliance on government expenditure as the most promising sources of growth.** Going forward, the country would like to move to a more private sector-driven growth model, capitalizing on their comparative advantages: a niche agriculture and high-end tourism. The Government expects these sectors will provide adequate jobs (and income) to the labor force profile of STP. Oil exploitation can further support growth, though it is not included in the baseline scenario

**Figure 3. Coffee and Cocoa Production: 1961–2013**




*Source:* Food and Agricultural Organization.

**Figure 4. Tourism Arrivals: Total and Main Origins: 2010–2014**




*Source:* Directorate of Tourism and Hotels.

**Table 1. Selected Economic Indicators**

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| | | | | Projected | | |
| **Real Economy** | | | *Annual Percentage Change* | | | |
| GDP at constant prices | 4.5 | 4.0 | 5.0 | 5.5 | 5.5 | 5.5 |
| Imports of goods and non factor services | 28.6 | -17.4 | 11.8 | 7.0 | 5.8 | 2.9 |
| Exports of goods and non factor services | 64.3 | -9.2 | 9.2 | 7.2 | 6.5 | 8.2 |
| CPI (end of period) | 6.4 | 4.0 | 6.0 | 5.0 | 4.0 | 4.0 |
| **Fiscal Accounts** | | | *Percentage of GDP* | | | |
| **Total revenue** | **25.9** | **28.0** | **35.1** | **33.4** | **33.5** | **33.7** |
| Tax Revenue | 14.1 | 14.3 | 14.9 | 15.2 | 15.8 | 16.0 |
| Nontax revenue | 1.5 | 1.5 | 2.2 | 1.3 | 1.3 | 1.3 |
| Grants | 10.3 | 11.4 | 17.3 | 16.6 | 16.4 | 16.4 |
| **Total expenditure** | **31.4** | **34.2** | **44.1** | **37.3** | **36.2** | **35.2** |
| Current Expenditure | 18.5 | 18.2 | 18.0 | 17.2 | 17.0 | 16.7 |
| Of which: personnel costs | 9.1 | 8.9 | 8.9 | 8.7 | 8.7 | 8.5 |
| Interest due | 0.7 | 0.8 | 0.7 | 0.7 | 0.7 | 0.7 |
| Goods and services | 3.6 | 3.4 | 3.3 | 3.1 | 3.1 | 3.0 |
| Transfers | 3.7 | 3.5 | 4.0 | 3.7 | 3.5 | 3.5 |
| Other | 1.5 | 1.6 | 1.1 | 1.0 | 1.0 | 1.0 |
| Capital expenditure | 12.7 | 15.5 | 25.8 | 19.5 | 18.9 | 18.5 |
| Of which: financed by the Treasury | 0.9 | 0.7 | 0.9 | 1.3 | 2.0 | 2.2 |
| Financed by external sources | 11.8 | 14.7 | 20.2 | 17.9 | 16.7 | 16.3 |
| HIPC Initiative-related social expenditures | 0.2 | 0.6 | 0.9 | 0.6 | 0.5 | 0.7 |
| **Domestic primary balance** | **-3.3** | **-2.9** | **-2.0** | **-1.9** | **-1.7** | **-1.6** |
| **Overall balance (commitment basis)** | **-5.5** | **-6.2** | **-9.0** | **-3.9** | **-2.7** | **-1.5** |
| **Selected Monetary Accounts** | | | *Annual Percentage Change* | | | |
| Base money | 23.2 | 37.5 | 10.4 | 6.3 | 7.2 | 9.7 |
| Credit to the economy | -1 | 3.8 | 7 | 4.8 | 5.2 | 7.5 |
| Central Bank reference interest rate | 12.0 | 10.0 | N.A. | N.A. | N.A. | N.A. |
| Bank deposit rate | 8.9 | 6.9 | N.A. | N.A. | N.A. | N.A. |
| **Balance of Payments** | | | *Percentage of GDP* | | | |
| Current Account Balance (exclude official transfer) | -32.6 | -28.2 | -29.5 | -29.7 | -29.3 | -26.4 |
| Imports | 42.8 | 37.2 | 37 | 37.7 | 38.7 | 36.4 |
| Exports | 5.1 | 3.9 | 4.6 | 4.8 | 4.9 | 5.1 |
| Foreign direct investments | 5.6 | 6.3 | 1.2 | 2.7 | 4.0 | 5.6 |
| Gross reserves (in millions of US$) | 56.5 | 61 | 72.8 | 75.9 | 82.4 | 87.6 |
| Gross reserves (in months of imports) | 4.2 | 4.4 | 5.0 | 5.0 | 5.1 | 5.1 |
| Exchange rate (dobras per US$, end of period) | 20,148 | 22,424 | | | | |
| External debt | 50.0 | 59.0 | 58.5 | 61.8 | 63 | 60.8 |
| Other memo items: | | | | | | |
| GDP nominal in US$ (millons) | 338 | 318.2 | 349.2 | 371.2 | 396 | 429 |
| GDP (billions of Dobras) | 6,242 | 7,028 | 7,847 | 8,287 | 8,839 | 9,533 |

*Source: São Tomé and Príncipe Authorities and IMF and Bank staff estimates and projections (Oct/2016).*

**Table 2. Balance of Payment Financing Requirements and Sources**

| *US$ Million* | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| | | | Projected | | | |
| **Gross financing requirements** | | | | | | |
| Current account, excluding official transfers | -123.8 | -110.5 | -119.2 | -117.5 | -127.9 | -124.7 |
| Financial account | -3.2 | -2.6 | -3.2 | -3.2 | -3.4 | -4.9 |
| Scheduled amortization | -0.7 | -1.6 | -1.3 | -1.4 | -1.6 | -4.8 |
| IMF repayments | -1.4 | -0.9 | -0.7 | -0.6 | -0.5 | -0.5 |
| Other public sector flows (net) | -1.1 | -0.1 | -1.1 | -1.2 | -1.3 | 0.4 |
| Change in external reserves (-ve=increase) | -10.5 | -18.2 | -13 | -3.9 | -8.4 | -6.7 |
| Available funding | 123.8 | 110.5 | 119.2 | 117.5 | 127.9 | 124.7 |
| National Oil Fund (net) | 2.3 | 2.0 | 1.3 | 2.2 | 1.8 | 1.4 |
| Oil signature bonuses | 0.0 | 2.4 | 2.5 | 0.0 | 0.0 | 0.0 |
| Saving (-ve=accumulation of oil reserve fund) | 2.3 | -0.4 | -1.2 | 2.2 | 1.8 | 1.4 |
| Expected disbursements | 53.4 | 86.8 | 89.6 | 82.6 | 82.8 | 77.7 |
| Multilateral HIPC interim assistance | 0.8 | 6.0 | 6.6 | 6.7 | 6.7 | 5.2 |
| Capital transfers | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Grants | 35.2 | 30.4 | 53.7 | 56.5 | 59.6 | 62.7 |
| Concessional loans | 17.4 | 34.7 | 29.3 | 19.5 | 15.9 | 9.8 |
| Private sector (net) | 25.2 | 19.6 | 20.3 | 21.4 | 22.8 | 24.6 |
| IMF | 0 | 0.9 | 1.8 | 1.8 | 1.8 | 0 |
| Financing gap | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 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 | 0.0 | 0.0 |

*Sources: São Tomé and Princípe Authorities and WB and IMF staff estimates and projections (Oct/2016)*

**Table 3. Central Government Operations and Financing Needs Requirements and Sources**

| *% of GDP* | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| | | | Projected | | | |
| Overall fiscal balance (commitment basis) | -5.5 | -6.2 | -9.0 | -3.9 | -2.7 | -1.5 |
| Grants | 10.3 | 11.4 | 17.3 | 16.6 | 16.4 | 16.4 |
| Overall fiscal balance (cash basis) | -3.3 | -7.5 | -10.1 | -4.9 | -3.6 | -2.6 |
| Financing | 3.3 | 7.5 | 10.1 | 4.9 | 3.6 | 2.6 |
| Net External | 3.2 | 8.1 | 6.1 | 4.3 | 3.4 | 2.3 |
| of which program financing (loans) and disbursement (projects) | 5.1 | 10.8 | 8.4 | 5.2 | 4.2 | 3.4 |
| of which scheduled amortization | -1.9 | -2.7 | -2.3 | -1.0 | -0.8 | -1.1 |
| Net domestic | 0.1 | -0.6 | 4.0 | 0.6 | 0.2 | 0.3 |
| Net bank credit to the government | 0.1 | -0.6 | -1 | 0.6 | 0.2 | 0.3 |
| of which banking system credit (excluding National Oil Account) | -0.6 | -0.5 | 0.0 | 0.0 | -0.3 | -0.1 |
| of which National Oil Account | 0.7 | -0.1 | -1 | 0.6 | 0.5 | 0.4 |
| of which nonbank financing | 0.0 | 0.0 | 5.0 | 0.0 | 0.0 | 0.0 |
| **Financing gap** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |

*Sources: São Tomé and Princípe Authorities and WB and IMF staff estimates and projections (Oct/2016)*

## 2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

30. **The medium-term outlook for growth is that of gradual improvement.** No change in growth drivers is foreseen in the short term. Growth will still be driven by government spending, agriculture, and tourism. Government capital spending is expected to be kept at a high level due to maturing

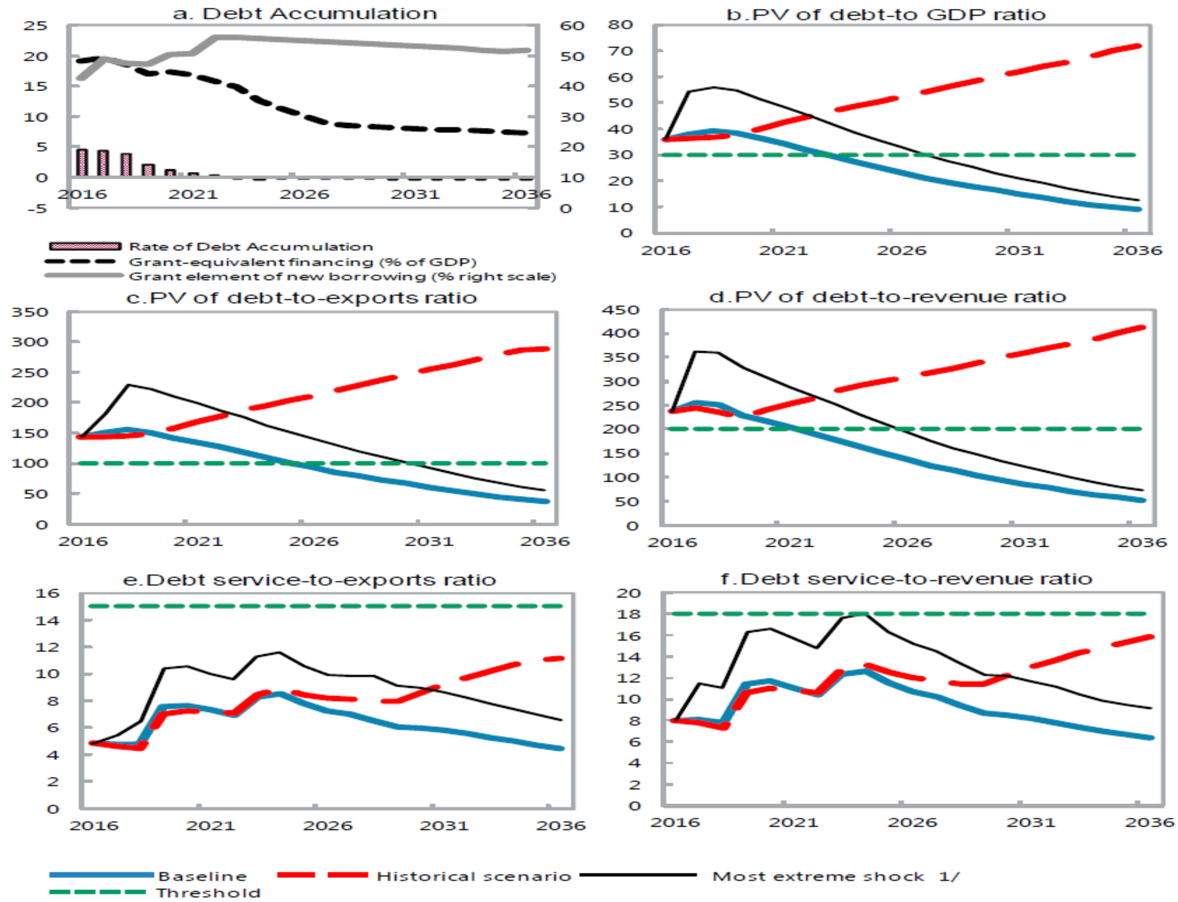
investments from the London conference and the larger IDA envelope. A gradual improvement in private investment is expected due to Government's policies to attract FDI. Similarly, public investment will start to benefit from improved management practices. Current expenditure expansion will be restrained due to fiscal consolidation efforts supported by the IMF program. Agriculture and tourism should see moderate improvements. As mentioned, oil production is not expected before 2020. Inflation will moderate, but a full convergence to the euro area is not expected in the medium term, given STP's characteristics such as insularity and large weight of food products in the CPI basket. External accounts will show improvements on the back of lower oil prices and growing agricultural exports. Financing should be secured by the pickup of FDI, propelled by oil and continuing tourism receipts.

