Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 06-Aug-2020| Report No: PIDC26378

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Sao Tome and Principe	P168335	STP COVID-19 Human and Economic Response, Recovery and Resilience DPO (P168335)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
AFRICA EAST	Nov 11, 2020	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Ministry of Planning, Finance and the Blue Economy	Ministry of of Planning, Finance and Blue Economy		

Proposed Development Objective(s)

The objective of this operation is to support the government's response to the human and economic impact of the COVID-19 pandemic and economy-wide and sectoral reforms for a stronger recovery.

Financing (in US$, Millions)

SUMMARY

Total Financing	10.00

DETAILS

Total World Bank Group Financing	10.00
World Bank Lending	10.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

Sao Tome and Principe (STP) is a low middle-income and small-island country that faces challenges typical of small states. The country consists of two main islands in the Gulf of Guinea with a surface area of 1,001 km2. STP is a multiparty democracy and a unitary state, and its total population is approximately 200,000 people, with 42.6 percent of the population at or below the age of fourteen. In 2018, the country's per capita gross national income was estimated at US$3,430 in purchasing power parity (PPP), and its per capita GDP was US$2,043. In 2018, the country's per capita gross national income was estimated at US$3,430 in purchasing power parity (PPP), and its per capita GDP was US$2,043. As of 2018, two-thirds of the population lived in poverty according to national poverty methodology, including 34.4 percent living on less than US$ 1.90 in PPP 2011 per person per day, the global poverty line. STP's development challenges are typical of small island nations, including a high fixed cost of public goods limiting effective investments in human development and geographic isolation and small market size as on obstacle to dynamic, competitive markets.

The country's GDP growth rate averaged 5 percent from 2001 to 2014 – STP's golden growth era - before starting to gradually decline, reaching 2.9 percent in 2018 and 1.3 percent in 2019. The economy's main growth drivers, public spending—mainly public investment financed by grants and loans—FDI, tourism, and agriculture, have declined or slowed down in recent years.1 Public investments declined due to a reduction in loan and grant disbursements. Grants dropped from an average of 15.2 percent of GDP in 2010-2015 to 10.6 percent in 2016-2019. FDI peaked in 2010 and 2011 during the initial oil licensing round but declined when no viable oil reserves were discovered. In recent years, the tourism sector, which generated US$61 million in 2018, has grown at a slower pace, and both the volume and value of agricultural products have fallen slightly. The value of the country's cocoa exports, the main cash crop, dropped by 5 percent between 2016 and 2019, mostly due to producers' inability to cope with unfavorable weather patterns and agricultural pests

The COVID-19 pandemic has severely affected STP's economy, primarily through losses in the tourism industry. Despite taking early measures to prevent infections brought in from outside the islands, STP has suffered a significant outbreak of COVID-19, recording 875 confirmed cases and 15 death as of August 5. The case rate of about 429 infections per 100,000 population is among the highest in sub-Saharan Africa. On top of the direct impact of the pandemic, STP's economy was hit by a near-total drop in foreign tourist arrivals since March. The tourism industry, which has been a driver of private sector growth in recent years and is responsible for a large share of formal employment, came to a stand-still, resulting in a loss of labor earnings, foreign exchange and fiscal revenues. A spike in newly detected COVID-19 cases in May forced the government to put in place rigorous social distancing, tightening restrictions on domestic activities that create opportunities for contagion. The impact of COVID-19 spread and reactive measures on services demands and supply further depressed economic activity, while scarce government capacities and resources had to be redirected to strengthen the overwhelmed health care system. By June 17, the government ended the State of Emergency (replacing it with a State of Calamity) and began preparing for a re-opening of borders. However, the spread of the virus has continued, with over 100 new COVID-19 cases detected in July.

