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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
PROGRAM DOCUMENT
FOR A PROPOSED LOAN
IN THE AMOUNT OF US\$7 MILLION TO
THE REPUBLIC OF SEYCHELLES
FOR THE
DISASTER RISK MANAGEMENT DEVELOPMENT POLICY LOAN WITH A
CATASTROPHE DEFERRED DRAWDOWN OPTION
AUGUST 29, 2014

Urban, Rural and Social Development (GURDR)
Southern Africa Country Department 2 (AFCS2)
Africa Region

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**REPUBLIC OF SEYCHELLES
CURRENCY EQUIVALENTS**

CURRENCY UNIT: SEYCHELLES RUPEE (SR)
US\$1 = SR 12.34 (MAY 8, 2014)

WEIGHTS AND MEASURES

METRIC SYSTEM

FISCAL YEAR

JANUARY 1 – DECEMBER 31

ABBREVIATION AND ACRONYMS

AFD	French Development Agency
AfDB	African Development Bank
Cat DDO	Catastrophe Deferred Drawdown Option
CBS	Central Bank of Seychelles
CPS	Country Partnership Strategy
CRED	Centre for Research on the Epidemiology of Disasters
DaLA	Damage, Loss and Needs Assessment
DDO-DPLs	Deferred Drawdown Option for Development Policy Loans
DFID	United Kingdom Department for International Development
DPL	Development Policy Loan
DRDM	Division of Risk and Disaster Management
DRM	disaster risk management
DRR	disaster risk reduction
EEZ	exclusive economic zone
EFF	Extended Fund Facility
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
GFDRR	Global Facility for Disaster Reduction and Recovery
GoS	Government of Seychelles
HFA	Hyogo Framework for Action
IBRD\Bank	International Bank for Reconstruction and Development
IEG	Independent Evaluation Group
IMF	International Monetary Fund
IOC	Indian Ocean Commission
IPCC	Intergovernmental Panel on Climate Change
JICA	Japan International Cooperation Agency
MDG	Millennium Development Goals
MEE	Ministry of Environment and Energy
M&E	monitoring and evaluation
MoFTI	Ministry of Finance, Trade, and Investment
MTNDP	Medium-Term National Development Plan
MTEF	Medium-Term Expenditure Framework
NDC	National Disaster Committee

NDRMP	National Disaster Risk Management Plan
OFDA	Office of U.S. Foreign Disaster Assistance
PDO	Project Development Objective
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
SADC	Southern African Development Community
SEYPEC	Seychelles Petroleum Company
SOE	State-owned enterprise
UNDP	United Nations Development Programme

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REPUBLIC OF SEYCHELLES

DISASTER RISK MANAGEMENT DEVELOPMENT POLICY LOAN WITH CAT DDO

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LOAN AND PROGRAM SUMMARY

REPUBLIC OF SEYCHELLES

Disaster Risk Management Development Policy Loan with a Cat DDO

Borrower	Republic of Seychelles
Implementing Agency	Ministry of Finance, Trade, and Investment
Financing Data	IBRD Loan: a USD-denominated IBRD flexible loan with fixed spread with disbursement-linked level repayments, a final maturity of 18 years, including a grace period of 10 years. Amount: US\$7 million.
Operation Type	Disaster Risk Management Development Policy Loan with a Catastrophe Deferred Drawdown Option (DPL with Cat DDO)
Pillars of the Operation and Program Development Objective(s)	<p>The two pillars of the proposed operation are: (i) strengthening the institutional/legal framework for disaster risk management, and (ii) integrating disaster risk reduction into development planning and decision-making.</p> <p>The development objective of the proposed operation is to strengthen the Government of Seychelles' Disaster Risk Management policy and reform agenda and enhance its capacity to efficiently respond to disasters.</p>
Results	<ul style="list-style-type: none"> • Five districts have updated protocols for preparedness and response; • The National Emergency Operations Center conducts annual drills and exercises; • Public DRM education and awareness campaigns are conducted twice a year; • A least five sector specific contingency plans have been updated and are officially approved by the Cabinet of Ministers; • A geospatial risk data sharing platform is updated annually; • Line ministries, agencies and the private sector include risk information in their development projects.
Overall risk rating	The proposed loan is rated as presenting a <i>moderate</i> risk, due to macroeconomic, policy, institutional, and coordination challenges.
Operation ID	P148861

International Bank for Reconstruction and Development
Program Document for a Proposed
Disaster Risk Management Development Policy Loan with Cat DDO
to the Republic of Seychelles

1. INTRODUCTION AND COUNTRY CONTEXT

1. This program document proposes a US\$7 million Disaster Risk Management Development Policy Loan with a Cat DDO (DPL with Cat DDO) as budget financing for the Government of Seychelles (GoS) for an initial period of three years¹. The development objective of the proposed operation is to strengthen the Government of Seychelles' disaster risk management (DRM) policy and reform agenda and enhance its capacity to efficiently respond to disasters. To achieve this objective, the operation supports reforms in two policy areas: (i) strengthening the institutional/legal framework for disaster risk management, and (ii) integrating disaster risk reduction into development planning and decision-making.

2. Seychelles is a small, service-based, middle-income, island-state economy. With a gross national income per capita of US\$12,180 in 2012, it is classified as a high-middle-income country. It has an estimated population of 88,300 (2012), comprises 115 tropical islands spread over 45,166 hectares in the Indian Ocean, and has an exclusive economic zone (EEZ) of almost 1.4 million square kilometers in one of the world's major tuna fishing grounds. Tourism and fishing/fish processing are the major pillars of the economy, contributing 25 percent and 8 percent of gross domestic product (GDP) respectively. Seychelles has better social indicators than comparable small countries. It has already achieved most of the Millennium Development Goals, especially for education, health, poverty eradication, and the environment.² Poverty in Seychelles is relatively low, with less than 2 percent of the population living on less than US\$2 per day. Inequality increased between 2000 and 2007; the Gini coefficient went from 0.42 to 0.65.

3. Seychelles enjoys a stable political system and has made significant progress in improving public sector governance. In the last election (May 2011), the incumbent (Mr. James Michel) was elected for another five-year term.³ Since 2008, the Government has implemented a series of reforms to address public sector governance issues, which improved a number of governance indicators.⁴

4. Seychelles has come a long way since its 2008 crisis. After high external indebtedness and a loss of competitiveness built up over prior years had depleted foreign exchange reserves and led to a payment default in 2008, Seychelles Government energetically pursued reforms, with support from the International Monetary Fund (IMF) and World Bank, among others. Its economic restructuring program focused on liberalizing the exchange regime, significantly

¹ The standard drawdown period for the Cat DDO is three years, renewable four times (for a total of 15 years).

² Gross enrollment in primary and secondary education is close to 100 percent. The country's life expectancy at birth is 73 years, compared to 68.3 for Fiji and 70.7 for Cabo Verde.

³ Following the September 2011 Parliamentary elections, the ruling party holds all but one seat in the National Assembly. The main opposition group boycotted this election, leading to the establishment of the Forum for Electoral Reform led by the Electoral Commission. The commission submitted a reform proposal, which is currently being studied by the authorities.

⁴ Seychelles ranked at the 55th percentile on Rule of Law in the 2012 World Bank's Worldwide Governance Indicators, and it ranked 4th in the 2013 Ibrahim Governance indicators of African countries, in line with previous years.

tightening fiscal policy, and reducing the state's role in the economy to boost private sector development. The public debt portfolio was restructured with the Paris Club and other private creditors. Seychelles managed to secure generous debt relief, which together with fiscal consolidation has put it on a path to fiscal and external sustainability.

5. These achievements aside, a number of challenges remain to be addressed. Seychelles confronts the challenges inherent in a small and remote island state that is highly dependent on tourism and vulnerable to a range of potential shocks. Its vulnerability is high given its exposure to the global economy, especially the predominance of European tourism in Seychelles economy. Limited land, capital, and human resources inhibit its ability to benefit from economies of scale in production. Public debt is high and the need for external gross financing will remain high due to growing debt service and a high (albeit declining) current account deficit, as well as an underdeveloped domestic financial market. The investment climate needs to be strengthened to harness private sector growth⁵, while bottlenecks in infrastructure remain a critical constraint. In the social sectors, teen pregnancy is a major issue⁶ as well as non-communicable diseases and the relatively poor quality of education outcomes, particularly in science.⁷ Continued reforms and strong macroeconomic policies are needed to address these challenges.

6. As a small island state, Seychelles is exposed to a disproportionately high economic, social and environmental impact of natural and environmental disasters. The country's location, topography and landscape make it vulnerable to tropical cyclones, tsunamis, storm surge, extreme rainfall, flooding, landslides, rockslides and forest fires⁸. These adverse effects are further exacerbated by the medium to long term effects of climate change and present significant risks to the country's sustainable development. Vulnerability characteristics such as the concentration of population and development in narrow coastal zones make the country extremely sensitive to the natural hazards and associated impacts. Adaptation to the adverse impacts of climate change and a robust disaster prevention and mitigation program are major priorities for Seychelles.

7. Between 1980 and 2013 the impact of natural disasters totaled US\$40.1 million, affecting 21,328 people.⁹ Major events included (i) severe floods on the three main islands and a landslide at St. Louis, leading to US\$0.16 million in damages (August 31–September 1, 1985); (ii) Cyclone Ikonjo on Desroches Island, causing US\$1.5 million in damages (May 17–23, 1990); (iii) the ENSO rainfall event of August 12–17, 1997, leading to US\$1.7 million in damages; (iv) the Great Indian Ocean Tsunami of December 26, 2004, resulting in US\$30 million in damages; (v) the Indian Ocean Tsunami/Sumatra on September 12, 2007 (no damage data available); and (vi) Tropical Cyclone Felleng in January 2013, causing floods, mudslides, and rock fall, resulting in US\$8.4 million in damages (equivalent to 0.77 percent of the 2012 country's GDP) and losses in key sectors.

⁵ Seychelles is ranked 80th on the 2014 World Bank Doing Business index for "Ease of Doing Business," a fall from position 74 in 2013.

⁶ Thirty-two percent of all first pregnancies occur among girls aged 15 to 19.

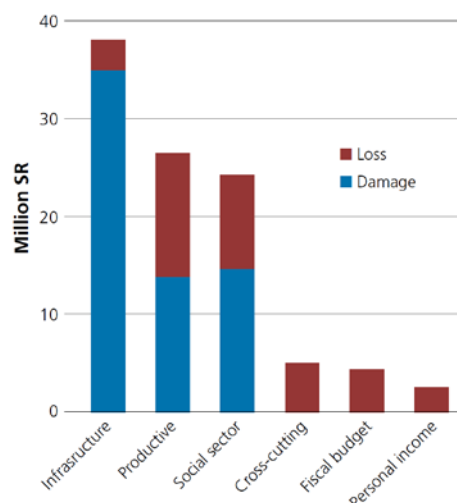
⁷ The Bank and other partners are involved in trying to address the challenges in health and education. The Bank has just undertaken a public expenditure review in those sectors.

⁸ United Nations Development Programme: Disaster risk profile of the Republic of Seychelles (July 2008), Government of Seychelles/World Bank Damage, Loss and Needs Assessment (2013).

⁹ Emergency Events Database EM-DAT: The Office of U.S. Foreign Disaster Assistance (OFDA)/Centre for Research on the Epidemiology of Disasters (CRED) International Disaster Database, Université catholique de Louvain, Brussels.

8. The most recent Damage, Loss and Needs Assessment (DaLA) carried out by the GoS took place in January 2013, after the heavy rains resulting from Tropical Cyclone Fellingeng, after which recovery and reconstruction needs were estimated at US\$30.3 million.¹⁰ This estimate is based on a disaster resilience framework that includes a short-term action plan to repair the damages and restore the losses, and a medium- to long-term action plan that integrates risk reduction into development.

Figure 1: 2013 Floods Damage and Losses by Sector



Source: Seychelles Damage, Loss and Needs Assessment (DaLA) 2013 Floods

9. **The GoS places a high priority on increasing disaster resilience by having a comprehensive disaster risk financing strategy in place.** One of the recommendations of the DaLA was to provide a DPL with Cat DDO as part of a larger recovery and reconstruction strategy. This request for a DPL with Cat DDO by the GoS will complement an ongoing program to strengthen disaster risk management, with an emphasis on disaster prevention and preparedness, as opposed to only disaster response.