31. **The baseline is for continued and sustained fiscal consolidation, but not without challenges.** Fiscal accounts will show a gradual improvement, anchored by the IMF program. Improvements in revenue collection will underpin more balanced budgets. High domestic resource mobilization will allow more capital expenditures to be financed through domestic revenues. Fiscal risks especially from the energy sector and other SOEs will be reined in. Main risks to this scenario are an increase in current expenditures propelled by higher domestic revenues and a delay in implementing the taxation measures needed to increase revenues.

32. **STP is still at high risk of debt distress.** An update of the joint World Bank-IMF Low-Income-Country Debt Sustainability Analysis was carried out in May 2016 and assessed STP to remain at high risk of debt distress. This assessment is based on the fact that three solvency-based indicators remain well above the threshold for the foreseeable future. The largest risks to the analysis come from the exchange rate and shocks to export. The exchange rate is a risk because most of the country's debt is contracted in foreign currency. If the peg is abandoned for any reason—a 30 percent depreciation of the currency would increase the ratio of debt (present value [PV]) to GDP by 18 percentage points—the largest impact in all shocks simulated. To avoid falling in debt distress, STP needs to maintain an adequate level of international reserves—estimated at 3.9 months of import by the IMF—and adopt a more prudent fiscal stance.

33. **On balance, 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 more than five years. The BCSTP has been undertaking efforts to improve monetary policy tools, support solid credit growth and reinforce its commitment to price stability. Fiscal policy has been the main fragility of the macroeconomic framework, with persistent budget deficits. This is being addressed by the Government under the ECF through limits to current expenditures, improved domestic revenue mobilization and settling of government arrears. External imbalances are more of a structural nature given STP's insularity and lack of established comparative advantage. Nonetheless, the Government has been taking measures to secure Balance of Payments financing in the short term through grants and concessional loans and supporting economic activities such as agriculture and tourism that can increase export earnings. The overall macroeconomic outlook is positive, but risks related to the country's small size, openness and limited engines of growth remain. Given this characterization, the macroeconomic policy in STP is deemed adequate.

**Figure 5. STP: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2016–2036**




Sources: São Tomé and Príncipe authorities' data; and IMF staff estimates.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

## 2.3 IMF RELATIONS

34. **The operation builds on collaboration with the IMF.** This programmatic series was conceived and will be implemented along with the current IMF program. The ECF was approved in July 2015, at the request of the new Government, to be implemented until 2018. The new ECF supports fiscal consolidation and sustainable debt while aiming to create space for growth-enhancing capital spending. It supports policy measures on clearing domestic arrears, enhancing domestic revenue mobilization, and PFM and financial sector reforms. The World Bank and the IMF are aligned in supporting measures that will help remove the obstacles to growth such as the fragile budget position and the fiscal risks arising from the energy sector, as well as risks and bottlenecks to growth from the banking sector.

## 3. THE GOVERNMENT'S PROGRAM

35. **The government program is built around two documents: the second National Poverty Reduction Strategy Paper and the Government Program of the 16th Government.** The second National Poverty Reduction Strategy was approved in 2012 and is valid until 2016, while the government's program covers the period from 2015 to 2018. Both documents acknowledge the centrality of faster economic growth and the role of the private sector to growth. Solid institutions, resilient public finances,

and good governance are seen as underpinnings both to growth and to poverty reduction. The Government also held a donors and private sector round table in London (STEP IN) in October 2016 to muster resources and support for its program and poverty reduction strategy. The Government is now working toward securing the resources for the implementation of these projects.

36. **The Government is drafting a new poverty reduction strategy and a long-term development plan.** The new poverty reduction strategy that will cover the period from 2017 to 2021 is being drafted with support from development partners. The process is advanced and the proposed strategy will be soon released for public consultation. The country is also working on a long-term development plan called Vision 2030 in which it aims to lay out broad strategic guidance for the country's development. An interim version of the strategy was disclosed in the London conference. It is structured in four axes: (a) rule of law; (b) sustainable growth; (c) human development; and (d) shared development policies. A set of reforms and policy measures are derived from these axes, forming a transformation agenda.

## 4. THE PROPOSED OPERATION

### 4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

37. **The proposed operation is aligned with the Government's program and objectives.** The operation supports mainly the first axis of the Government's strategy – economic growth and employment generation; however some support to the second axis – social cohesion and external credibility – is given though the support to the social protection policy. The growth enabling reforms supported by this DPF (Pillar 1) are foreseen in the first and third chapters of the first axis in the government strategy. The Government document also dedicates a full chapter (chapter 2 of the first axis) to public finance, which is supported by the second pillar of the DPF. For example, the support to the single registry aligns with the listed government action to continue the implementation of assistance and protection policies to extreme poor and vulnerable population. Another example is the support to the regulatory agency in implementing the provisions of the energy sector regulation, which is the first measure listed in the government strategy for the energy sector. 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 policy actions supporting the new social protection policy.

38. **The proposed operation incorporates the lessons learned from previous World Bank operations in STP.** The key constraint faced by previous operations was the relatively weak implementation capacity. As a result, proposed operations have to balance between ambitiousness and feasibility when setting the expected results. Operations should not be overly complex and contain an excessive number of prior actions and targets. This operation has taken these lessons into account and is proposing six prior actions. They are all supported by technical assistance, previous analytical work, or other current and prospective World Bank engagements. Legal changes that require parliament approval are included only when the law was already approved or after careful assessment between criticality to the operation's objective and political economy feasibility. The World Bank is in close contact with development partners, and the implementing agencies for this operation have a long experience working with the World Bank.

### 4.2 PRIOR ACTIONS, RESULTS, AND ANALYTICAL UNDERPINNINGS

39. **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.

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

40. **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 series, and are supported by analytical work. All financial sector reforms are being supported in coordination with the IMF.

**Component A.1: Introduce growth-enabling reforms in the financial sector and business environment**

**Financial Sector**

41. **The risk of having banking sector problems with relevant economic and fiscal impacts is not negligible.** The rapid expansion of the banking sector was challenging for the Central Bank, which did not have in place the processes or staff to review requests for licensing and authorization of new banks as well as effective supervision of the industry. Provisions as a percentage of NPLs are high—90.4 percent in 2015, but the costs of nonperforming assets undermine the profitability of the banking system. As banks are not profitable, many will likely see their capital erode from negative earnings and provisioning costs for bad debts.

42. **The BCSTP is aware of the critical nature of the problem and has taken measures to improve bank supervision.** The BCSTP increased the number of staff working on bank supervision and conducted more on-site inspections rather than off-site monitoring. It has approached the management of problematic banks to increase capital and has requested support from both the IMF and the World Bank. As a result, key legislation is being revised and a financial sector development strategy has been adopted.

43. **The proposed series supports the GoSTP to enhance financial sector soundness and stability.** The objective is to enhance the capacity of the BCSTP to carry out more effective banking supervision and resolve distressed financial institutions. The first prior action of this operation supports the introduction of a new bank resolution law, which was passed in December 2015. This law, to which the World Bank Group and the IMF provided technical advice, establishes the framework for effective bank resolution. The effectiveness of the new resolution framework was successfully put to test with the revoke of the operating license of Bank Equador in August 2016. The next step for the BCSTP is to revise all lower-level regulations on bank resolution to adapt them to the new law. After that, the BCSTP will move to implement the good practice of having a Prompt Corrective Action (PCA) framework to deal

with existing and potential banking sector problems. The adoption of the PCA is an indicative trigger for the second operation. Its objective is to allow the BCSTP to anticipate potential problems and address them at an early stage, when the cost of correction is lower, rather than just dealing with insolvency. The third operation brings a trigger on asset quality review, which is an exercise carried out by the Central Bank, wherein a large sample of the bank's loan portfolio are scrutinized for proper risk rating and proper provisioning. The policy reforms on bank supervision will be monitored by the bank's compliance with the minimum Capital Adequacy Ratio required by the BCSTP, which is directly linked to the reforms supported as well as under its direct influence.

***Prior action 1:*** *The Recipient, through its National Assembly, has approved a banking resolution law (Medidas Especiais de Saneamento, Resolução e Liquidação de Instituções Bancárias) 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.*
***Trigger 1 (DPF2):*** *The Recipient's Central Bank has established a Prompt Corrective Action framework to address events of noncompliance with banking sector regulation.*
***Trigger 1 (DPF3):*** *The Recipient's Central Bank has carried out a review of the quality of banking sector assets (Asset Quality Review- AQR) and implemented an action plan to address its recommendations.*
***Result Indicator 1:*** *Number of banks below the Central Bank's minimum Capital Adequacy Ratio. Baseline (2015): 3; Target (2018): 0*

44. **Inadequate institutional setup is preventing the credit market from flourishing and hindering growth, but measures to address this problem are under way.** The inability or difficulty for individuals and firms to obtain credit affects the potential growth rate of the country by reducing consumption and investment possibilities. Following banking sector deregulation and oil discoveries, banks went on a lending spree that led them to learn the hard way that the country lacks the adequate framework to assess the borrower's creditworthiness, to pledge collaterals, and to secure payments on NPLs. STP has a credit registry, but few lenders reference the credit registry for lending decisions given gaps in its information. 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 are in agreement that the institutional setup is not conducive to functional credit markets in STP. The Government is taking policy measures to address this problem such as the judicial sector reform and revision of key legislation. A new director was sworn in as part of the public notary office entrusted with the priority to modernize the registry. The private sector, in particular banks, has taken more seriously its tasks relating to the credit registry.

45. **The proposed DPF series helps address some of the underlying causes that are preventing the development of a sound credit market.** This DPF series contain a trigger for the second operation on the establishment of a legal framework for secured transactions. Collateralized loans are easier to recover, which should make banks more willing to lend. A trigger on the improvement of the credit registry is proposed for the third operation. This reform should close the information and coverage gaps in the existing registry and thus incentivize its use. The reform also foresees the inclusion of secured transactions in the registry. The achievement of this set of reforms will be measured by the coverage of the credit registry that will include not only the loans that are not currently in the registry, but also information on the registered loans that are missing and information on the new secured transactions.

***Trigger 2 (DPF2):*** *The Recipient has submitted to the parliament a law on secured transactions that widen the range of assets that can be used as collateral to boost credit.*
***Trigger 2 (DPF3):*** *The Recipient has implemented an enhanced registry that includes more information on each loan*

| |
|---|
| *transaction and covers secured transactions.*<br>***Result Indicator 2:*** *Credit registry coverage. Baseline (2015): 90%; Target (2018): 100%.* |

46. **Limited access to finance is a barrier to economic development and poverty reduction.** Although 48 percent of the population has a savings account, few of those access 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 4.3 percent of adults have some form of private insurance. Financial inclusion is hindered by outdated payment systems, access to banks, lack of alternative to banks, and economic informality. Most bank branches are concentrated in the capital city. There are two districts with no bank branches, and when present, banks are located only in the district capital. Issues of scale prevent their expansion into unserved areas. More cost-effectiveness alternatives such as agent banking and mobile money are not allowed. The banking sector represents 96 percent of the financial sector, and alternatives such as microfinance institution and consumer finance organization are either nonexistent and/or not regulated. The lack of access to credit reduces the capacity of individuals and micro, small, and medium enterprises to stimulate their incomes and smooth consumption, which ultimately contributes to the high poverty incidence.