Public revenues—especially tax revenues—were weak and declining even before the COVID-19 crisis. One of the main causes of STP's fiscal fragility is its low capacity to mobilize domestic revenues. Current expenditures are not excessively high and have generally been under control, leaving low tax revenue as the main source of budget imbalances. Current expenditures averaged 18.1 percent of GDP from 2010 to 2015, before declining to an average of 16.8 percent of GDP in 2016-2019. The domestic primary deficit increased from an average 1.6 percent of GDP from 2010 to 2015 to 3.3 percent of GDP from 2016 to 2018 but decreased to 0.4 percent of GDP in 2019, signaling that the persistence of the budget deficit is primarily due to underperforming tax revenues. Overall budget deficits have been reduced since 2010, but this is mostly due to reduced investment and interest costs. The COVID-19 crisis has forced the government to increase spending by 3.1 percent of GDP, while tax revenues have declined since the economic disruption began in late March of 2020, resulting in an increase in the primary deficit before grants.

The total debt-to-GDP ratio increased significantly from 58.5 percent in 2008 (when it completed the Heavily Indebted Poor Countries (HIPC) program and the Multilateral Debt Relief Initiative) to 94.8 percent in 2019. A large part of the public investment that boosted growth from 2001 to 2014 was paid for by external loans, which, though on cencessional terms, increased the publixc debt stock. The debt also increased during part of this period due to lower fuel prices in STP than abroad, creating a fuel subsidy that was assumed by the government in the form of debt with the fuel supplier. This subsidy has been reversed since 2016 as domestic prices are now higher than international prices and the difference is being used to gradually reduce this debt. The increase in external debt slowed after 2015 due to lower external loan disbursements, the forgiveness of pre-HIPC debt from China, and gradual amortization of debt related to past fuel subsidies. However, domestic debt increased. An expansion of the electricity grid provided access to energy to more people in both islands, but greater access generated new public debt from the loss-making utility (EMAE) whose debt is guaranteed by the government. Insufficient revenues resulted in the government accumulating arrears with EMAE, the telecom company (CST) and other suppliers, and domestic banks.

STP, a grant-only IDA country due to its small-state status and debt distress situation, has an active IDA program. The country benefited from the increase in the IDA18 base allocation that more than tripled the country's envelope, allowing IDA to increase the size of development policy operations (DPOs) and finance transformational projects in energy and transport, while upgrading current engagements on education and social protection as well as capacity building for public administration. Moreover, the expanded IDA envelope was used to adjust a larger IDA program to the country's urgent needs in the COVID-19 crisis.

Relationship to CPF

The proposed operation is aligned with the Country Partnership Strategy (CPS) 2014-2018, which was extended to 2020, and the twin goals of ending extreme poverty and promoting shared prosperity in a sustainable manner. The CPF is built into two pillars: (i) supporting macroeconomic stability and national competitiveness; and (ii) reducing vulnerability and strengthening human capacity. In line with the CPF, the proposed operation is the first of a programmatic DPO series which supports the Government of STP (GoSTP) in mitigating the impact of the COVID-19 crisis on businesses, jobs and the financial sector, while setting the foundations for higher and more sustainable economic growth in the medium and long term. The DPO also supports the GoSTP in mitigating the impact of the COVID-19 crisis on lives and livelihoods and strengthening institutions for investment in human capital.

C. Proposed Development Objective(s)

The proposed development objective of this operation is to support the government's response to the human and economic impact of the COVID-19 pandemic and economy-wide and sectoral reforms for a stronger recovery.

Key Results

In line with these objectives, the key expected results for this operation are as follows: For Pillar I it is expected that there will be an improvement in STP's performance on the Global Health Security (GHS) index to a score equal or greater than 20; FETP will train 20 frontline epidemiologists; there will be a reduction in the dopout rate of girls in secondary school; there will also be a reduction in the share of education wage bill spending spent on overtime pay; and the number of beneficiaries covered by social protection programs will increase to 7,500. For Pillar 2 it is expected that domestic tax revenues as a percent of GDP will increase to 15 percent; STP will publish a borrowing plan; 80 percent of banks will be complient with regulations related to loans classification and provision, capital adequacy and AML/CFT; there will be an increase in coverage of credit registry to 25 percent; the Doing Business getting credit strength of legal rights index will improve to a score equal to 4; the number of tourist arrivals will increase; and net fiscal losses in the energy sector will decrease from 4 to 2 percent of GDP.