2. MACROECONOMIC POLICY FRAMEWORK

2.1 Recent Economic Developments

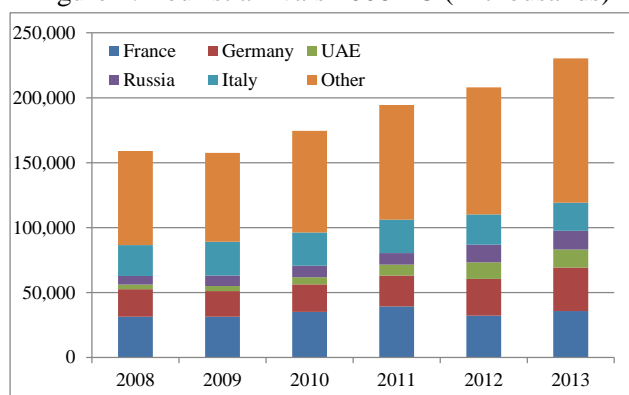
10. **Economic growth in Seychelles accelerated to 3.5 percent in 2013, compared to 2.8 percent in 2012.** Tourist arrivals grew by 10.7 percent, resulting in an 11 percent increase in tourism earnings for the year, despite a marginal decrease in the average length of stay. The tourism sector (which directly contributes 25 percent to GDP) proved resilient despite uncertainties in the economies of Europe, which supply 70 percent of Seychelles' tourists, and the elimination of direct flights to Europe.¹¹ Tourist arrivals from non-traditional markets (Russia, China, the Middle East, and Germany) also increased as a result of a consistent and

¹⁰ Seychelles Damage, Loss and Needs Assessment (DaLA) 2013 Floods, a Report by the Government of Seychelles with the support of the European Union, United Nations, and the World Bank (June 2013).

¹¹ Air Seychelles was restructured in 2012 and entered into a strategic partnership with Etihad Airways.

aggressive marketing strategy. Production in other sectors such as tuna and telecommunications also experienced strong growth of 17 percent and 7 percent respectively. On the downside, the delaying in construction of several large hotel projects translated into a contraction in the construction sector of 1.2 percent. In addition, the Seychelles Petroleum Company (SEYPEC) continued to incur losses in its tanker operations.¹²

Figure 2: Tourist arrivals 2008–13 (in thousands)



Source: National Bureau of Statistics.

11. Fiscal performance continues to be strongly supported by expenditure containment.

Tax collection at 32.4 percent of GDP was lower than forecast in the 2013 public budget (37.6 percent of GDP), with most tax categories underperforming in relation to budget projections.¹³ This was partially compensated for by non-tax revenues that were better than projected (4.5 percent of GDP), composed mainly of dividends from parastatal bodies. The government adjusted its public expenditure during the year in line with the deficit objective. This was largely driven by a decline in capital spending to 9 percent of GDP (5 percentage points lower than budget projections) and a reduction in transfers to the public sector to 4.0 percent of GDP, compared to 4.3 percent of GDP in 2012. As a result, the primary fiscal surplus for 2013 stood at 4.7 percent of GDP, in line with the target needed to reach the 50 percent debt-to-GDP ratio in 2018.

12. **Debt reduction accelerated and debt restructuring is almost complete.** The debt restructuring effort, launched in the aftermath of the country's 2008 debt crisis when total debt had reached 131 percent of GDP and external debt was 83 percent of GDP, is now almost complete, pending final resolution with Russia.¹⁴ As a result, public sector debt declined to 65.3 percent of GDP by the end of 2013 compared to 77.5 percent of GDP in 2012.

13. The current account deficit improved in 2013, due mainly to increased tourism and tuna exports, and was comfortably financed by foreign direct investment (FDI).

The current account deficit stood at 16.9 percent of GDP in 2013, a decline from 25.2 percent of GDP in 2012. This was the result of an 18 percent increase in exports of goods and services, supported by 11 percent growth in tourism earnings and a 25 percent increase in tuna exports. Import

¹² SEYPEC now has a new contract with German Tanker Shipping that is expected to stop the losses.

¹³ ¹³ Despite successful introduction of VAT in 2013, toward the end of the year, VAT receipts began to fall a little short of projections in part because of a decline of activity in some industries (such as the construction sector).

¹⁴ Russia signed the agreed Paris Club minutes, but has yet to reach a bilateral agreement with Seychelles to implement the terms.

growth was moderate at 6.4 percent, with net oil imports—about 8 percent of GDP as two-thirds of oil imports are re-exported—remaining at the 2012 level. Despite a slowdown in FDI associated with the phasing-out of some large hotel projects, FDI stood at 13.2 percent of GDP¹⁵, which together with high private inflows translated into a positive balance of payments. As a result, foreign exchange reserves increased by more than 40 percent to reach US\$423 million, the equivalent of 3.8 months of imports, compared to 3.0 months of imports in 2012.

14. Inflation continued on a downward path to reach 4.3 percent in 2013, and excess liquidity in the banking system is being addressed. Inflation reached a peak year-on-year rate of 13.1 percent in 2012, before declining to lower levels, thanks to successful monetary tightening. The introduction of VAT in the first quarter of 2013 and the rebalancing of utility tariffs in November 2013 caused a temporary uptick in inflation. In addition, nominal exchange rate appreciation associated with strong tourism receipts and lower imports of investment-related goods have further supported disinflation. The continuous buildup of international reserves by the Central Bank of Seychelles (CBS) was, however, not sterilized, which created excess liquidity in the banking system to the tune of 7 percent of GDP, thus undermining the transmission mechanism of the authorities' monetary policy. This is being resolved in 2014 as the Treasury and the CBS have agreed to issue medium-term treasury bonds representing 4.5 percent of GDP to deal with excess liquidity.

15. The financial sector remains strong, albeit with challenges related to high costs and relatively low financial inclusion. Indicators of financial sector stability and soundness have improved since 2010 but require careful monitoring. The ratio of capital to risk-weighted assets stood at 26.7 percent in 2013, in line with 2012 figures and above the minimum adequacy ratio of 12 percent. In addition, the share of non-performing loans was 9.4 percent, which is still high, but declining. Overall, the financial system is relatively small and underdeveloped, and the ratio of domestic credit to GDP is 35 percent.¹⁶ Limited access to credit and high lending spreads continue to be serious limitations. Access is constrained by weak capacity in the commercial banking sector to serve small and medium enterprises (SMEs) and by the lack of a coherent strategy for developing the integrated financial sector.¹⁷ On the positive side, deposit accounts in Seychellois banks are high.¹⁸ High lending spreads reflect the perceived risks of lending to the private sector and high costs of operations in a small market, as well as limited competition in the banking sector. The situation is improving, with commercial lending steadily growing in real terms, albeit at a lower rate than the rate of expansion of deposits, and average interest rate spreads dropping from an average of 12.2 percent in 2010 to 8.2 percent in December 2013.

¹⁵ The IMF revised the FDI numbers to include an estimate for the offshore sector in the balance of payments (US\$60 million in 2014).

¹⁶ Compared, for instance, to 88 percent in Mauritius.

¹⁷ The World Bank is currently undertaking a comprehensive assessment of the financial sector to help the government devise a Financial Sector Development Implementation Plan.

¹⁸ In 2012, there were a total of 84,438 deposit accounts in Seychellois banks for a population of 88,303, of which about 63,400 are adults and among which an estimated 40,000 are considered bankable by commercial bankers. In addition, there were 12,726 commercial bank and credit union borrowers.

Table 1: Selected Economic Indicators, 2011–16

Indicator	2011	2012	2013	2014 (proj)	2015 (proj)	2016 (proj)
National Income and prices (annual percent growth)						
Real GDP growth	7.9	2.8	3.5	3.7	3.8	3.6
Consumer Price Index inflation (end-of-period)	5.5	5.8	3.4	4.0	3.2	3.1
Government Budget (percent of GDP)						
Total revenues and grants	37.7	38.9	36.5	33.8	32.7	32.5
Tax revenue	35.3	34.4	32.4	31.0	30.9	30.9
Non-tax revenue	4.0	4.7	4.5	3.4	3.2	3.2
Expenditure and net lending	35.2	36.7	36.5	33.2	32.4	32.0
Current expenditure	27.2	25.8	27.1	26	25.2	24.7
Wages and salaries	6.7	6.5	6.8	7.0	6.9	6.8
Capital expenditure	8.0	10.4	9.0	6.4	5.8	5.6
Overall balance, accrual basis (GFS)	2.4	2.2	0.0	0.7	0.3	0.5
Primary balance, accrual basis (GFS)	5.3	5.7	4.7	4.0	3.2	3.2
Financing:						
Foreign financing	0.0	0.3	0.7	1.7	0.4	0.0
Domestic financing	-1.3	-3.2	-0.8	-2.7	-0.9	-0.5
Privatization and long-term lease of fixed assets	0.7	0.5	0.3	0.4	0.2	0.0
Total public debt	73.3	77.5	65.3	64.5	61.1	57.5
Total domestic debt ^{a/}	27.7	32.2	27.7	27.3	24.6	22.5
Total external debt	45.6	45.3	37.6	37.2	36.5	35.0
External Sector and Gross Financing Requirements (in US million)						
Exports of Goods and Services	947	932	1,102	1,125	1,177	1,228
Tourism earnings	291	310	344	366	390	415
Imports of Goods and Services	1,172	1,174	1,249	1,342	1,371	1,406
Current account deficit, including official transfers	294	285	234	279	276	265
Amortization of medium- and long-term debt	10	17	23	22	24	35
Gross External Financing requirements	304	301	256	300	299	299
Available financing	264	327	370	271	290	294
Net FDI	231	208	184	244	231	241
Medium- and long-term borrowing	--	20	30	21	31	33
Gross official reserves (end of year)	277	307	423	455	481	506
Reserves in terms of months of imports	2.8	3.0	3.8	4.0	4.1	4.2
Memo Items						
GDP (US\$ million)	1,075	1,129	1,386	1,476	1,552	1,645
Total external public sector debt (US\$ million)	490	512	521	549	567	576
Current acc. balance, incl. official transfers (% GDP)	-27.4	-25.2	-16.9	-18.5	-17.7	-16.0
FDI (% GDP)	21.5	18.4	13.2	16.1	14.9	14.7
Exchange rate (Seychelles Rupee per dollar)	13.7	13.0	12.1	-	-	-

Source: National Bureau of Statistics, Central Bank of Seychelles, IMF, and staff estimates.

Note: a/ Includes debt issued by the Ministry of Finance for monetary purposes.

2.2 Macroeconomic Outlook and Debt Sustainability

16. **The economic outlook is broadly positive, although with some downside risks.** Real GDP growth for 2014 is forecast to edge up to 3.7 percent and remains at that level in the medium term as IT-enabled services develop (building on the recently installed transoceanic fiber-optic cable) and the tourism sector continues to diversify into non-traditional markets. The tourism sector is expected to grow, albeit at a slower pace than in 2013, reflecting an expected modest rebound in Europe and further penetration into new markets such as Russia and Asia. In this scenario, tourism earnings are expected to rise gradually to over US\$400 million in 2016 compared to US\$344 million in 2013.¹⁹ Growth over the medium term will continue to depend on prospects in the tourism sector and remain sensitive to developments in the euro zone, even as market diversification (within and outside Europe) will help.

¹⁹ While penetrating new markets will certainly help, experience shows that this takes time. The policy of developing additional outer islands for tourism will also be useful in the longer term.

17. Fiscal policy is geared toward reducing the debt-to-GDP ratio to 50 percent by 2018, which will further reduce external vulnerabilities. The primary budget surplus is projected to be around 4 percent of GDP in 2014 and remain at around 3.2 percent of GDP in the medium term in line with the debt target. Revenues are projected to fall by 1.4 percent points, and limited additional tax reforms with the potential to boost tax revenues are envisaged after successful revenue reforms were implemented in the recent past.²⁰ The government expects to reduce public expenditure as a share of GDP by 3.2 percentage points in 2014 and beyond. Close monitoring will be needed to ensure that the government's priorities receive adequate resources within the overall envelope. For instance, a recent salary increase in the public service of between 10 to 20 percent that has raised the wage bill from 6.8 percent of GDP in 2013 to 7.0 percent of GDP in 2014 has been accompanied by the freezing of recruitment and a reduction in non-priority expenditures. In addition, the government's efforts will focus on accelerating infrastructure development to compensate for years of underinvestment. As the government is gradually aligning utility tariffs with cost recovery levels, this will further open the space for private sector financing of the infrastructure program.