47. **The proposed operation supports the strengthening of the legal framework to modernize the payment system and foster financial sector competition, supporting increased access to finance.** The second prior action foresees the streamlining of all BCSTP's responsibilities related to oversight, policy formulation, and development of the national payment system in a single structure within the Central Bank, replicating an organizational structure that is prevalent in most central banks. These tasks were formerly scattered around several areas in the BCSTP. As a result, they were not prioritized and coordinated. In addition, banks and payment system companies had difficulty to engage with the BCSTP on this topic because there was no clear counterpart. The unit is already operational and staffed and ready to perform its role. The indicative trigger for the second operation is a new legal framework, to be formulated by the new directorate, which aims to strengthen the security of the overall payment system and transactions in the country. Although the new law would serve other purposes—such as tourism—rather than only access to finance, its existence is a precondition to increase access to finance. Currently, there is no adequate legal safeguard for electronic transactions and digital financial services in STP. As a result, least-cost options such as mobile money and agent banking that could boost access to finance do not exist. The enactment of these regulations will lay the foundation for financial inclusion by laying out the regulation for mobile money and agent banking. The indicative trigger for the third operation—a draft law on microfinance—has a double objective. First, it will incentivize a sector that is practically nonexistent and put it under the BCSTP surveillance, increasing consumer protection. Second, it will foster financial sectors competition by allowing the creation of alternative financial institutions other than banks. This set of reforms on financial inclusion will be monitored by the share of transactions that are settled through the national payment system (switch).

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| ***Prior action 2:*** *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.*<br>***Trigger 3 (DPF2):*** *The Recipient's Central Bank has issued regulation on modern payment methods including agent banking, mobile money, and electronic payments.*<br>***Trigger 3 (DPF3):*** *The recipient has submitted to the parliament a draft law on microfinance.*<br>***Result Indicator 3:*** *Number of transactions settled through the national payment system (switch) Baseline (2015): 0%; Target (2018): 30%.* |

**Business Regulation**

48. **A property registry is a cornerstone activity in a well-functioning economy.** It secures property rights allows the development of a real estate and housing market. The proper registry of properties and related transactions such as mortgages allow these assets to be safely pledged as collateral. Collateralized loans tend to have lower delinquency rates and lower interest rates. A well-functioning mortgage registry would allow for the expansion of credit to firms and households, easing an important constraint to growth in STP, which is the underdeveloped credit market. Despite its centrality, the property registry in STP suffers from several problems. Most registry services are offered only in the country's capital city. In the case of mortgages, the fees are imposed twice both at the register and at the cancelation of the mortgage, files and procedures are manual, and the legislation is from colonial times. In addition, the cost of registering property and other transactions such as mortgages are subject to hefty fees—which are calculated as a proportion of the property value—and taxes. As a result, processes are burdensome and complex. Citizens and firms tend not to register their property and transactions, and when they do, it is normally undervalued. This whole setup undermines the ability of the register to serve as a trusted source for real estate and financial transactions.

49. **The GoSTP is undertaking a full-fledged revision of business related legislation.** It includes the revision of the judicial, property registration, and the notary code. The Government has made early moves to reduce the cost of registering mortgages. In July of 2016, the council of ministers reduced the cost of registering mortgages by half and determined that the fee should be levied only on the initial registration and not on the cancellation of the mortgage as it was done formerly. This reform is the third prior action of the first DPF. The revision of the property registration and notary code will result in additional cost reduction to users but also in less burdensome and less complex processes. Thus, the revision of the notary code and the property registration code is included as an indicative trigger for the third operation. This reform will be monitored by the number of properties and mortgages registered in the public notary. It is expected that the cost reduction and the simplification of procedures will encourage people and firms to register their properties and mortgages with positive spillovers to credit markets.

***Prior action 3***: *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.*
***Trigger 4 (DPF3):*** *The Recipient has revised the property registration and public notary code to reduce costs and simplify procedures to register property.*
***Result Indicator 4:*** *Number of real estate properties and mortgages registered in the Public Notary Registry. Baseline (2015): 216; Target (2018): 280.*

**Component A.2: Introduce growth-enabling reforms in the infrastructure sector**

50. **Energy supply in STP is costly and unreliable, reaches about half of the population, and is predominantly generated by nonrenewable sources.** The 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 than 1 MW. The rest of the energy is provided by low-efficiency thermal generators, leading to high fuel consumption. In addition, years of underinvestment has left generating assets and the grid in poor condition and highly vulnerable to failure across the generation, transmission, and distribution segments. As a result, extensive outages are frequent, especially during periods of peak demand. This limited supply, even to those connected to the grid, leaves only privately owned diesel or gasoline generators for reliable supply. It has also resulted in a costly and unsustainable proposition in the long term for household budgets and private sector growth.

51. **Apart from its technical problems, EMAE is also faced with challenges related to management and commercial viability.** Two third of the estimated 40 percent of losses in 2015 are non-technical. These alone are estimated to increase the overall cost of production of electricity by over a third, independent of the energy source used. Therefore, despite high tariffs, EMAE is not able to recover energy costs with its revenues. As a result, EMAE has accumulated arrears with the Government and suppliers. It has also underinvested in the company, leading to low-quality service and high customer dissatisfaction. The major commercial problem faced by EMAE is proper metering, billing, and payments of the clients' bills. Not all clients have meters and those who have are not measuring electricity consumption properly because of their age. As a result, clients are billed by estimate or the minimum amount. Reports of incorrect metering and billing as well as energy theft are not uncommon, contributing to client base alienation.

52. **The GoSTP is fully aware of the development problem brought about by costly and unreliable energy supply and is working to address this problem.** The Government is investing to expand the electricity grid outside of the country capital and also to increase supply and reliability of energy. It has reached an agreement between EMAE and ENCO to settle the arrears among them. Supporting this agreement, there is a long-term vision and a plan to reduce the cost of energy in the country by resorting more on renewable and environmental-friendly energy sources. This shift is being supported by the World Bank Power Sector Recovery Project (P157096) which promotes an increase in renewable energy generation by rehabilitating the main hydropower plant and critical components of the grid as well as a comprehensive metering campaign for large customers and households. It also provides technical assistance to the regulatory agency and EMAE to improve the performance of the utility. The project also provides the GoSTP with critical analytical work and statistics on the sector.

53. **This DPF supports EMAE's management efforts to reduce commercial losses and addresses the high cost of energy generation.** This operation supports policy and management measures to deal with the problems aforementioned. A comprehensive sector intervention is being handled by the concurrent energy project, which will result in a reduction in technical and commercial losses as well. The first operation supports the introduction of a new computer system that underpins the prepaid energy service for a targeted number of customers. This system has allowed EMAE to resume the offer of prepaid energy services. This type of service has two benefits for EMAE. First of all, it requires the installation of new and accurate meters. Second, it eliminates nonpayment of energy bills. The second operation includes a trigger on the development and adoption of an energy generation expansion plan by the GoSTP, which will allow STP to choose the least-cost options to expand energy generation and thus address the issue of high tariffs. After that, the third operation foresees a trigger on the revision of tariffs and subsidies. This set of reforms will be measured by the level of EMAE's non-technical losses. This indicator was set in alignment with the results indicator of the energy operation, which includes an indicator on combined losses.

***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.*
***Trigger 4 (DPF2):*** *The Recipient has adopted an integrated Least-Cost Power Development Plan.*
***Trigger 5 (DPF3):*** *- EMAE has revised its tariff structure to better target subsidies and recover costs.*
***Result Indicator 5:*** *EMAE's non-technical losses. Baseline (2015): 26.4%; Target (2018): 24%.*

54. **Regulatory and planning capacity is scarce.** The regulatory agency, General Regulatory Authority (*Autoridade Geral de Regulação*, AGER), currently has little capacity to assume its role in the energy sector, and thus there is no agency monitoring service quality or auditing EMAE's accounts to assess revenue requirements and set tariffs. The energy regulation law, approved in 2014, foresees

several pieces of regulations to be issued as well as the establishment of a concession contract between the Government and EMAE. AGER has mapped all the pending regulations that need to be issued and is working to address this issue. Technical support to AGER is also foreseen in the energy project. This DPF series will support AGER to take the first steps to regulate the energy sector. The first operation supports the issuance of an ordinance to EMAE mandating it to have a comprehensive customer complaint redress system and to send monthly reports to AGER on customer complaints. This overall objective is to improve the quality of energy services. This will be done by monitoring the customer's complaints and using this data to inform inspections and other activities of the regulatory agency. The reports will be sent monthly to AGER and will also include the number of solved cases. These monthly reports will not only increase accountability at EMAE but also will help inform AGER's operation. The second DPF will support the establishment of minimum quality requirements for the energy 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. This string of policy actions will be monitored by the number of customer complaints. Although not available at this stage, the number of complaints addressed will be monitored going forward to avoid perverse incentives from the monitoring of complaints and also to assess if a more effective resolution system can lead to an increase in the number of complaints.

***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.*
***Trigger 5 (DPF2):*** *- AGER has set and published the minimum quality criteria for energy service to improve the reliability of the energy supply.*
***Trigger 6 (DPF3):*** *AGER has signed a concession contract with EMAE including all the company's obligations including rules on tariffs and sanctions.*
***Result Indicator 6:*** *Number of complaints received by EMAE. Baseline (2015): 6,542; Target (2018): 3,000.*

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

55. **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 historical unbalanced budgets and a long-standing high risk of debt distress. Several factors are at the root of it: 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 ability of capital expenditures. Short-term fiscal challenges are being addressed by the IMF program, while the DPF focus more on structural measures.

**Component B.1: Generate fiscal resources and savings**

56. **The country's revenue underperformance is a result of poor tax policy and tax administration.** The tax policy and tax structure have been partially modernized, but overall they still look very old-fashioned and typical of countries with a low development level. Tax revenues come mainly from custom duties. A stamp tax is still levied on many transactions, and several consumption taxes are imposed, sometimes on top of each other on the same good. STP is one of the few countries in Africa

that do not have a VAT. Tax administration practices also falls short of needs. Customs and taxes are managed by different offices, creating difficulty for cooperation and imposing additional administrative costs. The taxpayer cadaster fails to include all citizens and firms in the country. Collection of tax arrears is rare and enforcement of tax sanctions is a costly and long process, which creates an incentive for not paying taxes.

57. **The Government is working to broaden the tax base and reform tax policy as a way to close the tax gap**. In 2015, the tax office conducted a field work to identify firms and individuals outside of the tax cadaster and is now working to include them as regular taxpayers. On tax policy, the Government is revising the threshold values for income taxation for both corporate and personal income. Currently, PIT and corporate income tax operate on a dual structure. Large taxpayers pay their taxes according to a progressive ad valorem tax rate. Taxpayers who report no or little income have to pay a fixed amount, set by progressive structure with six brackets. The tax structure is the same for companies and liberal professionals. Moreover, the threshold values have remained the same since 1995, not being adjusted for inflation. The Government has obtained legislative approval to change this rule. It intends to update these values, reduce the number of brackets from six to one, and differentiate the minimum tax levied on personal income from corporate income. This policy measure is supported by the DPF as the six prior action of the first operation. Still on the tax policy, the Government is preparing to institute 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 that STP has in place the necessary regulations for fiscal invoicing and supporting accounting and tax information from taxpayers. Thus, the DPF series has included the introduction of such regulations as an indicative trigger for the second operation. Given the broad range of the reforms supported on revenue mobilization, this set of policy actions will be monitored by the overall tax-to-GDP ratio.

***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.*
***Trigger 6 (DPF2):*** *The Recipient has mandated companies to issue fiscal invoices and to provide the associated fiscal and accounting information.*
***Trigger 7 (DPF3):*** *The Recipient has submitted to the parliament a draft law to implement a VAT.*
***Result Indicator 7:*** *Tax revenues (as a share of GDP). Baseline (2015): 14.3%; Target (2018): 15.5%.*

58. **The Government is the sole owner of several companies, notably those that are vital for the competitiveness of the economy.** The state is the sole owner of four companies—EMAE, National Enterprise of Airports and Air Safety (*Empresa Nacional de Aeroportos e Segurança Área*), National Enterprise of Ports (*Empresa Nacional de Portos*), and Postal Service. These companies exercise the monopoly to provide services on water and energy, airport, port, and postal services respectively. The Government also holds relevant participation in seven other companies, including the only oil importer and largest gas station company (ENCO), the largest bank (BISTP), the telecom company (CST), and the local airline (STP Airways).