D. Concept Description

The proposed operation, in the amount of SDR 7 million (equivalent to US$10 million), is the first in a proposed programmatic series of three development policy operations (DPOs). The first DPO directly supports policy responses to COVID-19 and is strucutred into two pillars: (i) to support the GoSTP in mitigating the impact of the COVID-19 crisis on lives and livelihoods and strengthening institutions for investment in human capital; and (ii) to support the GoSTP in mitigating the impact of the COVID-19 crisis on businesses and jobs and lay the institutional foundations for higher and more sustainable economic growth.

The proposed operation is aligned with pillars II and III of the GoSTP´s program. Under the pillar II, the government aims to achieve a robust economic growth and job creation. The operation will support the strategic police objective to strengthen domestic revenues, transparency and debt managament, therefore contributing to reinforce fiscal sustainability. In addition, the operation will support measures that mitgate the financial sector impacts of COVID-19 and enhance financial inclusion and financial sector resilience. The first DPO will also support the government´s objective to enhance the long-term recovery through improved efficiency in the energy sector. Finally, under pillar III of GoSTP's program, the operation will support the government´s objective to improve the quality of health and social protection through measures to strength the health sector institutional capacity, and to extend the coverage of the cash-transfer program. Moreover, the proposed operation directly supports girl's education and women's empowement and investing in human capital, especiallly targeting equity in access to learning by ensuring that pregnant girls will not be excluded from continuing their studies in the day shifts.

The future DPOs in the proposed programatic series build upon the first operation, deepening reforms in a step-by-step approach in the supported areas, in synergy with other ongoing World Bank operation. Indicative triggers consist of measures to strentghen GoSTP capacity to respond to health emergencies and improve local capacity to fight epidemics, strentghen prevention of gender based violence and promote sexual and reproductive health among adolescent to prevent early pregnancies, increase accountability and transparency to promote the efficient use of education funds, strentghen the social protection framework for poverty reduction and girls' empowerment, strentghen debt management and domestic revenue mobilization, address financial sector stability and integrity while improving access to financial services, support the recovery of the tourism sector and enable high-value exports, strengthen the institutional framework for the tourism sector and remove obstacles to entry of domestic and foreign investors, and further improve efficiency and financial performance in the power sector.

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

Overall, the proposed DPO supports policy and institutional changes that are expected to have poverty-reducing effects in the short, as well as in the medium - to long-term. The main direct poverty-reducing effects from this DPO come from the support to the expoansion of social protection cash transfer to poor and vulnerable families and the protectin of formal employment though temporary wage subsidies. Other refroms supported under the prosposed programatic series, such as reforms mobile money and financial inclusion are also expected to have postive impacts on the poor. The short-term negative effect on poverty could result from the introduction of VAT. However, the introduction of the VAT will help improve the fiscal position of the government and to improve macro-stability and economic growth in the medium to long term. In turn, this could help prevent economic crisis-induced increases in poverty. Potential poverty impacts form the prohibition of incandescent lighbulbs will be mitigated though the program of providing households with new LED bulbs in exchange.

Environmental, Forests, and Other Natural Resource Aspects

Specific policies supported by the DPO series are not expected to have a significant negative effect on STP's forests, water resources, habitats, or other natural resources. The country has a legal and institutional framework to manage and respond to environmental challenges. The General Directorate of Environment (DGE), under the Ministry of Infrastructure, Natural Resources and Environment (MIRNA), is the central institution responsible for environmental management. It oversees all projects expected to have a potential positive or negative impact on the environment. Even though an institutional and legal framework is in place, the inconsistent monitoring, compliance, and enforcement of environmental laws and regulations are of concern, and some prior actions to be implemented under this proposed DPO series are likely to have environmental effects and therefore need to be scrutinized and closely supervised. The elimination of incandescent bulbs, replacing them with more efficient LED can bring environmental benefits. Positive environmental impacts on deployment of LED bulbs are related to its lifecycle environmental impacts, which are significantly less in comparison to the traditional incandescent bulbs. Moreover, the use of LED bulbs can contribute to significant energy savings, lower local pollution, and reduce greenhouse gas (GHG) emissions

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APPROVAL

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