18. The 2014 Debt Sustainability Analysis (DSA) projects that the debt-to-GDP ratio will gradually be reduced to 50 percent by 2018 from 65 percent in 2013.²¹ This reduction is also expected to cause external debt to decline from 38 percent of GDP in 2013 to 31 percent of GDP by 2018. This scenario will require sustained fiscal containment and the steady implementation of reforms. However, significant risks still exist given Seychelles' high public and external debt, short-term debt profile, and extensive need for gross external financing. Several potential individual shocks²² could increase the debt-to-GDP ratio above the 50 percent goal in 2018, but with a declining trajectory. Possible shocks to the external debt are a broadening current account deficit and a depreciation of the Seychelles rupee, but external debt after the shock would have a declining trajectory.²³ Rollover risks are partially offset by significant government deposits (around 20 percent of total rollover needs). In addition, ongoing government efforts to provide more medium-term monetary instruments will further reduce this risk. Should major shocks materialize, the government will need to maintain its commitment to fiscal discipline.

19. The need for gross external financing will remain high, associated with a large current account deficit and increasing debt repayments. The current account deficit is expected to remain at around 16 percent of GDP in the medium term, with growth in the tourism industry offsetting FDI-related imports. As a result of increasing debt repayments and income repatriation, gross external financing requirements will be around US\$300 million a year. This is expected to be financed by substantial FDI (around 80 percent of total requirements) with minimum recourse to additional external debt (around 10 percent of total requirements). Financing external requirements will therefore be very dependent on export gains (particularly in the tourism sector) and available FDI. The flexible exchange rate, which according to the IMF's Extended Fund Facility (EFF) is broadly in line with fundamentals, will provide a buffer against

²⁰ Revenue efforts will focus on streamlining exemptions, improving excise management, enhancing audit functions, and strengthening compliance.

²¹ This baseline projection is based on 3.7 percent real GDP growth rate, 3 percent inflation rate over the medium term, a primary fiscal surplus of 3 percent until 2017, and a current account balance that converges to 16 percent in the medium term.

²² The shocks considered include (i) two-year GDP growth of -1.3 percent; (ii) a two-point increase in interest rates; (iii) a 30 percent real exchange rate depreciation; and (iv) a primary fiscal surplus during two years that is two percent points lower than the baseline projection.

²³ If the current account increases to around 18 percent of GDP, the external debt is projected to rise to 48 percent of GDP by 2019. Similarly, a 30 percent depreciation of the Seychelles rupee would increase external debt to around 44 percent by 2019.

external shocks to the economy, and the CBS will continue to progressively build up international reserves, mainly through purchases on the domestic interbank market, albeit at a more moderate pace than previously. International reserves are projected to be within the range of 4 to 4.2 months of imports in the medium term.

20. Overall, Seychelles' macroeconomic framework for 2014–16 is adequate for development policy lending. This assessment is based on the country's broadly favorable macroeconomic performance during the past three years, policymakers' continued commitment to sound macroeconomic management, and the progress made on implementing structural reforms. While substantial external uncertainty may affect the economy in 2014 and beyond, Seychelles has recently established a track record of quickly recovering when confronted with economic adversity. The Government's growing external reserves, a flexible exchange rate, high Government deposits, and a fiscal surplus provide some bulwark against external shocks, which will be further reinforced by the contingent lending from this operation. Furthermore, reforms supported by this operation and by the IMF's EFF are helping Seychelles build up its economic resilience.

2.3 IMF Relations

21. The Bank's program has been closely coordinated with that of the IMF since 2008. Building on the success of its Stand-By Arrangement and the three-year EFF in Seychelles, the IMF approved a new three-year EFF for US\$17.8 million on June 4, 2014. The aim of the EFF is to reduce public debt to below 50 percent of GDP by 2018, gradually increase external reserves, implement an ambitious structural reform program to foster GDP growth, and improve public financial management (PFM) and oversight of State-owned enterprises (SOE). The IMF EFF and World Bank DPL have been closely coordinated to support the overall government reform program, particularly in areas such as pension and social assistance reform, SOE supervision, and the revised utility tariff structure. Together with the Commonwealth Secretariat, the Bank and the Fund have provided support for improving the fiscal terms of the petroleum model contract and revising the petroleum legislation. The Bank and the Fund are also jointly providing assistance for the Seychelles Medium-Term Debt Strategy (MTDS).

3. GOVERNMENT'S PROGRAM

22. The proposed activities in this operation were identified in close consultations with the GoS and are consistent with the following main national strategic development documents: (i) National Sustainable Development Strategy 2012-2020: this strategy seeks to mainstream disaster risk reduction as an important part of the key thematic areas of Climate Change, Land Use and Coastal Zones; and (ii) the Medium-Term National Development Plan Strategy 2013–2017: the strategy aims to reduce the risk and vulnerability of the people of Seychelles to natural and man-made disasters.

23. The Government of Seychelles recognized the increasing threat of natural disaster and responded by setting up a National Disaster Committee (NDC) in 1997. The NDC is a multisectoral body that functions as the “national platform” for coordination and policy guidance on disaster risk reduction. In 2006, the NDC secretariat was upgraded and established as the Division of Risk and Disaster Management (DRDM), which initially fell under the Office of the President and later under the Office of the Vice-President. It thus formed the operational body of

the NDC and oversaw day-to-day and comprehensive implementation of the disaster management program. Since July 1, 2010, as a result of government restructuring, the DRDM now falls under the mandate of the Department of Environment in the Ministry of Environment and Energy (MEE).

24. The DRDM is responsible for coordinating the disaster risk reduction effort in Seychelles as well as the emergency response in the event of a natural catastrophe or man-made emergency. The Department is also charged with executing the actions, regulations and directives towards the reduction of disaster impacts on human lives, goods and society. These actions include: planning, supervision, assessment, scientific research (risk mapping), information dissemination, education, public policy implementation and coordination of DRM initiatives with all national and international organizations.

25. In 2005, the government subscribed to the Hyogo Framework for Action (HFA) 2005–2015, which has provided a sound, comprehensive framework for the preparation of national initiatives and programs to integrate disaster risk reduction (DRR) across development sectors to develop and implement a comprehensive DRM program in Seychelles.²⁴

26. In 2011, a National Disaster Policy, directly linked to the HFA’s five pillars, was developed to guide the country to achieve its objectives regarding disaster preparedness, management, response and recovery.

Box 1. Seychelles Progress toward Building Disaster Resilience

Over the past two decades, Seychelles has increasingly advanced its efforts to improve resilience to disasters. The country is a signatory to both the HFA and the Intergovernmental Panel on Climate Change (IPCC) and has proactively invested in producing information on its underlying risks for disaster management and emergency preparedness. Main achievements to date include:

- A dedicated DRM governmental department
- Establishment of a National Disaster Committee
- A draft Disaster Management Strategic Policy Framework
- A multi-hazard disaster risk profile
- A National Emergency Operations Center and shelters
- Sector DRM contingency plans, including education, tourism, industry, and municipalities

27. Enhanced preparedness and awareness have reduced vulnerability to disasters. A new National Emergency Operations Center has been created and the government is currently developing a Master Plan for Disaster Risk Management. This plan, which builds on a multi-hazard risk assessment and contingency plans and strategies across sectors, is intended to be implemented across various sectors and by all stakeholders at various levels, from the national to community level.

²⁴ The HFA is a 10-year plan to make the world safer from natural hazards. It was endorsed by the UN General Assembly in the [Resolution A/RES/60/195](#) following the 2005 World Disaster Reduction Conference.

28. The authorities are strengthening the technical capacity for DRM and are working on putting a disaster risk financing strategy into place. These efforts will strengthen the government's capacity to respond to an adverse natural event, evaluate the impact of a disaster, and at the same time protect fiscal stability through risk-financing tools (risk sharing, risk pooling, contingent financing, and catastrophe-related bonds and insurance, for example). The country has established two reserve/savings funds for more frequent disasters with lower magnitude. These are a Budget Contingency Fund and a National Disaster Relief Fund. Additionally, Seychelles is a member of the Southwest Indian Ocean Risk Assessment and Financing Initiative (SWIO RAFI) and as part of that program, it is initiating the process of developing a disaster risk financing strategy. In collaboration with the local insurance industry, the GoS has introduced an agriculture insurance scheme and is planning to set up an emergency assistance scheme for fishermen. Seychelles is an active participant in regional and international DRM forums, including the Indian Ocean Commission (IOC) and the United Nations International Strategy for Disaster Reduction (UNISDR). A comprehensive disaster risk financing strategy is needed to protect the country against both recurrent and catastrophic natural disasters, which will strengthen the government's ability to use funds effectively.

29. However, in spite of progress experienced since 2006, there is still a lot of work to be done in establishing a full-fledged DRM framework. Notably, a legal foundation to provide the mandate and means to the DRDM to coordinate prevention and emergency response is lacking. Furthermore, the current National Policy is outdated and does not provide adequate guidance to implement DRM. Little information is available on multi-hazard risks, vulnerable areas, and historic and future impacts.

30. To increase disaster awareness, training programs have been launched for district level officials, school children and vulnerable communities. This, however, has not reached all the communities across the various islands. To improve land use planning, hazard maps for cyclones, storm surge, rainfall, floods, forest fires, and climate change issues have been developed; however, they are not yet widely applied. While progress has been made to improve institutional capacity to engage in DRM, gaps exist in the technical capacity of the agencies to implement a comprehensive DRM strategy.

4. THE PROPOSED OPERATION

4.1 Link to Government Program and Operation Description

31. Seychelles' island economy is vulnerable to climatic changes, which calls for urgent attention to strengthen resilience and response to natural hazards. Increasing development and the trends of global climate change, coupled with the constraints and vulnerabilities inherent in being an isolated small island archipelago, dictate the need for building resilience to disasters at community, district and national levels. In Seychelles this is an increasingly important component of the national pursuit of sustainable development.

32. Having recognized the progress that has been made in developing a DRM program, as well as the remaining challenges, this operation proposes a set of activities aimed at filling critical gaps in the current institutional framework to strengthen the government's ability to respond to natural disasters and effectively manage liquidity in the aftermath of a catastrophe. In terms of reforms, this operation focuses on further strengthening the institutional/legal

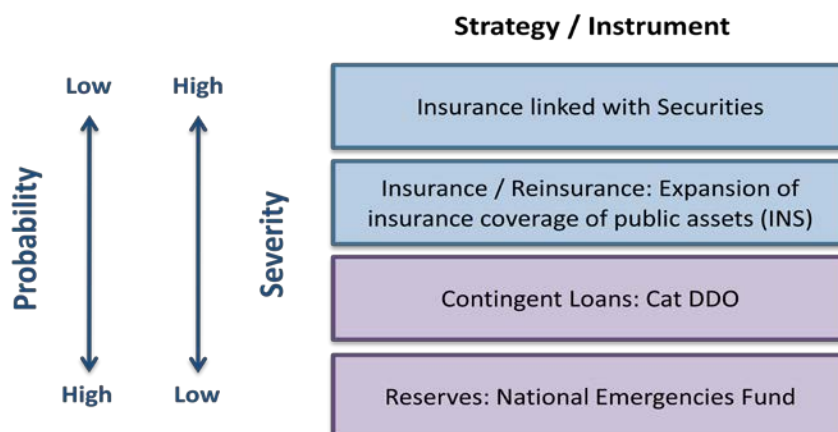
framework for disaster risk management and integrating disaster risk reduction into development planning and decision making. At the same time, it will enable the government to respond effectively to disasters by providing immediate liquidity to address urgent post-disaster needs.

33. **The 2013 floods, with an impact totaling US\$8.4 million, demonstrated the government’s need to access resources for emergency response.** The DPL with Cat DDO can thus help meet Seychelles’ need for immediate, liquid assets in the aftermath of a catastrophic disaster. This flexible and prompt financial tool is designed to address risks to which the country is prone. It will enable the GoS to focus on emergency response measures in the aftermath of a disaster rather than spend valuable time and resources trying to raise funds.

34. **The design of this DPL with Cat DDO takes into account the lessons learned from 25 years of Bank operations and programs in the area of disaster risk management, as reflected in the Independent Evaluation Group Report “Hazards of Nature, Risks to Development: An Evaluation of World Bank Assistance for Natural Disasters.”**²⁵ This operation also incorporates key lessons learned from prior DPLs with Cat DDO in Colombia (2008), Costa Rica (2008), Guatemala (2009), El Salvador and Peru (2010), and Panama and the Philippines (2011), and draws on experiences of the DPL with Cat DDO project recently approved in Sri Lanka in FY14. Key lessons learned include the following: (i) from an operational standpoint, a successful Cat DDO operation needs to carefully align actions and activities with government priorities; (ii) disaster risk management policy is most effective when based on adequate risk identification, including both the physical and fiscal risk; and (iii) the implementation of a DPL with Cat DDO should be set within a broader disaster risk financing strategy.