59. **The SOEs face a number of challenges related to transparency, efficiency, and financial viability.** The legal and regulatory framework for SOEs is adequate, but it has not been fully implemented. Ownership and accountability mechanisms are unclear. The law foresees a nonexecutive administrative board that was not implemented. The managing directors are appointed formally by the Council of Ministers for a three-year term. The chief financial officer nomination comes from the Ministry of Finance, while the other managers' names are suggested by the overseeing ministry. In some cases, like National Enterprise of Airports and Air Safety (*Empresa Nacional de Aeroportos e Segurança Área*), each manager is appointed by a different ministry. Despite the obligation to follow general

principles on legality, efficiency, effectiveness, and economy on its acts, SOEs are not bound by any specific fiscal and financial outcomes. SOEs are not transparent; they lack performance monitoring systems, and managers are hardly accountable.

60. **The management of SOEs needs great improvement, with many of them falling short of their objectives**. Moreover, they normally exert fiscal pressures on the Government's budget through high tariffs, forfeiting tax or dividends payments. For example, EMAE charges the highest tariff on government clients. In spite of that, it is financially unsustainable. It does not pay dividends to the Government and fails to pay its suppliers and make the investments needed for an adequate energy service. As a result, the oil importing company, EMAE's main supplier, missed tax payments, and past arrears with suppliers have become the Government's debt. In connection with the support to the energy sector, but also more broadly, this DPF series supports better control and management of SOEs. The second operation has a trigger on the adoption of an SOE strategy, and the third operation had an indicative trigger on the implementation of such a strategy. Monitoring will be made following frameworks set out in the World Bank toolkit for SOEs.

***Trigger 7 (DPF2):*** *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.*
***Trigger 8 (DPF3):*** *The Recipient has set financial and non-financial targets for the four SOEs, with clear sanctions for non-compliance.*
***Result Indicator 8:*** *Government revenues from SOE dividends (as a share of GDP). Baseline (2015): 0.18%; Target (2018): 0.30%*

**Component B.2: Improve the quality of public expenditures**

61. **STP lacks an adequate framework to prioritize public investment.** The main problem with PIM practices is the lack of a structured process and objective criteria to select the projects to be implemented. There are no specific provisions for special PIM procedures in the public finance legislation. The criterion for project selection is unclear, and a lot of decisions are made without taking into consideration a sound and objective technical analysis. Cost and time overruns are also common. Strategic guidance for public investments is given by the National Poverty Reduction Strategy and the Government Program. Those documents are very broad and failed to provide effective guidance. The Directorate of Planning does not do any selection, ranking, or recommendation of investment projects. The Directorate of Budget also does not have any formal process for selection of investment projects. Overall, great emphasis is given to the availability of financing and the preference of donors and lenders to finance specific interventions.

62. **This DPF series aims to support policies to strengthen debt management and PIM practices.** It includes an indicative trigger in the second operation to make a comprehensive and multiyear list of all public investment projects in the pipeline. Currently, the budget only lists projects under implementation or those that will start implementation in the budget year. This measure will also increase transparency in project selection and debt contracting. The third operation contains an indicative trigger to make the Government reconcile its investment needs (public investment pipeline) with the resources available (borrowing space). These triggers will be monitored by the inclusion of a multiyear estimate of borrowing plan in the budget.

***Trigger 8 (DPF2):*** *The Recipient has included in the budget law a list of all public investment projects in the pipeline including the respective financing source.*

***Trigger 9 (DPF3):*** *The Recipient has reconciled public investment projects and borrowing plan on a multiyear basis using a clear and objective prioritization criterion.*
***Result Indicator 9****: Estimate of multiyear borrowing plan included in the budget. Baseline (2015): No; Target (2018): Yes.*

63. **Years of continued growth has not translated into poverty reduction and shared prosperity**. Poverty is estimated to affect two-thirds of the country population, while extreme poverty incidence is at 32.5 percent. Despite the difficulties in tracking poverty over time in STP, it is accepted that poverty has remained stagnant in the last decade. The good growth track record unfortunately was not sufficient to raise people out of poverty.

64. **The inability of growth to reduce poverty is partly related to an inadequate SP framework.** Current SP policies have a small coverage with regard to beneficiaries and are fragmented and inefficiently designed. SP expenditures amount to 0.4 percent of GDP, including public works programs. There are 11 social programs in the country, excluding higher education scholarships. However, the only program that covers 100 percent of the target population is the school feeding program. All other programs either could not have their coverage estimated or did not reach a third of population coverage. In addition, several programs have part of their expenditures covered by aid resources. This is the case of the largest program—the school feeding program. SP programs also suffer from other problems such as low value of benefits, weak control, and uncertainty in funding. All of these problems reduce the efficiency of the SP framework.

65. **The GoSTP has devised a new SP strategy, which is embodied in the National Policy and Strategy for Social Protection (*Política e Estratégia Nacional de Proteção Social,* PENPS) approved in 2014.** The PENPS foresees the streamlining of existing SP programs into three core programs. The first one is a conditional cash transfer for families in extreme poverty. The second one is noncontributory pension to the poor elderly, handicapped, and chronically ill people, while the third is a labor-intensive public work and community service program. This DPF series supports the implementation of the policy. An initial step is the development and adoption of an operational manual for the new Vulnerable Families Program foreseen in the PENPS. The manual includes the targeting methodology and eligibility criteria. Follow-on actions included as triggers are the registry of all beneficiaries in a single register (trigger for DPF2) and the institution of a formal payment mechanism for the SP programs (trigger for DPF3). The payment will be made preferentially through the banking system, fostering financial inclusion, and will allow tracking and reconciliation of the public funds.

66. **The results of this operation will be monitored by the number of enrolled beneficiaries, registered and actually receiving payments from the three core SP programs.** The enrollment will be made possible by the existence of the operational manual, and the payment system will allow for regular payments, once resources are guaranteed. Currently, there are around 1,000 beneficiaries registered, but they are not receiving regular payments. The indicator aims to monitor not only the registry, but also the actual and regular payment of the benefits to ensure the effectiveness of the policy. The rationale is that these programs will be more effective in poverty reduction, and their expansion will be an indirect measure of the reduction in poverty headcount, which is the ultimate objective. New measurements of poverty headcount are expected in 2018 after the planned household survey in 2017 is carried out.

***Trigger 9 (DPF2):*** *The Recipient has registered all beneficiaries of the three core SP programs defined by the Social Protection Policy and Strategy in the Social Registry.*
***Trigger 10 (DPF3):*** *The Recipient has instituted a predominantly bank-based formal payment mechanism for SP programs that allows for tracking and reconciliation of funds allocated to subsidies.*

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| ***Result Indicator 10:*** *Number of beneficiaries enrolled in the three core SP programs and receiving regular payments. Baseline (2015): 0; Target (2018): 4,000.* |

67. **This operation has been informed by the analytical work listed below.** Policy actions supported on component A.1 benefited from the diagnostic undertaken as preparation by the financial sector strategy. In particular, they were instrumental to find out that the declining credit trend is due to the failure of the laws to allow for collateralized loans. Policy reforms on the energy sector are supported by the knowledge obtained by the energy sector operation, which also underscored the need for SOE reforms. Support to social protection policy is based on an extensive analytical work carried out by the Bank in 2014 and 2015, which concluded that the inefficiency of the social protection to reduce poverty was in its lack of funding and multiplicity of programs.

**Table 4. DPF Prior Actions and Analytical Underpinnings**

| Prior Actions | Analytical Underpinnings |
|---|---|
| **Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure** | |
| **Prior action 1:** The Recipient, through its National Assembly, has approved a banking resolution law (Medidas Especiais de Saneamento, Resolução e Liquidação de Instituções Bancárias) 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. | Financial Sector Development Implementation Plan: 2016–2020 (World Bank Group) |
| **Prior action 2:** 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 3:** 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. | Doing Business Report 2016 (World Bank Group)<br>Private Sector Development Strategy - STP (African Development Bank 2015) |
| **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. | Adopting and Implementing an Automatic Fuel Price Mechanism - Technical Assistance Report (IMF 2015)<br>Power Sector Recovery Project (World Bank 2016) |
| **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. | |
| **Pillar B: Generate fiscal resources and savings and improve the quality of public expenditures** | |
| **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. | World Bank Assessment on Tax Policy and Tax Administration in STP (2016)<br>Action Plan for Public Finance Reform in STP (European Union) |

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

68. **The proposed operation supports both themes of the current Country Partnership Strategy (CPS) FY14-FY18 (Report number 83144), discuss by the Board in July 2014.** 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 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 SP programs, expanding the coverage, and improving the target of the SP policy framework.

69. **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. Supported policies on the credit market will help increase access to credit and market opportunities for the people in the bottom part of the income distribution.

70. **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 issues 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 in the country, 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 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. Analytical works on debt and PIM are foreseen to start in 2016.

### 4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

71. **The Government held consultations during the preparation of STP's current poverty reduction strategy.** The Government carried out open consultative meetings in every district in a participatory budget preparation that served to inform the 2015 budget as well as the following budgets. Public consultation with financial sector stakeholders was conducted throughout the formulation of the financial sector development strategy. Similarly, in the process of formulation of the PENPS, various rounds of consultation were taken with stakeholders such as implementing partners and nongovernmental organizations. In addition, a formal council on SP was established by the PENPS. The policies actions supported in this operation underwent consultation inasmuch they are an integral part of the overall government program

72. **This DPF series is coordinated with the main developing partners working in STP.** The supported policies complement and leverage the support given by other development partners. The African Development Bank is providing technical assistance, infrastructure, and the equipment needed for the revenue administration of STP. The European Union is working on PFM issues, focusing on expenditure management and transparency. Altogether, this support helps the country achieve a more balanced budget position. Portugal has been providing technical assistance to the justice sector in STP.

This will help address concerns that banking and credit reform effectiveness might be compromised by the lack of reforms in the judiciary sector.

## 5. OTHER DESIGN AND APPRAISAL ISSUES

### 5.1 POVERTY AND SOCIAL IMPACT

73. **The proposed DPF series will have a positive social impact on poverty reduction, however the net impact is uncertain.** The most relevant and direct impact comes from the implementation of the SP policy framework. The new PENPS, as discussed above, is better targeted, benefiting the extreme poor population in STP. The utilization of a poverty map is behind the better targeting and the undertaking of a new household survey will not only allow the updating of this map but also better monitoring of the SP programs. Positive effects are also expected from the policies supported on access to finance and from overall growth-enabling reforms. The poverty and social impacts from the reforms in the energy sector are mixed and uncertain. On one hand, it will allow greater access to energy for poor households, however the reform of tariffs and subsidies, together with improved management of EMAE, might impose higher payments on part of the population. The World Bank, through its energy sector project and support to the new household survey, is collecting data that will allow the tariff and subsidy reform to be designed in a way to reduce adverse impacts on poverty.

74. **The support given to policy actions on revenue mobilization has a clear distributional impact.** The changes promoted tend to include more people in the tax base but also make it more progressive. However, given that household data is outdated and not of the highest quality, an incidence analysis of the proposed reforms could not be carried out. Such exercises will be made possible by the new household survey and can be carried out in future poverty assessments or public expenditure reviews. Another impact of the tax policy and administration reforms is the increase in domestic resources, which if directed to SP, will ensure the effectiveness of the new SP framework.

75. **Policy support to the financial sector and business environment in this operation has a small poverty and distributional impact.** The policies supported in the first operation are geared more to support the foundations of the financial sector, which will allow in the following operations for increased access to finance and thus a greater impact on poverty reduction.

### 5.2 ENVIRONMENTAL ASPECTS

76. **The proposed DPF series has neutral environmental impacts.** The policies supported in the financial sector, business regulation, and fiscal policy 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.

### 5.3 PFM, DISBURSEMENT, AND AUDITING ASPECTS

77. **PFM practices have continuously improved and the Government is committed to further implementation of PFM reforms.** The Government’s commitment to improving PFM is exemplified by

the reform progress supported by the last DPF series in areas related to comprehensiveness and transparency of the budget documents, the medium-term fiscal planning, and external auditing through the submission of the 2013 financial statements of the State to the court of accounts. The overall conclusion of the latest PEFA completed in 2013 is that that progresses have been made and there is an improvement in the scoring that demonstrated broad engagement to the PFM reform as well as strong government commitment to continue reform implementation. The Bank in collaboration with other development partners will continue to support the government initiatives and the needed further reforms. The PEFA report acknowledges positive development in relation to performance in PFM as result of progress made in implementation of reforms, which includes: (i) progress in the orderliness and participation in the annual budget as well as greater transparency and comprehensiveness of the budget information available to the public; (ii) some improvement in relation to the medium fiscal framework; (iii) availability to public of documents budget before and after approval through the Ministry of Finance and Public Administration web site; (iv) improvement in the legislative (parliamentary) scrutiny of the annual budget law; (v) establishment of the Treasury Single Account (TSA), reduction of accounts outside the TSA, and greater control over bank accounts and deposits in commercial banks; (vi) implementation of government IFMIS (SAFE-e); (vii) positive trend in relation to internal control at transaction level; and (viii) the government made some progress on the tax area. The reported noted also that the ongoing reform efforts are yet to address the following challenges (i) credibility of the budget remains; (ii) structural and institutional reforms in are of tax management; (iii) reaching a stable production stage and continuing to roll-out of the government IFMIS (SAFE-e); and (iv) follow-up on the findings of the audit and monitoring process. However, the Government commitment to reform the country's PFM will contribute to further improvement of PFM country systems.

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 public procurement system is becoming increasingly transparent.** A Procurement Supervisory Body and a Coordination and Assistance Procurement Cabinet (COSSIL), created in 2009, centralize procurement information, assist the decentralized procurement units, and ensure uniformity and quality across units. According to the law, COSSIL may suspend, cancel, or invalidate a particular contractual procedure that is not in accordance with the applicable legislation. Despite the improvements on the legal and institutional front, poor practices like the non-formal appointment of the members of the Conflict Resolution Commission[10] and general capacity constraints at central-level institutions as well as in the Procurement Management Units at the sector level hamper good public procurement system performance.

80. **The latest IMF safeguard report was completed in February 2016.** It states that progress in strengthening safeguards at the BCSTP has been slow. Capacity constraints remain a key challenge, including in the independent oversight of the audit mechanisms, internal controls, and financial reporting. External audits conducted by a reputable audit firm continue to serve as a critical safeguard. The legal framework is inadequate and does not provide for the needed autonomy from the Government and for independent oversight of the Central Bank's operation. Efforts are under way to amend the BCSTP organic law, but, so far, the proposed amendments fall short of the needs. The BCSTP does not follow international standards for financial reporting yet—known as International Financial Reporting Standards—but is working with support from the Central Bank of Brazil and IMF to adopt

[10] As a result of these practices, the PEFA Score on public procurement indicator (PI 19) has an overall score of C+ and did not improve compared to the 2010 PEFA.

them. The overall exchange control is satisfactory, however some challenges remain and the BCSTP is taking the actions recommended by the IMF to address them and the progress will be monitored by the IMF. For the purpose of this operation, additional fiduciary risk mitigation measures will be triggered as described in the paragraph below.

81. **The amount of SDR 3.6 million (US$5 million equivalent) will be disbursed upon grant effectiveness and following the recipient's request for withdrawal of proceeds of the grant.** The grant will follow IDA's standard disbursement procedures for DPFs. IDA has informed the recipient that no withdrawal shall be made of the operation unless IDA is satisfied (a) with the program 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 Board and becomes effective, and following the Recipient's request for withdrawal of proceeds of the grant, IDA will disburse the proceeds of the grant to a dedicated foreign currency account maintained at the BCSTP and forming part of the official reserves of STP. Within 30 days of the receipt of the deposit, the recipient shall provide confirmation to IDA that (a) the grant proceeds were received into an account of the government that is part of the country's foreign exchange reserves (including the date and the name/number of the government's bank account in which the amount has been deposited); and (b) an amount equivalent to the grant proceeds from IDA has been credited in the recipient's budget management system within 5 working days of the receipt, with an indication of the exchange rate applied, where applicable. The conversion from the foreign currency to the local currency will be based on the prevailing exchange rate on the date that the funds are credited to the budget management system. The Central Bank of STP will not impose any charges or commissions on the recipient for these transactions.

82. **The dedicated account shall be audited on terms of reference acceptable to IDA.** The Recipient shall have the dedicated account audited by an independent auditor acceptable to IDA. The audit will provide assurances that (a) the funds have indeed been received and deposited into the account; (b) the funds received in the dedicated account were, within 5 working days of receipt, converted into local currency and transferred to the consolidated fund account (Treasury Account) of the Government of STP to finance budgetary expenditures; and (c) the amounts so received have been appropriately accounted for in the financial management system of the Government. The Recipient will furnish to IDA, within four months from the date of receipt of the funds in the dedicated account, a certified copy of the report of such audit. 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 said payment to IDA. Amounts refunded to IDA, upon such request, shall be cancelled. The administration of this grant will be the responsibility of the Ministry of Finance and Public Administration.

### 5.4 MONITORING, EVALUATION, AND ACCOUNTABILITY

83. **The Ministry of Finance and Public Administration 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.

84. **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.

85. **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

86. **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 political and governance, macroeconomic, and institutional capacity for implementation and sustainability.

87. **Political and governance risk is Substantial**. Governance, rather than political risk, is the major source of risk to the operation in the first category. The ruling party enjoys an absolute majority in the legislative. Thus, political support to the reforms is guaranteed. Governance is a greater risk because transparency, accountability, and participation practices in STP are below the world average, even though they are superior to the African standards in some aspects. One clear example of governance risk is the possibility that STP enters into debt contracts that breach its international agreements once more, not only derailing reforms on PIM and debt management but also the whole macro framework in which the operation is built upon.

88. **Macroeconomic risks are also substantial.** As discussed earlier, despite the fairly good economic performance, there are several vulnerabilities to growth. Sources of macroeconomic risk to the operation include lower economic activity, increase in oil prices, and higher inflation. For example, lower than expected economic activity might reduce the revenue gains from tax reforms. The external environment through exchange rate movements might affect debt sustainability. An increase in oil prices will exert pressure on EMAE's finance and on the budget, reducing the fiscal space that might be generated by the second pillar of the operation. Aggravation of problems in the banking sector might derail the BCSTP's effort to improve access to finance and bank supervision. Macroeconomic risks are being closely monitored by the World Bank and the existence of an IMF program serves as a safeguard against inconsistent policy responses. In addition, the Government has a good track record on monetary and external policy that provides additional comfort in the event of a crisis.

89. **Institutional Capacity for Implementation and Sustainability is also rated as Substantial.** Institutional capacity is a binding constraint in STP and a major risk to the operation because it might prevent the authorities from carrying out and effectively implementing the reforms in the agreed time frame. The Government does not have the capacity to implement most of the reforms by itself. Thus, a

lack of support from the World Bank and other donors might hamper the reforms. Technical assistance to address the institutional capacity risk is in place for all policies supported in the financial sector. The energy operation and the associated trust funds include several technical assistance components. Lastly, a new institutional strengthening operation will be prepared to support fiscal policy and SP.

**Table 5. 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 | Moderate |
| 7. Environment and Social | Moderate |
| 8. Stakeholders | Moderate |
| **Overall** | **Substantial** |

## ANNEX 1: POLICY AND RESULTS MATRIX

| Prior Actions and Triggers | | | Results |
|---|---|---|---|
| **Prior Actions under DPF 1** | **Triggers for DPF 2** | **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** | | | |
| **Prior action 1:** The Recipient, through its National Assembly, has approved a banking resolution law (*Medidas Especiais de Saneamento, Resolução e Liquidação de Instituções Bancárias*) 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. | **Trigger 1:** The Recipient's Central Bank has established a Prompt Corrective Action framework to address events of noncompliance with banking sector regulation. | **Trigger 1:** The Recipient's Central Bank has carried out a review of the quality of banking sector assets (Asset Quality Review- AQR) and implemented an action plan to address its recommendations. | **Result Indicator 1**: Number of banks below the Central Bank's minimum Capital Adequacy Ratio<br>**Baseline** (2015): 3<br>**Target** (2018): 0 |
| | **Trigger 2:** The Recipient has submitted to the parliament a law on secured transactions that widen the range of assets that can be used as collateral to boost credit. | **Trigger 2:** The Recipient has implemented an enhanced registry that includes more information on each loan transaction and covers secured transactions. | **Result Indicator 2**: Credit registry coverage<br>**Baseline** (2015): 90%<br>**Target** (2018): 100% |
| **Prior action 2:** 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. | **Trigger 3:** The Recipient's Central Bank has issued regulation on modern payment methods including agent banking, mobile money, and electronic payments. | **Trigger 3:** The Recipient has submitted to the parliament a draft law on microfinance. | **Result Indicator 3**: Number of transactions settled through the national payment system (switch)<br>**Baseline** (2015): 0%<br>**Target** (2018): 30% |
| **Prior action 3:** 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 | | **Trigger 4:** The Recipient has revised the property registration and public notary code to reduce costs and simplify procedures to register property. | **Result Indicator 4**: Number of real estate properties and mortgages registered in the Public Notary Registry.<br>**Baseline** (2015): 216<br>**Target** (2018): 280 |
| **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 | **Trigger 4:** The Recipient has adopted an integrated Least-Cost Power Development Plan. | **Trigger 5:** EMAE has revised its tariff structure to better target subsidies and recover costs. | **Result Indicator 5:** EMAE's non-technical losses<br>**Baseline** (2015): 26.4%<br>**Target** (2018): 24% |
| **Prior action 5:** The Recipient, through AGER, has mandated EMAE to: (i) establish a | **Trigger 5:** AGER has published the minimum quality criteria for energy | **Trigger 6:** AGER has signed a concession contract with EMAE including all the | **Result Indicator 6:** Number of complaints received by EMAE |

| Prior Actions and Triggers | | | Results |
|---|---|---|---|
| **Prior Actions under DPF 1** | **Triggers for DPF 2** | **Triggers for DPF 3** | |
| 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. | service to improve the reliability of the energy supply. | company's obligations including rules on tariffs and sanctions. | **Baseline** (2015): 6,542<br>**Target** (2018): 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. | **Trigger 6:** The Recipient has mandated companies to issue fiscal invoices and to provide the associated fiscal and accounting information. | **Trigger 7:** The Recipient has submitted to the parliament a draft law to implement a VAT. | **Result Indicator 7**: Tax revenues (as a share of GDP)<br>**Baseline** (2015): 14.3%<br>**Target** (2018): 15.5% |
| | **Trigger 7:** 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. | **Trigger 8:** The Recipient has set financial and non-financial targets for the four SOEs, with clear sanctions for non-compliance. | **Result Indicator 8**: Government revenues from SOE dividends (as a share of GDP)<br>**Baseline** (2015): 0.18%<br>**Target** (2018): 0.30% |
| **Component B.2: Improve the quality of public expenditures** | | | |
| | **Trigger 8:** The Recipient has included in the budget law a list of all public investment projects in the pipeline including the respective financing source. | **Trigger 9:** The Recipient has reconciled public investment projects and borrowing plan on a multiyear basis using a clear and objective prioritization criterion. | **Result Indicator 9**: Estimate of multiyear borrowing plan included in the budget.<br>**Baseline** (2015): No<br>**Target** (2018): Yes |
| | **Trigger 9:** The Recipient has registered all beneficiaries of the three core SP programs defined by the Social Protection Policy and Strategy in the Social Registry. | **Trigger 10:** The Recipient has instituted a predominantly bank-based formal payment mechanism for SP programs that allows for tracking and reconciliation of funds allocated to subsidies. | **Result Indicator 10**: Number of beneficiaries enrolled in the three core SP programs and receiving regular payments.<br>**Baseline** (2015): 0<br>**Target** (2018): 4,000 |

## ANNEX 2: LETTER OF DEVELOPMENT POLICY

**REPÚBLICA DEMOCRÁTICA DE S.TOMÉ E PRÍNCIPE**
(Unidade-Disciplina-Trabalho)
**MINISTÉRIO DAS FINANÇAS, COMÉRCIO E ECONOMIA AZUL**
**GABINETE DO MINISTRO**

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

Ref. **1498**/GM/2016
São Tomé, 21 de Outubro

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 do programa em apoio ao fortalecimento do crescimento e política fiscal de São Tomé e Príncipe.Essa operação e seu respectivo donativo apoiarão os esforços do país para realizar reformas indutivas ao crescimento económico, geração de recursos próprios para o financiamento do desenvolvimento e melhoramento 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 mais eficácia no combate à pobreza.