Box 2. Catastrophe Risk Financing Strategy

A risk financing strategy should differentiate between a range of higher-frequency/lower-cost events and lower-frequency/higher-cost events. Lower layers of risk (higher-frequency/lower-cost events) can generally be financed through reserve mechanisms, special budget appropriations, and budget reallocations. These sources of funds are rarely sufficient to face higher layers of risk for which other risk financing instruments are generally needed. This DPL with Cat DDO operation has been designed to provide liquidity in the case of medium-sized (or cumulative) disasters that cannot be funded with the internal reserves and to provide bridge financing while other sources of funding are being mobilized in the case of major disasters.



²⁵ “Hazards of Nature, Risks to Development: An IEG Evaluation of World Bank Assistance for Natural Disasters,” World Bank Independent Evaluation Group, World Bank, Washington, DC, 2006.

35. Operations undertaken as part of a programmatic approach create valuable synergies and efficiencies for World Bank teams and Government counterparts. In Seychelles, the DPL with Cat DDO operation is complemented by technical assistance grants provided by the Global Facility for Disaster Reduction and Recovery (GFDRR) to strengthen institutional and technical capacities and support. Additionally, given the small size of the country, and the fact that Government officials are few, preparation of the operation was done in parallel with the Third Sustainability and Development Competitiveness Loan which supports reforms that will: (i) improve the business climate; (ii) enhance fiscal transparency; (iii) improve public financial management; (iv) improve targeting of social assistance; and (v) increase fiscal oversight and controls over public enterprises.

36. The financial features of the DPL with Cat DDO are as follows:²⁶

- **Size.** Drawing on an analysis of lending space available within the existing IBRD envelope, the Government of Seychelles requested a loan of US\$7 million. This exceeds the maximum amount of DPL with Cat DDO funding, which should be no more than the lesser of 0.25 percent of GDP or US\$500 million, whichever amount is smaller. With a 2012 GDP of US\$1.205 billion, the stated limit would indicate an operation of US\$3.0125 million, which would be too small to fund the capacity necessary for the Government of Seychelles to provide immediate liquidity in the aftermath of natural disasters. However, in the minutes of the Board's approval of the instrument in 2008, the Executive Directors recognized the fact that this limit would constrain small states and recommended that volume limits for small states to be examined on a country-by-country basis. As a result, in accordance with the provisions of Section III.1 of the Bank Policy "Operational Policy Waivers", (Catalogue No. OPCS5.06-POL.01), and the applicable procedures spelled out in the Bank Procedure, "Operational Policy Waivers and Waivers of Other Operational Requirements", (Catalogue No. OPCS5.06-PROC.01), both dated April 7, 2014, the team is requesting a waiver to the provisions of paragraph 24 of the Board Paper on "Introducing the DDO Option for Catastrophic Risk" (SEC-R2008-0018) dated February 4, 2008, which limits the volume of the Deferred Drawdown Option (DDO) for catastrophic risks per country, as mentioned above. As per required procedures, the Managing Director, Sri Mulyani Indrawati, concurred with the waiver request on July 18, 2014 as specified in the Memorandum of the President and the waiver is hereby submitted for approval by the Bank's Board of Executive Directors.
- **Pricing.** Pricing for the DPL with Cat DDO is aligned with the IBRD Flexible Loan, and includes a 0.50 percentage point front-end fee of the loan amount, due within 60 days of the effectiveness date and which may be financed out of loan proceeds. A renewal fee of 0.25 percentage points of the undisbursed balance of the loan will be due at the time of renewal.
- **Drawdown conditions.** Funds may be drawn upon the declaration of a state of emergency as established by the Constitution of 1993. According to Seychelles legislation, a state of emergency can be invoked in the event of an eminent natural or man-made disaster. The drawdown trigger for the DPL with Cat DDO is limited to declaration of a state of emergency resulting from a natural disaster (Box 3).

²⁶ "Memorandum from the President to the Executive Directors, Subject: Proposal to Enhance the IBRD DDO and to Introduce a DDO Option for Catastrophic Risk (Cat DDO)," Document No. 42396, World Bank, January 29, 2008

- **Revolving feature.** The financial features of the DPL with Cat DDO are similar to those available for the Deferred Drawdown Option for Development Policy Loans (DDO-DPLs), with one exception: the DPL with Cat DDO has a revolving feature which allows for amounts repaid prior to the closing date to be made available for subsequent drawdown.
- **Drawdown Period and Renewals.** The drawdown period for this operation will be three years. The DPL with Cat DDO may be renewed up to four times for a total of 15 years. Renewals require that the original program remain largely in place, i.e., the adequacy of the macroeconomic framework and a disaster risk management program will be reconfirmed and updated upon renewal. Renewal will need to take place no earlier than one year and no later than six months before the expiration date.

Box 3. State of Emergency Declaration

The Constitution of the Republic of Seychelles of 1993 states that the State of Emergency can be declared by the President when “a grave civil emergency has arisen or is imminent, in Seychelles or in any part of Seychelles” (Part III, Art. 1.b). In addition, it states that “a declaration of emergency shall cease to have effect on the expiration of a period of seven days beginning with the date of the publication of the declaration unless, before the expiration of the period, it is approved by a resolution passed by not less than two-thirds of the number of members of the National Assembly” and “subject to resolution of the National Assembly, a declaration of emergency approved shall continue in force until the expiration of a period of three months beginning with the date of its approval or until such earlier date as may be specified in the resolution” (Part III, Art. 2 and 4). Finally, it asserts that “where the National Assembly resolves that the declaration of a state of emergency should not continue or revokes a declaration of state of emergency, the President shall not, within thirty days of the resolution or revocation, declare a state of emergency based wholly or mainly on the same facts unless the National Assembly has, by a resolution passed by the votes of a majority of its members, authorized the making of the declaration” (Part III, Art. 7).

The proposed reforms, as detailed in the DRM Act will better inform the decision to declare a State of Emergency by implementing a color coded monitoring and early warning system and mandate the National Emergency Center with the ability to effectively coordinate the emergency response.

The last time a State of Emergency was declared was on January 27, 2013, in the aftermath of heavy rains caused by the Cyclone Felleng. The State of Emergency was declared for four districts on the main island of Mahe and the secondary island of La Digue.

4.2 Prior Actions, Results and Analytical Underpinnings

37. Prior to the preparation of the DPL with Cat DDO the GoS had a weak regulatory framework in place. There was no Law that enforced DRM and the National DRM Policy, adopted in 2011 was outdated. The new DRM Act, approved by the National Assembly on July 29, 2014, will serve as the legal foundation for all DRM policymaking and investment in the country. This Act calls for the DRDM to formulate and adopt a national DRM Policy and a National Disaster Risk Management Plan (NDRMP), which detail responsibilities for implementation. Therefore the 2011 Policy has been revised to detail responsibilities in the areas of risk assessment; risk reduction; adaptation; preparedness and response. This DPL with Cat DDO facilitated prior actions in two key policy areas to strengthen: (i) the regulatory framework; and (ii) integration of DRR into development planning and decision-making.

38. **The prior actions are:**

- **Policy Area 1:** Strengthening the institutional/legal framework for disaster risk management. This will be achieved by the first two prior actions: (i) the National Assembly has adopted the Disaster Management Act, which provides a legal framework for disaster risk management including both a national disaster risk management plan and an integrated emergency management system, and (ii) the Cabinet of Ministers has approved an updated policy for disaster risk management submitted by the Minister for Environment and Energy, which establishes a fully functional early warning system, increases preparedness through updated sector contingency plans, and provides for the carrying out of information dissemination activities.
- **Policy Area 2:** Integrating disaster risk reduction into development planning and decision-making. This will be achieved by the third prior action: The Government has established a historic loss and damage database in collaboration with the United Nations International Strategy for Disaster Reduction and the Indian Ocean Commission, which is updated annually and fully accessible to all.

39. **The Policy Areas and Prior Actions presented above reflect those areas identified as particularly relevant in the context of Seychelles.** The monitoring framework of the Ministry of Finance, Trade and Investment (MoFTI) commits the DRDM to monitor progress on these (and other) aspects of implementation on a biweekly basis. This is a key tool for the GoS to measure the impact of policy changes. During implementation, the Task Team will provide technical assistance to strengthen national monitoring systems.

Policy Area 1: Strengthening the institutional/legal framework for disaster risk management

40. The GoS committed to a participatory process to develop the National DRM Act. The development of the DRM Act was led by the DRDM and consulted with representatives of the government, private sector, non-governmental organizations and development partners. Between February and May 2014, two rounds of consultation workshops were held with key government line ministries, followed by validation workshop to finalize the draft DRM Act. Results from the consultations informed the areas of focus of the draft Act including the disaster risk reduction and emergency response protocols. The new DRM Act was approved by the Cabinet of Ministers on July 16, 2014, after which it was approved by the National Assembly on July 29, 2014.

41. In addition, the DRM Policy was revised to ensure that it is aligned with the state of affairs of the National DRM Act. The DRDM initiated the revision of the current policy and conducted consultations and validations workshops with relevant stakeholders. The new policy was approved by the Cabinet of Ministers on July 16, 2014 and will establish a fully functional early warning system, increase preparedness through updated sector contingency plans and provide for the carrying out of information dissemination activities.

42. The National DRM Act and the updated policy form the cornerstone of Seychelles' national regime for disaster management. They are key to the protection of people and property, public awareness, capacity building, and the effective use of resources across all phases of disaster management, from prevention to rehabilitation.

43. One aspect of the DRM Act prioritized by GoS is financial protection against disasters. The draft DRM Act calls for “mechanisms to be in place to transfer or share risk among parties best placed to manage it.” In order to support and expand this policy commitment to financial resilience, the World Bank already supports the development of a national risk financing and insurance strategy in parallel with the provision of the DPL with Cat DDO through the South West Indian Ocean Risk Assessment and Financing Initiative. This support will enable the country to better manage the fiscal and other economic challenges posed by natural hazards.

Policy Area 2: Integrating disaster risk reduction into development planning and decision-making

44. Disaster risk management starts with the identification and analysis of risks. The challenge is to provide decision-makers with knowledge and information about disaster risk that enables them to take efficient decisions on how to manage the risk. The lack of a policy on spatial data has hampered sharing and communication of disaster risk information among stakeholders, which was evidenced in the 2013 floods and landslides that affected several schools, the national airport, police stations, and numerous houses and farms.

45. Seychelles has made progress toward developing risk assessment and monitoring systems. A number of geographic or hazard specific assessments have been undertaken, and a number of line ministries are demonstrating leadership in understanding risks for their sectors. However, a comprehensive national level assessment is lacking, and data sharing is weak. This negatively impacts the ability of the GoS to use risk information effectively in planning and decision-making for public and private infrastructure developments.

46. Under the new National DRM Act the GoS is committed to establishing a national risk information database. The DRDM is in the process of establishing an online platform to share geo-spatial risk information. To support risk identification and monitoring, the DRDM has already begun working with development partners, non-governmental organizations, and the private sector to collect and analyze information on disaster risk. Specific projects include a survey of geological risk and the establishment of an historic loss and damage database, in addition to probabilistic risk modeling. The key expected result is that information management and monitoring and evaluation (M&E) systems for DRM will be put in place and analytical capacities increased, which will in turn increase the application of risk information to development planning.