Antes de me deter com mais detalhe sobre o programa a ser apoiado, gostaria de tecer rápidos comentários sobre recentes acontecimentos políticos e a posição macroeconómica de São Tomé e Príncipe. No campo político, ressalto a realização da eleição presidencial no último mês de Julho. A eleição foi vencida em segunda volta pelo candidato Evaristo Carvalho, em um processo supervisionado pela União Africana.

No campo económico, é nossa convicção que uma gestão macroeconómica de fundamentos sólidos é condição *sine qua non* para o sucesso de qualquer estratégia de redução da pobreza. Nesse sentido, gostaria de ressaltar que o nosso compromisso com a boa gestão macroeconómica é real e credível e está substanciado no programa acordado com o FMI, por ocasião da aprovação pelo conselho de administração do Fundo da Facilidade de Crédito Alargado em Julho desse 2015. Também reafirmo nossa disposição de manter-lhe informado sobre qualquer acção do governo que possa interferir no programa ou com os nossos compromissos ao IDA ou decorrentes das rodadas de alívio da dívida.

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apresenta sinais de moderação, uma vez que os efeitos dos choques de oferta já foram absorvidos.

O Banco Central de São Tomé e Príncipe vem também conduzindo a política monetária no sentido de manter os agregados monetários em linha com a âncora cambial e desenvolver os instrumentos de política monetária como o mercado aberto e o mercado interbancário. Também é de extrema importância as medidas tomadas no campo da supervisão bancária com a fusão, liquidação e capitalização de bancos, de forma a evitar os custos de eventuais problemas bancários. Em particular, quero citar a revogação da licença de operação do Banco Equador, com o seu consequente encaminhamento para liquidação pelo Poder Judiciário.

O Ministério das Finanças vem conduzindo um esforço enorme para promover a consolidação fiscal e equilibrar o orçamento público. No ano de 2015, o défice primário (com recursos próprios) foi reduzido em 0,4 pontos percentuais do PIB, em que pese a baixa arrecadação de recursos próprios, a demanda não-atendida por serviços públicos e a volatilidade dos fluxos de donativos.

As contas externas de São Tomé são estruturalmente deficitárias devido ao pequeno tamanho do nosso país e de 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 trazidos pelos donativos e empréstimos externos tem sido essenciais para a sustentabilidade externa da economia. Não obstante, nota-se uma ligeira melhora nas contas externas são-tomenses, fruto de maior investimento directo por parte das empresas petrolíferas, queda do preço do petróleo e maiores receitas de turismo.

Por último, mas não menos importante, é a questão do crescimento económico. Em 2015, o crescimento do PIB desacelerou devido a aprovação tardia do orçamento, o que paralisou os investimentos públicos. A redução das exportações de cacau e turismo também impactaram negativamente a actividade económica. Esse quadro está sendo revertido em 2016, com a aprovação tempestiva do orçamento e o crescimento das receitas de turismo e exportações agrícolas. Espera-se com isso um maior crescimento económico – algo da ordem de 5 porcento - em 2016.

As perspectivas para a economia são positivas devido ao gradual desenvolvimento dos sectores to turismo e da agricultura. A produção de petróleo ainda que num horizonte mais longo também não é descartada. Não obstante a aceleração da economia, o desenvolvimento económico de São Tomé e Príncipe encontra-se constrangido por diversos factores: serviço de energia caro e instável; dificuldade de acesso ao crédito; ambiente de negócios custoso, infra-estrutura deficiente; baixa mobilização de recursos domésticos e ineficiência na aplicação dos recursos públicos, em especial no que tange aos investimentos públicos e suas respectivas fontes de financiamento.

São justamente esses factores de constrangimento que a estratégia do governo, apoiada por essa operação, busca enfrentar. A operação proposta está alinhada com os planos são-tomenses de desenvolvimento e redução da pobreza. Actualmente, encontra-se em vigor a Segunda Estratégia Nacional de Redução da Pobreza (PRSP-II), cuja vigência prevista é até o final de 2016. O governo, com o apoio dos parceiros de desenvolvimento, está elaborando uma nova Estratégia Nacional de Redução da Pobreza, conjuntamente com um plano de desenvolvimento de mais longo prazo, denominado Visão 2030. Ambos os documentos incorporarão os Objectivos de Desenvolvimento Sustentáveis definidos pela comunidade internacional em substituição aos Objectivos de Desenvolvimento do Milénio. A actuação do governo também é pautada pelo programa do 16º Governo Nacional de São Tomé e Príncipe, que se iniciou em 2015.

Em linhas gerais, o pilar central da estratégia do governo é e continuará sendo a aposta na aceleração do crescimento económico de forma a reduzir a pobreza por meio da geração de empregos. O governo reconhece o papel essencial do sector privado na geração de empregos e crescimento económico. Por isso, a estratégia do governo é de melhorar o ambiente de negócios e apoiar iniciativas de diversificação da economia. Por outro lado, o governo reconhece o seu papel inalienável no fornecimento de infra-estrutura social adequada para a população de São Tomé e Príncipe, bem como a importância de um arcabouço macroeconómico sólido para o desenvolvimento sustentável do país.

Face ao exposto acima, ressalto a plenaintegração da operação em tela com a estratégia do país. Muitas das reformas apoiadas já estavam previstas de forma literal no documento do programa do 16º Governo Nacional.Por exemplo, no âmbito do sector financeiro, o programa do governo prevê: "Reforçar a capacidade de supervisão do Banco Central através da adopção de normas que fortaleçam a sua autonomia de decisão em matéria de supervisão" e "Promover a poupança interna a eficiência bancária, através do desenvolvimento de novos serviços". Esses objectivos serão apoiados pelas acções prévias e indicativas que prevêem a implantação de uma nova lei de supervisão bancária, uma nova abordagem de supervisão mais proactiva com a adopção do arcabouço de correcção tempestiva (*PromptCorrectiveAction*) e a regulação do sector de microfinanças bem como de pagamentos por telemóvel. No sector energético, o programa do governo prevê: "Implementar a Lei de Bases do Sector Energético que contemplará o Sistema Eléctrico Público (SEP) e Sistema Eléctrico Independente (SEI), e a demais legislações de actividades do sector", o que será sustentado pelo apoio ao órgão de regulação, por exemplo, para estabelecer o contracto de concessão de transmissão e distribuição de energia. No campo das finanças públicas, o programa do país prevê: "Levar a cabo acções que visem o combate à evasão e fraudes fiscais, bem como o alargamento da base tributária", objectivo que será plenamente suportado com a revisão dos valores de tributação presumida e introdução do imposto de valor agregado.

A operação de apoio orçamental em tela vem de encontro aos nossos anseios para apoiar reformas robustas, direccionadas a atenuar e remover esses entraves ao desenvolvimento do nosso país. Ela também está coadunada com as demais operações do Banco Mundial em São Tomé e Príncipe, em particular, com o projecto de investimento na área de energia e o apoio técnico concedido à área de protecção social e ao Banco Central.

Nesse sentido, as medidas apoiadas na área do sector financeiro permitirá ao país afastar o risco e os custos de uma crise bancária, mas também ampliar o acesso ao crédito por meio de melhorias no arcabouço legal, no registo de operações de crédito, hipotecas, imóveis e garantias. Também é importante ressaltar que essas reformas são parte integrante de um pacote mais amplo e ousado de reformas do sector financeiro, que estão substanciadas na Estratégia de Desenvolvimento do Sector Financeiro, recém-lançada e que contou com apoio indispensável do Banco Mundial.

O alto custo da energia e a instabilidade no fornecimento da mesma é talvez o maior entrave ao crescimento económico de São Tomé e Príncipe. A maioria das empresas possui e utiliza frequentemente geradores próprios de energia, situação comum também em muitos domicílios residenciais. O governo vem actuando para reformar o sector de energia, expandindo a energia de fontes renováveis, ampliando a rede de distribuição e viabilizando uma melhor regulação do sector e da empresa pública. A operação de políticas de desenvolvimento apoiará o nosso país no âmbito das reformas regulatórias e de gestão da empresa pública de água e energia (EMAE) – como a formalização de um contracto de concessão entre o Estado e a EMAE, ao passo que a renovação das infra-estruturas e apetrechamento da empresa estão sendo apoiadas pelo projecto de investimento do Banco Mundial em energia.

Os obstáculos ao crescimento de São Tomé e Príncipe também estão relacionados à fragilidade fiscal do país. O nosso país tem um dos menores rácios de receita tributária sobre o PIB. Isso implica numa 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 implantação 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 implantação integral. Nesse sentido, eu louvo a abordagem dessa operação que casa esforços para ampliar as receitas domésticas com apoio a implantação da PENPS. Nesse sentido, o governo se compromete a garantir recursos progressivamente para o financiamento da PENPS, além de tomas as medidas necessárias para a implantação do programa de apoio as famílias vulneráveis de transferências condicionais de renda, como a adopção do manual operacional e o registo dos beneficiários.

As reformas previstas não se restringem ao lado das receitas, mas abrangem também as despesas. A maior despesa do nosso país é em investimentos públicos, que são financiados em 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 se compromete com um programa de análises e reformas na gestão de investimentos públicos e da dívida pública. Por último, reconheço a necessidade de reformar a gestão e controle das empresas públicas. Tais reformas gerarão duplos ganhos. Pelo lado do orçamento, conterão despesas e poderão gerar receitas de dividendos, e também colaborarão para reduzir os gargalos de infra-estrutura do país, dado a actuação monopolistas dessas empresas nas áreas de energia, portos e aeroportos.

Em resumo, 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 governodesde seu início em 2015fornecem a confiança necessária à consecução das políticas e atingimento dos resultados propostos.

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

**O Ministro,**

**Américo d'Oliveira dos Ramos**

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**DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE**

MINISTRY OF FINANCE, TRADE, AND THE BLUE ECONOMY

**OFFICE OF THE MINISTER**

Jim Yong Kim
President, World Bank Group
1818 H Street, NW
Washington, DC. 20433
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Ref. **1498**/GM/2016
São Tomé, October 21

Dear Dr. Jim Yong Kim,

On behalf of the Government of the Democratic Republic of São Tomé and Príncipe, I am pleased to submit, for your consideration, the document presenting the growth and fiscal policy strengthening program of São Tomé and Príncipe. This operation and the respective grant will support the country's efforts to implement reforms conducive to economic growth, the mobilization of domestic resources to finance development, and better quality of public expenditure. The latter component also entails improving national social protection policy, which, in conjunction with measures to broaden the scope of domestic resource mobilization, will make it possible to combat poverty more effectively.

Before discussing the proposed program in greater detail, I would like to comment briefly on recent political events and the macroeconomic position of São Tomé and Príncipe. In the political domain, last July's presidential election was won by Evaristo Carvalho after the second round of voting, in a process supervised by the African Union.

In the economic sphere, we believe that macroeconomic management with sound fundamentals is a *sine-qua-non* for the success of any poverty reduction strategy. In that regard, I would stress that our commitment to good macroeconomic management is real and credible, and it is substantiated in the program agreed upon with the International Monetary Fund (IMF), when the Fund's Board of Executive Directors approved the Extended Credit Facility in July 2015. I would also reiterate our readiness to keep you informed of any government action that might interfere with the program, or with our IDA commitments or those arising from past rounds of debt relief.

As regards the macroeconomic framework, I would draw attention to the vigorous process of inflationary convergence which São Tomé and Príncipe has been pursuing since 2010, when it anchored its currency on the euro. The inflation rate has been lowered year by year; and it ended 2015 at 4 percent, its lowest ever recorded rate. Price increases accelerated slightly this year however, but are now showing signs of easing since the effects of supply shocks have been absorbed.

The Central Bank of São Tomé and Príncipe has also been conducting monetary policy with a view to keeping the monetary aggregates in line with the exchange-rate anchor, and developing monetary policy instruments such as open market and interbank market operations. Extremely important measures have also been adopted in the field of banking supervision, with the merger, liquidation and capitalization of banks, to avoid the costs of potential banking problems. In particular, Banco Equador has had its operating license revoked, and the bank has been put into a judicial liquidation process.

The Ministry of Finance has been making a huge effort to promote fiscal consolidation and balance the public sector budget. In 2015, the primary deficit (with domestic resources) was reduced by 0.4 percentage points of GDP, despite the low level of internal revenue, unmet demand for public services, and the volatility of grant flows.

São Tomé's external accounts are in structural deficit owing to the small size of our country and population. Other factors that contribute to the deficit include our insularity and lack of large natural resources, or stablished comparative advantages. In this context, the resources provided by foreign grants and loans have been essential for the external sustainability of the economy. Nonetheless, the external accounts have improved slightly as a result of greater direct investment by the oil companies, the fall in the price of oil, and increased tourism earnings.

Last, but no less important, is the issue of economic growth. In 2015, GDP growth slowed owing to the late approval of the budget, which paralyzed public investment. Weaker cocoa exports and tourism flows also had an adverse impact on economic activity. The situation is being turned around in 2016 however, with the early approval of the budget and growth in tourism revenues and agricultural exports. As a result, economic growth in 2016 is forecast to be around 5 percent.

The outlook for the economy is positive, with the gradual development of the tourism and agriculture sectors. Oil production, albeit over a longer horizon, is also not ruled out. Despite the quickening pace of activity, the economic development of São Tomé and Príncipe is constrained by various factors: expensive and unstable energy service; difficulty in accessing credit; costly business environment and deficient infrastructure; low rates of mobilization of domestic resources and inefficiency in the use of public funds, particularly in relation to public investments and their respective financing sources.

It is precisely those constraints that the Government's strategy, supported by this operation, seeks to address. The proposed operation is aligned with São Tomé and Príncipe's development and poverty reduction plans. The Second National Poverty Reduction Strategy (PRSP-II) is currently being implemented, and is expected to run until the end of 2016. The Government, with support from its development partners, is preparing a new national poverty reduction strategy, together with a longer-term development plan, known as Vision 2030. Both documents will incorporate the Sustainable Development Goals defined by the international community, to succeed the Millennium Development Goals. The Government's action is also guided by the program of the 16$^{th}$ National Government of São Tomé and Príncipe, which took office in October 2014.

In general terms, the central pillar of the Government's strategy is, and will continue to be, its support for faster economic growth to reduce poverty through job creation. The Government recognizes the crucial role of the private sector in creating jobs and generating economic growth. For that reason, the Government's strategy is to improve the business environment and support initiatives to diversify the economy. The Government also recognizes its inescapable role in providing adequate social infrastructure for the population of São Tomé and Príncipe, together with the importance of a sound macroeconomic framework to underpin the country's sustainable development.

In view of the above, I would stress that the operation in question is fully integrated with the country strategy. Many of the reforms supported were already anticipated in the document setting out the program of the 16$^{th}$ National Government. For example, in the financial sector, the government program envisages: "strengthening the central bank's supervision capacity by adopting regulations that strengthen its decision-making autonomy on supervision" and "promoting domestic saving and banking efficiency, by developing new services." Those objectives will be supported by prior and indicative actions that involve the implementation of a new banking supervision law, a new approach to more proactive supervision with the adoption of the Prompt Corrective Action framework, and regulation of the microfinance sector, along with payments by mobile phone. In the energy sector, the government program envisages: "implementing the Basic Law on the Energy Sector, which will include the public electricity system (SEP) and the independent electricity system (SEI), and other laws governing the sector's activity." This will be sustained by support for the regulatory body, e.g., to establish the concession contract for energy transmission and distribution. In the public finance sphere, the country program foresees: "actions to combat tax evasion and fraud, together with an expansion of the tax base," an objective that will be fully supported with the revision of the values of presumed taxation and the introduction of value added tax (VAT).

The budgetary support operation in question meets our desires to support robust reforms aimed at alleviating and removing those obstacles to our country's development. It is also in harmony with the World Bank's other operations in São Tomé and Príncipe, particularly the investment project in the energy area and the technical support granted to the social protection area and the central bank.

In that regard, the measures supported in the financial sector will enable the country to ward off the risk and cost of a banking crisis, while also expanding access to credit through improvements to the legal framework in terms of the registration of loan, mortgage, real estate and collateral operations. Those reforms are an integral part of a bold and broader package of reforms in the financial sector, which are included in the recently launched financial sector development strategy, which had the essential support of the World Bank.

The high cost and instability of energy supply is perhaps the greatest obstacle to economic growth in São Tomé and Príncipe. Most firms have, and frequently use, their own power generators; and this is also a common situation in many residential homes. The Government has been taking steps to reform the energy sector, by increasing the use of renewables, expanding the distribution network and implementing better regulation of the sector and the public enterprise. The implementation of development policies will support our country in regulatory reforms and management of the public water and energy company (EMAE) — with the formalization of a concession contract between that enterprise and the State, while the renovation of infrastructures and provisioning of the firm are being supported by the World Bank's investment project in energy.

The obstacles to growth in São Tomé and Príncipe also stem from the country's fiscal fragility. The fact that our country has one of the lowest tax revenue/GDP ratios implies a more vulnerable fiscal position with constant deficits and difficulty for the Government to provide the public services needed by the population. An example of this difficulty is the implementation of the new National Social Protection Policy and Strategy (PENPS), which was approved by the Council of Ministers in 2015 but does not yet have all the resources needed for its full implementation. In that regard, I applaud the approach of that operation, which combines efforts to expand domestic revenues with support for implementing the PENPS. In that regard, the government commits to ensure that resources are progressively channeled to implement the PENPS, as well as to take the needed measures to implement the conditional cash transfer program to help vulnerable families, such as the adoption of the operational manual and registry of beneficiaries.

The reforms envisaged are not limited to the revenue side but also encompass expenditure. Our country's largest expense is in public investments, which are mainly financed by grants and concessional loans. These exert great influence on the country's economic activity, but their impact is below potential. São Tomé and Príncipe is committed to an analytical and reform program in the management of public investments and the public debt.

Lastly, I recognize the need to reform the management and control of public enterprises. Such reforms will generate twin gains. On the budget side, they will contain expenses and make it possible to generate dividend revenues; and they will also collaborate in reducing the country's infrastructure deficits, given the monopolistic actions of those firms in the areas of energy, ports, and airports.

In short, these are the reforms for which I would like to have the World Bank's support. I believe that the results already achieved by our country, along with the adequacy of our macroeconomic framework and the commitments undertaken and implemented by the Government since it took office in October 2014, provide the confidence needed to implement the policies and attain the proposed results.

Very truly yours,

**The Minister,**

**/s/**

**Américo d'Oliveira dos Ramos**

**ANNEX 3: FUND RELATIONS ANNEX**

**IMF Executive Board Concludes 2016 Article IV Consultation with São Tomé and Príncipe**

June 17, 2016

Press Release No. 16/289
June 17, 2016

On June 10, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the 2016 Article IV consultation[1] with the Democratic Republic of São Tomé and Príncipe.

São Tomé and Príncipe's economy has been resilient even after prospects for commercial oil production, which dominated the political and economic narrative until end-2013, became uncertain with the withdrawal of a large oil company from exploration in the Joint Development Zone shared with Nigeria. São Tomé and Príncipe's economic performance has been positive, despite a slowdown in growth in 2015. Real GDP in 2015 is estimated to have fallen below the projected 5 percent by almost 1 percentage point, driven by poor rains affecting crop yields, particularly, cocoa production and delayed implementation of public investment projects. Inflation fell below the projected 5 percent, aided by weakened demand and falling international prices of oil and other commodities.

The medium-term outlook is favorable but challenges remain. GDP is projected to grow by 5 percent in 2016—below the authorities' medium-term sustained target of 6 percent needed to significantly impact poverty—aided by higher public investments, a recovery in cocoa production, and increased foreign direct investment in the tourism sector. The authorities are however, facing macro-financial challenges. Elevated bank lending risks and potential contingent claims on the budget, in an environment marked by rising nonperforming loans (NPLs) and highly indebted households and businesses, will continue to hold private sector credit expansion and the prospects for higher growth. Inflation is expected to remain around 4 percent in 2016, and further stabilize around 3 percent over the medium term, on the back of falling international prices of food and petroleum products. The current account deficit is set to contract further in line with weaker-than-estimated demand and lower-than-expected commodity prices.

**Executive Board Assessment**[2]

Executive Directors welcomed São Tomé and Príncipe's progress toward greater macroeconomic stability, marked by sustained growth, declining inflation, and stable international reserves, even after prospects for commercial oil production became uncertain. Directors noted, however, that while some progress has been made, challenges remain and poverty is still high. Against this backdrop, they called for further efforts to enhance the economy's resilience by strengthening the financial sector, maintaining fiscal discipline, and implementing reforms to support sustainable and inclusive growth.

Directors supported the authorities' commitment to sustain the fiscal consolidation in order to bring debt toward a moderate risk of debt distress. In this regard, they stressed the importance of boosting tax revenue collection, clearing arrears, strengthening expenditure monitoring and control, and gradually scaling up the infrastructure program, which should be backed by enhanced investment management capacity. Directors also called for strengthening debt management capacity and for continued reliance on grants and concessional financing to mitigate the high risk of debt distress.

Directors stressed that maintaining financial stability is crucial. In this regard, they welcomed the authorities' decision to develop a strategy to address the large stock of non-performing loans and, where necessary, review provisioning practices and minimum capital requirements to ensure that banks are well capitalized. Directors also encouraged the introduction of a contingency plan to deal with potential fiscal risks. In addition, they called on the authorities to conduct a detailed asset quality review to reduce the uncertainty surrounding the quality of banks' assets and to work with commercial banks to increase the banking system's efficiency, profitability, and resilience.

Directors noted the authorities' commitment to the pegged exchange rate regime and the current level of the peg, which has served the country well as an effective anchor for inflation in the context of a prudent fiscal stance and an adequate level of international reserves. At the same time, they recognized the need to ensure external competitiveness through continued tight demand management and structural reforms aimed at enhancing the country's physical infrastructure, improving the business climate, promoting diversification, raising productivity, and boosting private investment.

**São Tomé and Príncipe: Selected Economic Indicators, 2014–19**

(Annual change in percent, unless otherwise indicated)