Table 2: DPL Prior Actions and Analytical Underpinnings

Prior Action	Analytical Underpinnings
PA1: The National Assembly has adopted the Disaster Management Act, which provides a legal framework for disaster risk management	<ul style="list-style-type: none"> • The Hyogo Framework for Action (HFA, 2005). This document, endorsed by the Government of Seychelles at the World Conference for Disaster Reduction in 2005 provides the guidelines for comprehensive disaster risk management actions. • Natural Hazards, UnNatural Disasters: The Economics of Effective Prevention (World Bank, 2010). The United Nations and the World Bank jointly published this report. The work aims to assess the economics of disaster prevention for the first time and in a comprehensive manner, rather than solely focusing on

including both a National Disaster Risk Management Plan, and an integrated emergency management system.	<p>damage and losses. Seychelles can benefit from the analysis presented on public-private partnerships and structural and non-structural measures used to reduce risk.</p> <ul style="list-style-type: none"> • Seychelles Damage, Loss and Needs Assessment (DaLA) 2013 Floods, a Report by the Government of Seychelles with the support of the European Union, United Nations and the World Bank (June 2013). The findings of the assessment were used to inform the development of a post-disaster reconstruction and recovery framework, which focused on more effective rebuilding, the strengthening of institutional emergency coordination at the government and community levels, the enhancement of emergency preparedness and response, and the development of risk transfer and insurance mechanisms to prevent future impacts of natural disasters.
PA2: The Cabinet of Ministers has approved an updated policy for disaster risk management submitted by MEE, which establishes a fully functional early warning system, increases preparedness through updated sector contingency plans and provides for the carrying out of information dissemination activities.	<ul style="list-style-type: none"> • The Hyogo Framework for Action (HFA, 2005). This document, endorsed by the Government of Seychelles at the World Conference for Disaster Reduction in 2005 provides the guidelines for comprehensive disaster risk management actions. • Catastrophe Risk Financing in Developing Countries (Cummins, Mahul, The World Bank 2009). The book makes a compelling case for public intervention to enhance catastrophe risk financing strategies and also lays out steps on how to mitigate the economic and fiscal impacts of disasters. This work provides the theoretical framework for this DPL with Cat DDO operation. • Adaptive Disaster Risk Reduction: Enhancing Methods and Tools of Disaster Risk Reduction in light of Climate Change (German Committee for Disaster Reduction – DKKV, 2011). This study formulates recommendations in order to strengthen practical linkages between disaster risk reduction and climate change adaptation. Additionally, the study emphasizes the importance of DRR tools for improving adaptation to extreme weather events in light of climate change, introducing Seychelles as a case study.
PA3: The MEE has established a historic loss and damage database in collaboration with UNISDR and the Indian Ocean Commission, which is updated annually and fully accessible to all.	<ul style="list-style-type: none"> • Natural Disaster Hotspots: A Global Risk Analysis (World Bank, 2005). This publication provides an assessment of hazard frequency and exposure with regard to six natural hazard types: earthquakes, windstorms, drought, flooding, landslides and volcanoes. • The Global Assessment Report (GAR) on Disaster Risk Reduction (UNISDR, 2013). This is a comprehensive review and analysis of natural hazards worldwide. It provides evidence on how, where and why disaster risks are increasing. This text places Seychelles in the larger context of global disaster risk management. • Seychelles Climate Change Scenarios for Vulnerability and Adaptation Assessment (UNFCCC and Seychelles Ministry of Environment and Natural Resources, 2007). This report provides a comprehensive climate change scenario modeling assessment of Seychelles, estimating the magnitude and location of potential future climate change impacts. • Disaster risk profile of the Republic of Seychelles (UNDP, 2008) This presents a comprehensive risk assessment of Seychelles for a number of hazards and how they are likely to be modified under climate change conditions. The report provides an analysis of the extent of flooding in the islands caused by the effects of global warming, climate change, and rises in sea level. The assessment will help to improve disaster management activities in Seychelles.

47. **The Government and the World Bank will maintain a close policy dialogue during the implementation of the program throughout the drawdown period.** The Bank will conduct two implementation support missions per year to monitor the program.

48. **The above-mentioned prior actions were agreed with the GoS and are consistent with the five good practice principles on conditionality,** as identified by the Bank's 2005 review and its updates. Box 4 describes how this DPL with Cat DDO is aligned with each of these principles.

Box 4. Good Practice in Development Policy Lending

Principle 1: Reinforce ownership

- This operation is driven by the Government of Seychelles and enjoys solid ownership in the country. The DPL with Cat DDO is aligned with the Government's DRM and risk financing strategy.

Principle 2: Agree up front with the Government and other financial partners on a coordinated accountability framework

- The proposed DPL with Cat DDO is based on a coherent framework of previous prior actions and expected outcomes that builds on the adoption of the Disaster Risk Management Act. The regular preparation of the "National Report on the Implementation of the Hyogo Framework of Action" and its contents on progress on DRM according to international standards will help facilitate the dialogue with the Bank.

Principle 3: Customize the accountability framework and modalities of Bank support to country circumstances

- The operation features the client's requests, and the policy matrix has been adapted to country circumstances as well as the modalities of the DPL with Cat DDO. This is in recognition of the GoS's work on and investment in DRM actions, with a strong emphasis on disaster prevention rather than on emergency response alone.

Principle 4: Choose only actions critical for achieving results as conditions for disbursement

- As indicated, funds may be drawn down upon the occurrence of a natural disaster resulting in a declaration of a state of emergency by presidential decree.

Principle 5: Conduct transparent progress reviews conducive to predictable and performance-based financial support

- The policy matrix contains outcomes that are closely linked to the supported policy actions and indicates the main responsible entity. This will help the Bank and GoS review progress during project implementation.

49. **Moving forward beyond the policy areas and prior actions selected for this operation, it would be important for the GoS to further strengthen DRM in the country** by (i) establishing DRM national budget appropriations; (ii) implementing a comprehensive disaster risk financing and insurance strategy; (iii) strengthening DRM at the community level; (iv) updating the country's risk profile; and (v) establishing an open multi-hazard risk information platform (Geonode).

4.3 Link to CPS and other Bank Operations

50. **The proposed DPL with Cat DDO is consistent with the Bank Group's Country Partnership Strategy (CPS) for Seychelles**, which was discussed by the Board of Executive Directors on February 22, 2012 and covers the period July 1, 2012 to June 30, 2015. The CPS is anchored in the country's Medium-Term National Development Plan (MTNDP) for 2013–2017, and aims to reduce Seychelles' vulnerability while providing the basis for long-term sustainable development. The CPS, under its Vulnerability and Resilience pillar, specifically identifies managing the risk of natural disasters and adaptation to climate change as a key area for Bank support. The specific CPS outcome to which this operation will contribute is the government's improved capacity to respond to disasters and climate change under implementation of a new DRM and climate change adaptation plan.

51. **The proposed DPL with Cat DDO complements other World Bank Group operations supporting private sector development, social protection, and fisheries development.** In Seychelles, the Bank is using both its lending and non-lending products to help build the DRM capacity of the Government agencies. This project builds on existing DRM work supported by the World Bank and other development partners. In addition it will benefit from cross-linkages with the (i) "Seychelles: Strengthening Disaster Risk Management for Sustainable Poverty Reduction project (P147236) to strengthen institutional and technical capacities and the (ii) South West Indian Ocean Risk Assessment and Financing Initiative (P149096), which is set to improve the understanding of disaster risks and risk financing solutions of five Indian Ocean island states, including Seychelles, in order to increase their capacities to meet post-disaster funding needs without compromising their fiscal balances and development objectives. The GFDRR has an active portfolio of activities in the region to support post-disaster recovery and response as well as longer-term risk reduction..

52. **This operation also benefits from and complements the ongoing Sustainability and Competitiveness Development Policy Loan (S&C DPL) Programmatic Series in Seychelles.** The Third S&C DPL, which was prepared in parallel to this operation, has a major component on improving fiscal sustainability by consolidating welfare schemes, introducing program-based budgeting and supporting reforms in the public enterprises. These reforms ultimately create some (albeit limited) fiscal space to accommodate unforeseen contingencies, including natural disasters. The DPL with Cat DDO provides an additional layer of contingent financing, should the fiscal space be constrained at the time of disasters.

4.4 Consultations, Collaboration with Development Partners

53. **Several development partners, including the Indian Ocean Commission (IOC), the European Union (EU), the French Development Agency (AFD), the UNISDR, Italian Civil Protection, Southern Africa Development Community (SADC) and the GFDRR, support the disaster risk reduction and management agenda in the Seychelles.** During the preparation of the DPL with Cat DDO, the Bank coordinated with all these partners, as well as with the IMF.

54. **Relevant to this operation**, support has been provided by UNISDR to establish the Historic Loss and Damage Database, as part of the Islands Project of the IOC with funding from the EU. In addition, the AFD's '*Risques Naturels*' Project supports community based risk

assessments. Furthermore, the Italian Civil Protection Department has provided technical assistance for the drafting of the proposed DRM Act. A regional project implemented by SADC supports the DRDM in conducting a vulnerability assessment of the main islands.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 Poverty and Social Impact

55. Exogenous shocks such as natural disasters have a direct impact on poverty. Disasters, whether recurrent or of a more catastrophic nature, cause damage to public and private infrastructure and immediate economic losses to productive sectors, as was evidenced in the 2013 floods and landslides provoked by Tropical Cyclone Felleng. Disasters cause the loss of livelihoods and property for the population.

56. Natural disasters also increase poverty indirectly through the effects of lower economic growth, higher inflation, and lower Government spending for social services²⁷. Although poverty in Seychelles is relatively low, the disruption of public utilities, such as potable water or sewage systems, communications, and transport infrastructure in the period following a disaster event, combined with the geographic isolation of Seychelles, can have a prolonged negative effect on health, education, assets, and livelihoods across the population.

57. The implementation of the DPL with Cat DDO is expected to have a positive poverty and social impact on poverty and social conditions by focusing attention on the obstacles to the government's ability to strengthen resilience against the risk of natural disasters. Risk management requires shared action and responsibility at different levels of society, from households to communities to enterprises, and governments have a critical role to play in creating an enabling environment for shared action and responsibility, while channeling support to vulnerable people²⁸.

58. Specifically, the prior actions will have positive social effects for vulnerable groups as follows:

- The implementation of the Disaster Management Act and adoption of the DRM policy will provide a stronger legal framework for the country's disaster risk management operations. It will also create a platform for greater accountability, transparency, and public participation.
- The establishment of a historic loss and damage database will allow for better analysis of vulnerabilities across geographic areas and populations.

59. Disasters preparedness can prevent disasters from increasing poverty. The proposed operation supports policies that seek to alleviate poverty by strengthening disaster risk management in Seychelles. . In the case of a declaration of a state of emergency, the activation of the DPL with Cat DDO will eliminate the need to deviate funds originally designated for development projects. This will guarantee the continuity of development plans, targeted mainly at addressing the needs of the poor.

²⁷ International Monetary Fund, Fund Assistance for Countries Facing Exogenous Shocks (Washington DC, 2003, available at <http://www.imf.org/external/np/pdr/sustain/2003/080803.pdf>)

²⁸ World Development Report 2014, Risk and Opportunity: Managing Risk for Development.

5.2 Environmental Aspects

60. **The proposed financing is expected to have indirect benefits for the environment by integrating risk reduction and resilience measures into development planning and decision making.** An illustrative example would be the improvement of solid waste services to reduce the risks of urban flooding caused by clogged drainage systems. In particular, this operation will help the GoS support and strengthen (i) institutional, legal, and policy frameworks for disaster risk management by focusing on key program milestones and outcomes; (ii) risk identification, assessment, and monitoring capacities by enhancing the institutional framework; (iii) knowledge management and education by implementing relevant programs (such building or renovating old schools with infrastructure more resilient to disasters); (iv) resistance to underlying risk factors such as by developing new projects in safe areas; and (v) preparedness for effective response and recovery by supporting DRDM.

61. **The *raison d'être* of the operation itself is to support the Government's effort to mainstream disaster risk management into a number of key areas, such as the environment.** Measures included in the 2010–2020 Seychelles Sustainable Development Strategy aim to reduce environmental risks and vulnerability to natural disasters, including through support for land zoning and urban development regulations and the sustainable management of water resources.

62. **The Cat DDO operation places particular emphasis on ensuring improved transparency and accountability on social and environmental issues with respect to governmental oversight and decision-making processes.** Seychelles Environmental Protection Act (Act 9 of 1994, amended by Act 15 of 1998) establishes a series of provisions for prevention, control, and abatement of environmental pollution, in addition to the enforcement of compulsory environmental impact assessments for any project or activity with the potential to cause environmental harm, as well as offences, penalties, compensations, and enforcement mechanisms. The Act also grants the Ministry of Environment and Energy (MEE) coordinating functions required in a state of environmental emergency or any other situation that may pose a serious threat to the environment.

5.3 Public Financial Management (PFM), Disbursement and Auditing

63. **Seychelles' fiduciary framework is adequate to support the proposed operations.** The 2011 Public Expenditure and Financial Accountability (PEFA) results noted improved PFM performance following the 2008 PEFA assessment. The 2011 PEFA report confirms that Seychelles' budget information is transparent. The public has adequate access to key fiscal information such as budget documents, which are freely available to the public on a timely basis. To address the weaknesses identified in the 2011 PEFA report, the Government designed and is implementing a 2012–14 action plan for PFM. The Public Finance Management Act was revised in 2012 to further strengthen budget processes including design, execution, and reporting. The IMF 2013 safeguard assessment report of the Central Bank of Seychelles (CBS) concluded that the CBS's internal controls, financial reporting, and external audit and internal audit systems were adequate and aligned with international standards.²⁹ The report called for CBS to pay

²⁹ The assessment found that the CBS has implemented the recommendations of the 2010 assessment, namely, it has strengthened its: (i) external audit mechanism (by approving a new auditor independence policy and proactively implementing external

further attention to developing and implementing a risk-based internal audit methodology and filling vacant staff positions. The CBS has committed itself to addressing the identified weaknesses in order to improve the safeguard environment. The CBS's operations are reflected transparently in its audited financial statements.³⁰

64. Loan disbursement will follow the World Bank's Disbursement procedures for development policy lending. The GoS has elected the deferred drawdown option (DDO) as the disbursement mode for this operation amounting to US\$7 million, which is subject to approval of the waiver on the policy volume limits by the Board of Directors. The DPL with Cat DDO feature gives the Borrower the option of drawing down the DPL during a three-year period, upon declaration of a state of emergency following a natural disaster.

65. Accordingly, the GoS will be able to access funds from the facility upon the declaration of a state of emergency resulting from an adverse natural event. Following a request for withdrawal and provided the World Bank is satisfied with the appropriateness of the Borrower's macroeconomic policy framework and the progress achieved by the Borrower in carrying out the Program, the Bank may disburse the proceeds into an account denominated in foreign currency that forms part of the GoS's official foreign exchange reserves held by the CBS. The CBS may use the proceeds as follows: (i) make budgeted foreign currency payments directly from this foreign currency bank account; (ii) transfer amounts from the foreign currency bank account to a local currency bank account of the GoS, which the GoS then uses to make payments for its budget expenditures; or, (iii) a combination of these approaches.

66. Accounting for the loan proceeds will be the responsibility of the comptroller-general at MoFTI. Government procedures will be followed to administer, record, and audit transactions relating to the loan proceeds and associated payment. Since the control environment is considered to be adequate, no additional fiduciary requirements shall apply.

67. Once the funds enter GoS foreign exchange reserves and the budget, they will be comingled with the GoS' other funds. This means that disbursements of the loan will not be linked to any specific purchases, except that the Borrower is required to comply with the standard negative list of excluded items that may not be financed with Bank loan proceeds, as defined in the loan agreement. If any portion of the loan is used to finance excluded expenditures as so defined in the loan agreement, the Bank has the right to require that the government to promptly, upon notice from the Bank, refund the amount equal to such payment to the Bank. Amounts refunded to the Bank will be cancelled from the loan.

68. The Government, through the MoFTI, will provide written confirmation to the World Bank within 30 days of disbursement that: (i) the loan proceeds were received into an account of GoS that is part of the country's foreign exchange reserves (including the date and the name/number of the GoS's bank account in which the amount has been deposited), and (ii) an equivalent amount has been accounted for in the GoS's budget management system (including the Chart of Accounts name/account number, the date, and the exchange rate used) within 5 business days of reception of the loan proceeds.

auditor's management letter issues); (ii) financial reports, which are now prepared in line with International Financial Reporting Standards and audited by an independent audit firm using international standards of auditing; and (iii) legal framework.

³⁰ Since the 2009 financial year, the CBS's financial statements have been prepared in accordance with international financial reporting standards, and they are available on the CBS website up to December 31, 2013.

69. **Conclusion.** In general, it can be determined that the GoS's PFM , together with the government's commitment to improving PFM performance through various initiatives as described above, gives reasonable assurance that it is capable of managing the country's budget resources appropriately. Hence, this is considered adequate to support the successful implementation of this operation.

5.4 Monitoring And Evaluation

70. **The MoFTI is the main counterpart of the Bank for this DPL with Cat DDO.** Nevertheless, implementation of the program is a shared responsibility among the DRDM under the MEE.

71. **The results framework presented in Annex 1 will be used as a monitoring tool by both the Government and the Bank.** The Government and the World Bank will review the progress of the DPL program twice a year, and a joint report will be prepared. The MoFTI will be responsible for the overall coordination and monitoring of the reform program supported by the DPL with Cat DDO and will furnish information to the World Bank, as required, to monitor outcomes in the results framework. The MoFTI will liaise with focal points in the other ministries, departments, and agencies involved as needed. Periodic monitoring and dialogue with the relevant line ministries and other stakeholders involved in implementing the reforms will take place through World Bank field missions.

72. **If at any time during the drawdown period the Bank concludes that the DRM program is not being implemented in a manner satisfactory to the Bank,** the Bank would promptly advise the Borrower of the need for improvement and that a subsequent review would be necessary to confirm that the DRM program is being implemented satisfactorily before it would be able to process any request for drawdown. In this case, follow-up monitoring would be more frequent until a review confirms that the program is back on track. Once the Bank is satisfied that drawdown conditions are again in place, the Bank would inform the Borrower, that its eligibility to submit disbursement requests has been restored.

6. SUMMARY OF RISKS

73. **The overall program risk rating is moderate.** The Government has shown remarkable leadership in pursuing the reform agenda, and the country has already achieved substantial results with the support two previous Sustainability and Competitiveness DPLs, which has reduced the risk of political and social resistance to reforms. The remaining risk of a limited institutional capacity within sector ministries is moderate, while political and social resistance to change is low. The risk of natural hazards affecting the implementation of this program is also moderate.

74. **Seychelles remains exposed to uncertain global developments that threaten its macroeconomic stability.** Country risks are high given its relatively high debt levels, small size, dependency on the global environment, and limited risk diversification options. The major risk is related to the uncertain developments in the euro zone to which Seychelles is highly exposed

through tourism and FDI, which present a threat on two fronts – the fiscal position and the current account deficit.

- i. **Fiscal position:** Slower global economic growth would depress domestic growth, reduce tax revenues, and put pressure on Government spending at a time when the fiscal position needs to be focused on bringing down public debt and funding priorities such as infrastructure development.
- ii. **Current account deficit:** High current account deficits are adequately financed, primarily through high FDI.³¹ However, gross financing needs will remain high due to growing debt service and high current account deficits. In addition, the concentration of exports on a few markets (in Europe) and products (tourism, fisheries, off shore banking)³² and the large import bill for fuel and commodities heighten the country's vulnerability to external shocks.

75. The Government has a reasonable number of tools to cope with external economic uncertainties and to maintain a stable macroeconomic environment for the implementation of this program. In the short term, the current level of international reserves (3.8 months of imports) provides some buffer against any potential deterioration in the balance of payments. In the medium term, the floating exchange rate facilitates the correction of external imbalances. On the fiscal front, the 0.2 percent of GDP (US\$3.7 million) contingency fund could sustain public expenditure in the short term as needed. The contingency assistance provided by the Bank Cat DDO also provides immediate relief should a national disaster materializes. In the medium term, fiscal space remains limited, given the Government's goal of bringing public debt down to 50 percent of GDP by 2018 and the need to reduce external gross financing. This will require additional public expenditure containment, preferably by increasing the efficiency of public enterprises.

76. Risks associated with limited capacity, especially in sector ministries, are being overcome by substantial technical assistance provided in parallel with the DPL with Cat DDO. In most of the areas covered by this program, parallel technical assistance and knowledge development and dissemination are being provided by the World Bank through technical assistance grants, while other partners have helped to implement reforms and building institutional capacity.

77. The Government is taking measures to mitigate and cope with the impact of natural disasters. Seychelles' vulnerability to natural disasters is being exacerbated by increasing development and climate change. To mitigate these risks, the Government has adopted a National Sustainable Development Strategy for 2012-2020 that includes disaster risk reduction measures in such key policy areas as climate change, land use, and coastal zone management. In

³¹ FDI is expected mainly in the tourism, port and offshore sectors. Delays in FDI in the tourism and port sector would also be accompanied by lower current account deficits given the considerable import content of these investments.

³² With regards to the offshore financial sector in Seychelles, there could be two potential risks. First, offshore funding might finance domestic activities, creating external exposures and vulnerabilities not captured in the domestic monetary data. Second, banks doing domestic and offshore intermediation might create spillover risks with regard to the capital position of banks, for example in the event that offshore activities would lead to unexpected losses that would have to be provisioned for. These risks are mitigated as for the time being there are not yet any domestic banks offering offshore banking services. Also, the Central Bank has not issued any authorization for offshore banks to operate in the domestic banking system. IMF support is being provided to implement the single-licensing regime.

addition, to strengthen its capacity to respond to and evaluate the impact of natural disasters, the government has created a National Emergency Operations Center and has developed a Master Plan for Disaster Risk Management. Furthermore, the DPL with Cat DDO will provide support to increase the country's resilience to disasters as a risk-financing tool to protect fiscal stability during an emergency.

78. In summary, the proposed loan is rated as presenting a *moderate risk*, due to macroeconomic, policy, institutional, and coordination challenges.

ANNEX 1 – Policy and Results Matrix

Policy Area	Prior Actions	Key Results Indicators	Responsible Agency
Strengthening the Institutional/legal framework for disaster risk management	1: The National Assembly has adopted the Disaster Management Act, which provides a legal framework for disaster risk management including both a national disaster risk management plan and an integrated emergency management system.	<ul style="list-style-type: none"> Districts have updated protocols for preparedness and response. Baseline: 0 in 2014 Target: 5 by 2017 The DRDM conducts annual drills and exercises Baseline: 0 in 2014 Target: 1 exercise per year 	<ul style="list-style-type: none"> DRDM MEE MoFTI
	2: the Cabinet of Ministers has approved an updated policy for disaster risk management submitted by the Minister for Environment and Energy, which establishes a fully functional early warning system, increases preparedness through updated sector contingency plans, and provides for the carrying out of information dissemination activities.	<ul style="list-style-type: none"> Annual public DRM education and awareness campaigns are conducted. Baseline: 0 in 2014 Target: 2 DRM awareness campaigns carried out at community level by 2017 A least 5 contingency plans have been updated and are officially approved by the Cabinet of Ministers Baseline: 1 in 2014 Target: 5 by 2017 	<ul style="list-style-type: none"> DRDM MoFTI
Integrating disaster risk reduction into development planning and decision-making	3: The Government has established a historic loss and damage database in collaboration with the United Nations International Strategy for Disaster Reduction and the Indian Ocean Commission, which is updated annually and fully accessible to all.	<ul style="list-style-type: none"> A geospatial risk data sharing platform updated annually; Baseline: 0 in 2014 Target: 1 annual update Line Ministries, agencies and private sector include risk information in their development projects Baseline: 0 in 2014 Target: 5 by 2017 	<ul style="list-style-type: none"> MEE DRDM MoFTI

ANNEX 2 – Fund Relations Note

IMF Executive Board Approves US\$ 17.6 Million Extended Fund Facility Arrangement for Seychelles

Press Release No. 14/262 June 5, 2014

The Executive Board of the International Monetary Fund (IMF) yesterday approved a three year SDR 11.445 million (about US\$17.6 million, or 105 percent of Seychelles' quota) arrangement under the Extended Fund Facility (EFF) for the Republic of Seychelles to support the authorities' economic program. The approval enables the immediate disbursement of SDR 1.635 million (about US\$2.5 million), while the remaining amount will be phased over the duration of the program, subject to semi-annual program reviews.

The authorities' EFF-supported program aims to reduce the high debt levels, improve external buffers and sustainability in the face of emergent balance of payments pressures, and strengthen the economy through sustained and inclusive growth.

Following the Executive Board discussion on Seychelles, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, said:

“The authorities have undertaken comprehensive reforms since the 2008 crisis that have supported a strong recovery and improvements in fiscal and external sustainability. Growth was strong in 2013, boosted by increased tourism arrivals. Inflation stabilized at a low level. The current account deficit fell sharply, allowing the central bank to rebuild its reserves. However, debt levels and the current account deficit remain high, while some persistent structural weaknesses are holding back growth potential and economic resilience.”

“The authorities' economic program supported by the EFF-arrangement appropriately focuses on reducing vulnerabilities and containing fiscal risks while fostering sustained and inclusive growth. The authorities' target of reducing the debt-to-GDP ratio to below 50 percent by 2018 remains an anchor for stability, while allowing the necessary investments in human and physical capital to support growth. The new monetary policy framework builds on recent progress in mopping up structural excess liquidity, and exchange rate flexibility and moderate reserve accumulation continue to facilitate adjustment to external shocks.”

“The structural reform agenda is ambitious and targeted. The adoption of a Medium-Term National Development Strategy, the associated medium-term fiscal framework, and a financial sector development strategy, together constitute critical reforms needed to promote growth. Reforms also aim to strengthen the management and transparency of public finances. Building on the progress already made, it is important to enhance the oversight of state-owned enterprises to contain fiscal risks and avoid excessive expansion from crowding out the private sector.”