| | 2014 | 2015 | | 2016 | | 2017 | | 2018 | | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | EBS/15/71 | | EBS/15/71 | | EBS/15/71 | | EBS/15/71 | | |
| | Actual | Program | Est. | Program | Proj. | Program | Proj. | Program | Proj. | Proj. |
| National income and prices | | | | | | | | | | |
| GDP at constant prices | 4.5 | 5.0 | 4.0 | 5.2 | 5.0 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| Consumer prices | | | | | | | | | | |
| End of period | 6.4 | 5.2 | 4.0 | 4.0 | 4.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Period average | 7.0 | 5.8 | 5.3 | 4.6 | 3.9 | 3.5 | 3.5 | 3.0 | 3.0 | 3.0 |
| External trade | | | | | | | | | | |
| Exports of goods and nonfactor services | 64.3 | 5.8 | -9.2 | 8.5 | 9.2 | 6.9 | 7.2 | 6.9 | 6.5 | 8.2 |
| Imports of goods and nonfactor services | 28.6 | -8.3 | -17.4 | 15.5 | 11.8 | 9.1 | 7.0 | 8.5 | 5.8 | 2.9 |
| Exchange rate (dobras per US$; end of period) [1] | 20,148 | ... | 22,424 | ... | ... | ... | ... | ... | ... | ... |
| Real effective exchange rate (depreciation = -) | 7.0 | ... | 0.8 | ... | ... | ... | ... | ... | ... | ... |
| Money and credit | | | | | | | | | | |
| Base money | 23.2 | 14.6 | 37.5 | 11.1 | 10.4 | 7.1 | 6.3 | 8.0 | 7.2 | 9.7 |
| Broad money (M3) | 16.8 | 15.1 | 13.1 | 11.4 | 11.6 | 6.6 | 6.3 | 7.5 | 7.2 | 7.9 |
| Credit to the | -1.0 | -0.7 | 3.8 | 1.6 | 7.0 | 3.4 | 4.8 | 5.3 | 5.2 | 7.5 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| economy | | | | | | | | | | |
| Velocity (GDP to broad money; end of period) | 2.6 | 2.6 | 2.6 | 2.4 | 2.5 | 2.4 | 2.5 | 2.4 | 2.5 | 2.5 |
| Central bank reference interest rate (percent) | 12.0 | ... | 10.0 | ... | ... | ... | ... | ... | ... | ... |
| Average bank lending rate (percent) | 23.2 | ... | 23.3 | ... | ... | ... | ... | ... | ... | ... |
| Average bank deposit rate (percent) | 8.9 | ... | 6.9 | ... | ... | ... | ... | ... | ... | ... |
| Government finance (figures in percent of GDP) | | | | | | | | | | |
| Total revenue, grants, and oil signature bonuses | 25.9 | 31.8 | 28.0 | 33.9 | 35.1 | 34.9 | 33.4 | 35.6 | 33.7 | 33.5 |
| *Of which*: tax revenue | 14.1 | 15.0 | 14.3 | 15.5 | 14.9 | 16.0 | 15.4 | 16.5 | 15.9 | 16.5 |
| Nontax revenue | 1.5 | 1.7 | 1.5 | 1.7 | 2.2 | 1.7 | 1.3 | 1.7 | 1.3 | 1.3 |
| Grants | 10.3 | 15.1 | 11.4 | 16.6 | 17.3 | 17.1 | 16.6 | 17.3 | 16.4 | 15.6 |
| Oil signature bonuses | 0.0 | 0.0 | 0.8 | 0.0 | 0.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total expenditure and net lending | 31.4 | 40.6 | 34.2 | 36.2 | 44.1 | 36.9 | 37.3 | 35.9 | 36.2 | 33.9 |
| Personnel costs | 9.1 | 8.8 | 8.9 | 8.7 | 8.6 | 8.6 | 8.5 | 8.5 | 8.4 | 8.4 |
| Interest due | 0.7 | 0.4 | 0.8 | 0.4 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Nonwage noninterest current expenditure | 8.7 | 8.7 | 8.5 | 8.7 | 8.1 | 8.4 | 7.9 | 8.2 | 7.6 | 7.6 |
| Treasury funded capital expenditures | 0.9 | 0.9 | 0.7 | 1.0 | 0.7 | 1.9 | 1.6 | 2.5 | 2.2 | 2.5 |
| Donor funded capital expenditures | 11.8 | 20.8 | 14.7 | 16.6 | 20.2 | 16.6 | 17.9 | 15.5 | 16.7 | 14.0 |
| HIPC Initiative-related social | 0.2 | 1.0 | 0.6 | 0.9 | 0.9 | 0.6 | 0.6 | 0.6 | 0.5 | 0.7 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| expenditure | | | | | | | | | | |
| Domestic primary balance [2] | -3.3 | -2.7 | -3.0 | -2.0 | -2.0 | -1.8 | -1.8 | -1.5 | -1.5 | -1.4 |
| Overall balance (commitment basis) | -5.5 | -8.8 | -6.3 | -2.3 | -9.0 | -2.0 | -3.8 | -0.4 | -2.5 | -0.4 |
| External sector | | | | | | | | | | |
| Current account balance (percent of GDP) | | | | | | | | | | |
| Including official transfers | -21.9 | -12.4 | -16.7 | -15.2 | -12.2 | -16.4 | -12.7 | -17.0 | -12.6 | -10.5 |
| Excluding official transfers | -32.6 | -28.5 | -28.2 | -32.7 | -29.5 | -34.3 | -29.7 | -35.1 | -29.3 | -26.4 |
| PV of external debt (percent of GDP) | 30.1 | 32.5 | 39.7 | 32.5 | 36.2 | 32.0 | 38.3 | 31.7 | 39.4 | 37.9 |
| External debt service (percent of exports) [3] | 3.7 | 4.8 | 4.3 | 4.2 | 4.8 | 3.9 | 4.3 | 3.7 | 4.0 | 3.8 |
| Export of goods and non-factor services (US$ millions) | 88.5 | 93.5 | 80.4 | 101.5 | 87.7 | 108.4 | 94.1 | 115.9 | 100.2 | 108.5 |
| Gross international reserves [4] | | | | | | | | | | |
| Millions of U.S. dollars | 56.5 | 66.9 | 61.0 | 80.5 | 72.8 | 97.7 | 75.9 | 102.7 | 82.4 | 87.6 |
| Months of imports of goods and nonfactor services [5] | 4.2 | 4.0 | 4.4 | 4.5 | 5.0 | 5.1 | 5.0 | 5.1 | 5.1 | 5.0 |
| National Oil Account (US$ millions) | 9.9 | 8.0 | 10.3 | 6.5 | 11.5 | 5.3 | 9.3 | 4.3 | 7.6 | 6.2 |
| *Memorandum Item* | | | | | | | | | | |
| GDP | | | | | | | | | | |
| Billions of dobras | 6,242 | 7,171 | 7,028 | 7,790 | 7,847 | 8,251 | 8,287 | 8,820 | 8,839 | 9,533 |
| Millions of | 338.0 | 325.6 | 318.2 | 356.3 | 349.2 | 381.8 | 371.2 | 412.9 | 396.0 | 428.8 |

U.S. dollars

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

[1]Central Bank (BCSTP) mid-point rate.

[2] Excludes oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.

[3] Percent of exports of goods and nonfactor services.

[4] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.

[5] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here:http://www.imf.org/external/np/sec/misc/qualifiers.htm.

| | 2014 | 2015 | | 2016 | | 2017 | | 2018 | | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | EBS/15/71 | | EBS/15/71 | | EBS/15/71 | | EBS/15/71 | | |
| | Actual | Program | Est. | Program | Proj. | Program | Proj. | Program | Proj. | Proj. |
| National income and prices | | | | | | | | | | |
| GDP at constant prices | 4.5 | 5.0 | 4.0 | 5.2 | 5.0 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| Consumer prices | | | | | | | | | | |
| End of period | 6.4 | 5.2 | 4.0 | 4.0 | 4.0 | 3.0 | 3.0 | 3.0 | 3.0 | 3.0 |
| Period average | 7.0 | 5.8 | 5.3 | 4.6 | 3.9 | 3.5 | 3.5 | 3.0 | 3.0 | 3.0 |
| External trade | | | | | | | | | | |
| Exports of goods and nonfactor services | 64.3 | 5.8 | -9.2 | 8.5 | 9.2 | 6.9 | 7.2 | 6.9 | 6.5 | 8.2 |
| Imports of goods and nonfactor services | 28.6 | -8.3 | -17.4 | 15.5 | 11.8 | 9.1 | 7.0 | 8.5 | 5.8 | 2.9 |
| Exchange rate (dobras per US$; end of period) [1] | 20,148 | ... | 22,424 | ... | ... | ... | ... | ... | ... | ... |
| Real effective exchange rate (depreciation = -) | 7.0 | ... | 0.8 | ... | ... | ... | ... | ... | ... | ... |
| Money and credit | | | | | | | | | | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Base money | 23.2 | 14.6 | 37.5 | 11.1 | 10.4 | 7.1 | 6.3 | 8.0 | 7.2 | 9.7 |
| Broad money (M3) | 16.8 | 15.1 | 13.1 | 11.4 | 11.6 | 6.6 | 6.3 | 7.5 | 7.2 | 7.9 |
| Credit to the economy | -1.0 | -0.7 | 3.8 | 1.6 | 7.0 | 3.4 | 4.8 | 5.3 | 5.2 | 7.5 |
| Velocity (GDP to broad money; end of period) | 2.6 | 2.6 | 2.6 | 2.4 | 2.5 | 2.4 | 2.5 | 2.4 | 2.5 | 2.5 |
| Central bank reference interest rate (percent) | 12.0 | ... | 10.0 | ... | ... | ... | ... | ... | ... | ... |
| Average bank lending rate (percent) | 23.2 | ... | 23.3 | ... | ... | ... | ... | ... | ... | ... |
| Average bank deposit rate (percent) | 8.9 | ... | 6.9 | ... | ... | ... | ... | ... | ... | ... |
| Government finance (figures in percent of GDP) | | | | | | | | | | |
| Total revenue, grants, and oil signature bonuses | 25.9 | 31.8 | 28.0 | 33.9 | 35.1 | 34.9 | 33.4 | 35.6 | 33.7 | 33.5 |
| *Of which*: tax revenue | 14.1 | 15.0 | 14.3 | 15.5 | 14.9 | 16.0 | 15.4 | 16.5 | 15.9 | 16.5 |
| Nontax revenue | 1.5 | 1.7 | 1.5 | 1.7 | 2.2 | 1.7 | 1.3 | 1.7 | 1.3 | 1.3 |
| Grants | 10.3 | 15.1 | 11.4 | 16.6 | 17.3 | 17.1 | 16.6 | 17.3 | 16.4 | 15.6 |
| Oil signature bonuses | 0.0 | 0.0 | 0.8 | 0.0 | 0.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total expenditure and net lending | 31.4 | 40.6 | 34.2 | 36.2 | 44.1 | 36.9 | 37.3 | 35.9 | 36.2 | 33.9 |
| Personnel costs | 9.1 | 8.8 | 8.9 | 8.7 | 8.6 | 8.6 | 8.5 | 8.5 | 8.4 | 8.4 |
| Interest due | 0.7 | 0.4 | 0.8 | 0.4 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Nonwage noninterest current expenditure | 8.7 | 8.7 | 8.5 | 8.7 | 8.1 | 8.4 | 7.9 | 8.2 | 7.6 | 7.6 |
| Treasury funded capital expenditures | 0.9 | 0.9 | 0.7 | 1.0 | 0.7 | 1.9 | 1.6 | 2.5 | 2.2 | 2.5 |
| Donor funded capital | 11.8 | 20.8 | 14.7 | 16.6 | 20.2 | 16.6 | 17.9 | 15.5 | 16.7 | 14.0 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| expenditures | | | | | | | | | | |
| HIPC Initiative-related social expenditure | 0.2 | 1.0 | 0.6 | 0.9 | 0.9 | 0.6 | 0.6 | 0.6 | 0.5 | 0.7 |
| Domestic primary balance [2] | -3.3 | -2.7 | -3.0 | -2.0 | -2.0 | -1.8 | -1.8 | -1.5 | -1.5 | -1.4 |
| Overall balance (commitment basis) | -5.5 | -8.8 | -6.3 | -2.3 | -9.0 | -2.0 | -3.8 | -0.4 | -2.5 | -0.4 |
| External sector | | | | | | | | | | |
| Current account balance (percent of GDP) | | | | | | | | | | |
| Including official transfers | -21.9 | -12.4 | -16.7 | -15.2 | -12.2 | -16.4 | -12.7 | -17.0 | -12.6 | -10.5 |
| Excluding official transfers | -32.6 | -28.5 | -28.2 | -32.7 | -29.5 | -34.3 | -29.7 | -35.1 | -29.3 | -26.4 |
| PV of external debt (percent of GDP) | 30.1 | 32.5 | 39.7 | 32.5 | 36.2 | 32.0 | 38.3 | 31.7 | 39.4 | 37.9 |
| External debt service (percent of exports) [3] | 3.7 | 4.8 | 4.3 | 4.2 | 4.8 | 3.9 | 4.3 | 3.7 | 4.0 | 3.8 |
| Export of goods and non-factor services (US$ millions) | 88.5 | 93.5 | 80.4 | 101.5 | 87.7 | 108.4 | 94.1 | 115.9 | 100.2 | 108.5 |
| Gross international reserves [4] | | | | | | | | | | |
| Millions of U.S. dollars | 56.5 | 66.9 | 61.0 | 80.5 | 72.8 | 97.7 | 75.9 | 102.7 | 82.4 | 87.6 |
| Months of imports of goods and nonfactor services [5] | 4.2 | 4.0 | 4.4 | 4.5 | 5.0 | 5.1 | 5.0 | 5.1 | 5.1 | 5.0 |
| National Oil Account (US$ millions) | 9.9 | 8.0 | 10.3 | 6.5 | 11.5 | 5.3 | 9.3 | 4.3 | 7.6 | 6.2 |
| *Memorandum Item* | | | | | | | | | | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| GDP | | | | | | | | | | |
| Billions of dobras | 6,242 | 7,171 | 7,028 | 7,790 | 7,847 | 8,251 | 8,287 | 8,820 | 8,839 | 9,533 |
| Millions of U.S. dollars | 338.0 | 325.6 | 318.2 | 356.3 | 349.2 | 381.8 | 371.2 | 412.9 | 396.0 | 428.8 |

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.
[1]Central Bank (BCSTP) mid-point rate.
[2] Excludes oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.
[3] Percent of exports of goods and nonfactor services.
[4] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.
[5] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here:http://www.imf.org/external/np/sec/misc/qualifiers.htm.

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## ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS

| 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:** 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 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 | No | No |
| **Prior action 2:** 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 | No | No |
| **Prior action 3:** 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 | No | No |
| **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. | No | No |
| **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 | No | No |
| **Pillar B: Generate fiscal resources and savings and improve the quality of public expenditures** | | |
| **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. | No | Yes |