Recent economic developments

In the five years following the 2008 crisis, the Seychellois authorities have successfully enacted a comprehensive IMF-supported program of reforms – floating the exchange rate, eliminating exchange restrictions, turning fiscal deficits into surpluses, and halving the debt burden with the assistance of external debt relief. Structural reforms sought to foster long-term growth, including through simplifying the tax system and promoting the private sector.

These reforms have borne fruit in the form of a strong and sustained recovery: real Gross Domestic Product (GDP) growth accelerated to around 3.5 percent in 2013, boosted by strong tourist arrivals. Inflation fell to 2.2 percent in March 2014. The external position improved thanks to a boom in tourism and tuna exports, and Foreign Direct Investment (FDI) flows remain strong. Reserve coverage reached an estimated 3.8 months of imports at end-2013, up from 3.0 months at end-2012. The 2013 fiscal outturn was largely in line with the authorities' ambitious targets, although business and income tax revenues were somewhat weaker than expected.

Nevertheless, important risks and challenges remain. At 65 percent of GDP, Seychelles' public debt remains high, as does the current account deficit (18.5 percent of GDP), —although the latter has been largely funded by FDI. Moreover, the balance of payments faces headwinds as debt service and investment income payments rise. Sustained GDP growth will require adequate infrastructure investment and an active reform agenda to enhance productivity. At the same time, fiscal policy faces pressures, as revenue and grants have been falling as a proportion of GDP.

Program Summary

The program is designed to strengthen macroeconomic stability, reduce vulnerabilities, and support wide-ranging structural reforms aimed at laying the foundation for sustained and inclusive growth. The macroeconomic framework is anchored on the authorities' goal of reducing the debt-to-GDP ratio below 50 percent by 2018. This requires continued fiscal primary surpluses of 3 to 4 percent of GDP over the medium term, a fiscal path which strikes a balance between the pace of debt reduction and addressing vital social and investment needs. Revenue measures under the program will focus on improving tax compliance and administration, while enhancing the quality of fiscal spending will be a core priority of the program.

The monetary policy framework aims to maintain low and stable inflation. In advance of the new program, the excess liquidity problem has been largely addressed through the issuance of medium-term Treasury bonds. The adoption of average reserve money targeting will further strengthen the policy framework, supporting the move towards a more forward-looking framework. While reserve coverage has recently reached the desirable range, maintaining it will require continued reserve accumulation in the face of balance-of-payments pressures. Exchange rate flexibility remains key to ensuring external stability over the medium term.

Sustaining growth and tackling risks to stability will require the implementation of a new generation of ambitious structural reforms, including: the adoption of a Medium-Term National Development Strategy, a medium-term fiscal framework, and a financial sector development strategy, as well as measures to combat international tax evasion. A new framework for Public Private Partnerships will support infrastructure investment and promote the role of the private sector. Establishing a registry of state assets, including land, will help protect public finances and support more efficient land use. The oversight of state owned enterprises will also be progressively strengthened, building on past progress, to contain fiscal risks and focus them on their core missions.

ANNEX 3- Letter of Development Policy



Republic of Seychelles

Ministry of Finance, Trade and Investment

The Minister

27th June 2014

Mr. Jim Yong Kim
President
The World Bank Group
Washington DC

Dear Mr. Kim,

1. On behalf of the Government of Seychelles, I hereby write to request the approval for the Third Sustainability and Competitiveness Development Policy Loan (DPL3) and the Disaster Risk Management Development Policy Loan with Catastrophe Deferred Draw Down Option (DPL with Cat DDO) to the Republic of Seychelles. This third development policy loan will support Seychelles in its ongoing reform process especially as we strive to improve the fiscal sustainability and enhance private sector competitiveness in order to sustain our achievements so far. The DPL with Cat DDO will strengthen the Government's Disaster Risk Management (DRM) policy and reform agenda and enhance its capacity to efficiently respond to disasters.
2. In 2013 we celebrated five years since we started the reform process and it is encouraging to see the broad based support for the process still exists and continues to be strengthened. The private sector and the civil society on their part continues to play an important role in the process, so that we ensure that our people continue to have a sound understanding of the ongoing reform process and appreciate the benefits. The international community, especially our development partners continues to equally extend their support to us through budget support and technical assistance in various areas. In December 2013 the series of IMF supported program we had embarked on since 2008 came to an end and earlier this month the IMF Executive Board approved the Government's request for a successor program- a new 3 year Extended Fund Facility of SDR 11.445 million. In December 2013 the African Development Bank also approved a 2 year budget support operation for FY 2013-2014 for an amount of USD 20 million.

Liberty House, P.O. Box 313, Telephone: 4382000, Ext: 2120, Telefax: 4325161, Email: minister@finance.gov.sc

Continuation

I. SEYCHELLES REFORM PROGRAM

I.1 Overview

3. The core aim of Seychelles Development remains the need to reduce its vulnerability and long-term sustainable and inclusive development. In order to maintain the gains we have achieved so far the overarching goal of Seychelles' fiscal policy remains to put public finances on a sustainable path, while creating the fiscal space to raise public investment and support targeted social safety nets. The 2014 budget reiterated government's commitment in that direction. The budget looks back on the reforms of the past 5 years and set the stage for the country to move beyond reforms and start focusing on accelerating growth for shared prosperity. The budget is based on two main objectives, which are critical for Seychelles to maintain its sustainability in the medium to long term- (i) a comprehensive review of the wage structure and wage levels in government-this is to allow government to pass more benefits of the reforms to the people and make government's pay structure more competitive and enable it to continue to attract quality staff; (ii) freezing of non-priority expenditures for the first half of 2014, until an exercise to rationalize the budget and identify possible wastage and savings is completed by mid-next year.
4. Seychelles embarked on a comprehensive reform program in late 2008 aimed at addressing large fiscal and external deficits and economic inefficiencies. At the end of our arrangement under the Extended Fund Facility (EFF) in late 2013, we have been able to achieve a satisfactory level of macroeconomic stability, which has sustained growth. However we are aware that the economy remains highly vulnerable to external shocks, and that we need to pursue further fiscal and monetary stabilization in order to preserve and strengthen our international reserve position, reduce the gross public debt to a more sustainable level. These would further strengthen resilience of the economy and support sustained growth. An active policy of structural reforms is also needed to promote inclusive growth and put the economy firmly on a sustainable path. In this context, we are of the view that an EFF-supported program would help to realize those objectives and maintain confidence of external partners, and provide an appropriate framework for stability and growth oriented policies.

II. MAIN ELEMENTS OF POLICY REFORMS

5. In order to sustain the achievements of the economic reform program and address the remaining agenda we will continue to ensure that we strengthen the institutional and governance framework in critical areas such as public finance management, public enterprise, and the investment climate among others.

1. Fiscal Policy

6. Strong fiscal adjustment has been and is central to the achievement of debt sustainability and sound public finances. In 2013 our primary surplus was 4.7 percent of GDP—These objectives have been achieved through a combination of expenditure restraint and strong public financial management. For 2014 we are aiming for a primary surplus of 4.2 percent of GDP. It is imperative that we maintain a primary surplus through to 2018 in order to achieve the 2018 public debt target of 50 percent to GDP.

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Continuation

7. We remain committed to having a modern tax system, an improved customs administration and to the improvement of the financial performance of the broader public sector. Our focus is on improving the functioning of tax administration, with particular attention to VAT and trade and excise taxes, with actions to facilitate electronic filing, speed up VAT refunds, reduce exemptions, simplify trade documentation filing and strengthen the audit and investigative capacity of the SRC. Specific measures will include: (i) a mandatory requirement for compulsory VAT registered businesses to file their monthly return online starting on July 1, 2014, following the establishment of an e-payment facility which will eliminate the need for payments in person; (ii) reducing the exemptions on VAT and further reduction of the threshold for compulsory registration; (iii) the introduction of the single window principle at customs, to avoid the involvement of more than one agency to which trade documentation has to be submitted; resulting in improved efficiency of official controls and lower compliance costs; (iv) an action plan on excise management including amendments to regulations, following a 2013 TA report; (v) the recruitment of more specialized audit personnel at SRC to strengthen its investigative and auditing function; and (vi) we are also taking measures on international tax cooperation.

2. Public Financial Management Reforms

Strengthening the Public Financial Management Framework and the budgetary process remains one of our key objectives. The government priorities in the area of public financial management are to: (i) prepare a full Medium Term Fiscal Framework (MTFF); (ii) gradually widen the adoption of Performance Program-Based Budgeting (PPBB) which has started with two ministries in 2014; (iii) strengthen public investment management by developing the Public Sector Investment Program (PSIP), formulating infrastructure plans in key areas, and preparing detailed guidelines for every stage of project preparation, execution and monitoring; (iv) adopt the necessary guidelines to prepare financial statements according to the International Public Sector Accounting Standards (IPSAS) principles, as it was started on a pilot basis for 2011; and (v) establish and publish comprehensive asset register for state-owned enterprises and public land and strengthen the management of public land.

MTFF- To enhance the predictability and sustainability of our public finances, we are preparing an MTFF which should be approved by Cabinet by end-September (structural benchmark). A key tool in strategic fiscal management, the MTFF will establish integrated multi-year policy-based targets for the main fiscal aggregates – debt, financing, primary balance, revenues and expenditures – consistent with the overall macroeconomic framework. Moreover, the MTFF will provide the foundation for a full MTBF to be elaborated next year, which will allow for an improved process for the allocation of budgetary resources.

Continuation

PPBB- The Ministry of Finance is providing support to the two pilot ministries and put in place all other necessary pillars required to implement PPBB in all ministries and agencies. A first step is to prepare strategic plans in the two pilot ministries by June 2014 and to launch the preparation of such plans in all other ministries, with assistance from the Department of Public Administration. PPBB will be introduced in three more ministries in 2015. Appropriate training of officials will be undertaken, with World Bank assistance, and the School of Business Management will help in building capacity, within its public finance management department.

Public Investment Management (PIM) and the Public Sector Investment Program (PSIP)- To improve the formulation and execution of the PSIP, a PSIP Development Committee will be established to coordinate the preparation of Investment program. This committee will comprise of representatives of the Ministry of Finance and line ministries. As part of the process, the Ministry of Finance will carry out quarterly review of projects above the threshold of SR 10 million. As part of its plan to encourage growth, Government is putting emphasis on infrastructure development.

PIM Guidelines and project monitoring- Over the medium term we aim to develop a complete, integrated set of guidelines or manual for PIM—covering all stages of PIM: project proposal submission, pre-screening, appraisal, financing, design, project management, monitoring and evaluation. We also aim to consolidate the legal foundation for project monitoring. In particular, the budget circular will add the reporting on monitoring as a requirement for budgeting that line ministries have to follow, and establish mechanism for periodic, on-site joint monitoring by the Ministry of Finance, NTB, and line ministries.

Financial Instructions and Accounting Manual: We have incorporating the revised articles of the PFM Act 2012 and elements relating to PPBB into the Financial Instructions and accounting manual to explain to the users the regulations and procedures. *(Prior action 5 of DPL 3).*

Preparation of financial statements in accordance with IPSAS- While the new PFM Act requires preparation of the financial statements in accordance with IPSAS, the applicable rules and regulations, incorporated in the accounting manual, needs to be amended. This requires further developing the legal and regulatory framework, the accounting policies, detailed accounting procedures including roles and responsibilities, use of the chart of accounts, required report formats, and related internal control procedures. The Government, supported by the AFRITAC South mission, has prepared financial statements in IPSAS format for the year 2011, based on the Annual Financial Statements (AFS 2011) which have been approved by the National Assembly. 2011 is therefore considered a parallel year.

A register for public assets of the state-owned enterprises, including state land, will be established and published, beginning with the five largest by the end of 2014. In 2015 a comprehensive government asset register will be prepared, and more transparency will be introduced in the management of public land, with clear valuation, and revenue and transaction reporting.

Continuation

3. Public Enterprise Reforms

8. The government through the PEMC will continue to strengthen transparency in the operations of all state-owned enterprises and ensure that they meet their performance objectives. The Public Enterprise Monitoring Commission (PEMC) will continue to strengthen its framework for monitoring of SOEs so as to minimize risks, particularly to public finances. We will seek technical assistance from our partners to strengthen capacity of the Commission. Following the enactment of the new PEMC Act last year, it is now a requirement that within three months of the end of their fiscal year each public enterprise will have to submit their audited financial statements to the Public Enterprise Monitoring Commission. To date 12 public enterprises out of 21 have submitted their audited financial statements to the PEMC (*prior action 6 of DPL3*). However only 1 of the 12 accounts submitted was done within the 3 months' timeframe. The reasons for delay are mainly due to a culmination of delays on the part of the auditing firm, and certain lapses in the process of the public enterprises themselves. We remain confident that by the time our request is submitted to the Board, we would have received the audited financial statements from all the entities, and next year the process should be more straightforward and the 3 months deadline adhered to. We continue to advance our privatization program. Government has successfully sold its remaining shares in SACOS Insurance Company Limited.
9. Following the adoption of the new Housing Finance Policy in December 2011 and the technical assistance received from the World Bank through the FIRST Initiative we have successfully introduce a housing finance subsidy scheme for the first time home buyer. We are now engaged in discussion with the World Bank through FIRST Initiative to see how to allow the private sector to play a more prominent role in the housing market.
10. Challenges in the utility sector remains and we continue to take measures to address the situation. In 2013 Government adopted a tariff re-balancing plan which will gradually see a rise in utility prices over the next 8 years to bring them to cost recovery levels (*prior action 10 of DPL 3*). However we recognize that the 8 year period may not be the most effective time frame, thus we are committed to reviewing the key parameters and development in the sector with a view to accelerating the completion of tariff rebalancing.
11. To further reduce the dependence on fuel and further our efforts to become an environmentally-friendly country the Government has been working on various schemes to promote the use of renewable energy by households. The 2014 budget has made provision for a total of SR4.0 million to support small businesses and households through a number of renewable energy schemes such as the photovoltaic rebate scheme and the Seychelles Energy Efficiency and Renewable Energy Programme (SEEREP).

Continuation

4. Social Sector Reforms

12. Following on from the reforms undertaken in the social sector since 2008, the Government remains committed to ensuring that the benefits delivered by the Agency of Social Protection is done in an efficient and targeted manner. In an effort to further reduce the share of ineligible beneficiaries of welfare assistance the Government has taken steps to effectively switch the burden of paying the first 15 days of annual sick leave compensation from the government to the employer (*prior action 7 of DPL 3*).
13. The Government continues to take measures to tackle the long-term fiscal risks and address the issue of sustainability of Seychelles' pension system, which are related to the system's generous benefits and limited contributions. It has been approved and implemented a 1% increase in pension contribution from 3% to 4%, with employers and employees contributing equally toward the increase (*prior action 8 of DPL3*). In addition to the increase in contribution rate, the benefit formula is also being revisited in order to strengthen the link between benefits and contributions (*prior action 9 of DPL3*).

5. Private Sector Developments

14. The Government remains committed to the process of sustained and inclusive growth. We recognize that the private sector is the engine of growth and will therefore continue to promote competition and the private sector involvement. Whilst the government continues to welcome new FDI, we have equally recognize the need to better appreciate and increase our support for local investors. In order to improve the investment climate, increase efficiency and improve service delivery, the development of e-services remains high on our agenda. We have identified a series of measures to assist in the process such as (i) online application for business licenses, (ii) e-payment of registration fees and charges for various government services, (iii) a collateral registry and (iv) extend e-filing and e-payment beyond Value-Added Tax and encourage migration to e-filing through incentives/benefits/education. The system for the e-payment of taxes is now fully developed and operational (*prior action 1 of DPL 3*). Currently this service is available to customers of the Barclays Bank only, while the other Banks continues to develop and upgrade their IT system so that they can also offer this service to their clients.
15. Following the setting up of the Commercial Division at the Supreme Court operators can also now benefit from the necessary mechanisms for alternative dispute resolutions. The necessary mediation rules have been successfully enacted, a code of conduct for mediation exists and the supplementary guidelines ensuring that the mediation framework is operational has been published. (*prior action 2 of DPL3*)

Continuation

6. Governance of Key Economic Sectors

16. The Government remains committed to ensuring that good governance and transparency exist in areas which are potential sources of public revenues.
17. The fisheries sector remains an important source of public revenue and financial transfers. The Seychelles Fishing Authority has successfully made operational the basic modules of a fisheries information system and is now disclosing statistics on its website every quarter to support fisheries management and inform decision makers and civil society (*prior action 4 of DPL 3*). This follows on from steps taken previously to disclose fishing agreements. The petroleum sector is another important sector whereby the government is keen to strengthen governance and transparency given the potential economic impact any future discoveries may have. Following the statement made last year of the government's intention to adopt the Extractive Industry Transparency Initiative (EITI) we have taken the necessary measures to comply with the candidacy steps (*prior action 3 of DPL3*). Having successfully constituted the multi stakeholder group and developing a costed work plan we have formally submitted our candidature application to the EITI secretariat for consideration.

7. Disaster Risk Management

18. A little more than a year ago during the week of January 27th, 2013, heavy rains resulting from tropical storm Felleng caused severe flooding and landslides in the Seychelles, particularly in four districts on the southeast coast of Mahé (Anse Aux Pins, 'Au Cap, Pointe Larue, and Cascade), as well as on the nearby islands of Praslin and La Digue. The rainfall, which represented 66% of the long-term average and was coming after heavier than normal rains for the month of January, overwhelmed existing natural and constructed drainage systems and retaining walls, causing floods, landslides, and rockfalls, and resulting in serious damage to homes and public buildings, roads, bridges, drainage systems, water and sanitation systems, crops, and farms.
19. Following the request to the international community for assistance, the World Bank responded with a team of experts to conduct a Damage, Loss and Needs Assessment (DaLA), which in turn received financial support through the Global Facility for Disaster Reduction and Recovery (GFDRR). Upon receiving the recommendations of the DaLA, the Government decided to consider the establishment of a DPL with Cat DDO.
20. Recognizing that the DPL with Cat DDO offers a source of immediate bridge financing after a natural disaster the Government is of the view that due to our specificities and vulnerabilities we should pursue this option. This will also assist in the strengthening of the disaster risk management policy and reform agenda in the sector.

Continuation

21. Recognizing the increasing threat of natural disaster and climate change issues, the government places a high priority on increasing disaster resilience with an emphasis on disaster prevention and preparedness by having a comprehensive disaster risk financing strategy in place.
22. In order to adequately institutionalize the DRM aspect in the country as whole it is imperative that the Department of Risk and Disaster Management (DRDM) is further strengthened. We have taken the necessary steps to provide the necessary legal framework for disaster risk management. The National Assembly has adopted the Disaster Management Act, which provides a legal framework for disaster risk management including both a National Disaster Risk Management Plan, and an integrated emergency management system. (*prior action 1 of DPL with Cat DDO*). The development of the National DRM Act has been done in consultation with representatives of government, private sector, non-governmental organizations and development partners.

In addition, the existing DRM Policy is being revised to ensure that it is aligned with the state of affairs of the new National DRM Act. The new policy encompasses a multi-hazard approach that in addition to DRR also includes emergency management and institutional framework for agency coordination. The Cabinet of Ministers has approved an updated policy for disaster risk management, which establishes a fully functional early warning system, increases preparedness through updated sector contingency plans and provides for the carrying out of information dissemination activities. (*prior action 2 of DPL with Cat DDO*)

23. A National Act on DRM and the updated DRM Policy form the cornerstone of Seychelles' national regime for disaster management, and key to the protection of people and property, public awareness, capacity building and effective use of resources across all phases of disaster management from prevention to rehabilitation.
24. With the Disaster Management Act, the Government has adopted a more proactive approach to disaster risk management. The law emphasizes the need for a coherent, comprehensive, integrated approach to disaster risk management across levels and sectors of government and establishes a clear institutional structure for disaster risk management in the country.
25. The National Policy for Disaster Risk Management seeks to facilitate the broad multi-sector approach that effective disaster risk reduction requires, and make this process transparent and thereby foster optimal stakeholder engagement and galvanize actions towards the common goal of building community, district and national resilience to disaster. In this sense, the Policy provides the parameters for the subsequent development of detailed action plans, procedures and protocols to address disaster risk management needs in the various sectors and scenarios present in Seychelles.

Continuation

26. Strengthening institutional basis for disaster risk reduction. The Government recognizes the key role of leadership and coordination for the proper integration of disaster risk reduction throughout socioeconomic sectors of society and as such undertakes to allocate resources for the development of appropriate policies, programs and laws on disaster risk reduction, and its integration into government development planning and sector strategies and plans. In addition, the Government invests into the development of capacities to address current and future DRM requirements, particularly in risk reduction and emergency response by building facilities in strategically positioned safe areas and in sound disaster proof structures.
27. The institutional strengthening effort is based on policies and strategies to promote community involvement in disaster risk reduction including the delegation and provision of the necessary authority and resources where appropriate.
28. Improving risk assessment, early warning systems and disaster preparedness. A knowledge and understanding of the nature and scale of potential hazards is central to the reduction of disaster risk, therefore to strengthen this essential knowledge base the Government of Seychelles is supporting the development and sustainability of the appropriate scientific, technological and technical capacities necessary to research, observe, analyze, map and forecast natural and related hazards, vulnerabilities and disaster impacts. This enhanced capacity will provide in a short-term periodic updating of risk maps and related information, including indicators of disaster risk and vulnerability at national and district levels for decision-making and the public.
29. Although Seychelles has made good progress towards risk assessment and monitoring systems a comprehensive national level assessment is lacking, and data sharing is weak. In order to address the situation under the National DRM Act it is a requirement for a national risk information database to be established. The DRDM is in the process of establishing an online platform to share geo-spatial risk information.
30. Seychelles is partnering with international agencies to establish and maintain databases on disaster occurrence, impacts and losses and disseminate related statistical information nationally and internationally as appropriate - including international cooperation in the assessment, monitoring and information exchange on regional and trans-boundary hazards. Currently a historic loss and damage database in collaboration with UNISDR and the Indian Ocean Commission was established and is available for on-line public consultation (*prior action 3 of DPL with Cat DDO*).
31. Drawing from the knowledge base, information, experience and international cooperation, the country has embarked in the task to develop targeted, effective, people-centered early warning systems with related actions, emergency protocols and regular drills. The enhancement of the system will support National Government decision-making processes and positively impact the capacity development in disaster risk reduction initiatives at regional level.
32. To further avoid disruptions in the aftermath of natural disaster the Government started to establish sector specific contingency plans, such as for education, tourism, industry and municipalities. The Government remains committed to develop more contingency plans for other critical sectors and continuously update existing contingency plans.

Continuation

33. Developing a culture of safety and resilience. The targeted provision of information to decision-makers, planners, and technicians, public agencies, the private sector and the general public is central to empowering society as a whole to make informed choices and foster a culture of disaster risk reduction and resilience. The government therefore is supporting the development, implementation and adaptive review of a national disaster risk reduction communications program to provide plain language information on disaster risks and protection options to the general public and hence enable people to take action to reduce risk and build resilience in their daily lives.
34. In spite of the progress achieved, the Government recognizes that further undertake needs to be carried out to develop a culture of safety and resilience in the country, such as the integration of disaster risk reduction knowledge into relevant aspects of school curricula and the development risk assessment and disaster preparedness programs in institutes of higher education, as well as the implementation of a multimedia-based public education and awareness program targeted at the different sectors of society as appropriate, with public outreach, consultations and sustained public education campaigns.
35. Reducing underlying risk factors. The integration of the tenants of disaster risk reduction into environment and development planning and management processes is key to the reduction of underlying risk factors, therefore Seychelles committed to the sustainable use and management of ecosystems by promoting land-use planning and development activities that reduce risk and vulnerabilities, implementing integrated environmental and natural resource measures that incorporate disaster risk reduction such as integrated flood management and sound management of fragile ecosystems, and factoring in risk reduction for existing climate variability and projected future climate change including the identification of climate-related disaster risks for decision-making processes and the design of specific risk reduction measures.
36. Incorporate systemic redundancy measures into social and economic development practices are critical to secure proper emergency management, daily life disruption, and continuation of services. The DRDM is in the process of mapping key assets and strategic infrastructure, and capabilities for rapid disaster response deployment, in addition to fostering public-private sector partnerships to harness full national capacities and encourage the private sector to develop a culture of disaster prevention.
37. The National Government has been proactively promoting the development of social support mechanisms such as insurance against disaster scenarios, through the agricultural insurance scheme, and establishment of national emergency provision funds in particular for the most vulnerable in society, through the establishment of two reserve/savings funds for more frequent disasters with lower magnitude, these are a Budget Contingency Fund and a National Disaster Relief Fund.
38. Finally, Seychelles has taken actions to mainstream disaster risk considerations into land use and development planning procedures by identifying zones that are available and safe for human settlement, incorporating disaster risk assessments into urban planning and disaster-prone and/or highly populated areas, integrating disaster risk considerations into planning procedures (i.e. design, approval and implementation) for major infrastructure and tourism projects, and revising existing or developing new building codes and standards, and reinforcing the capacity to implement, monitor and enforce such codes.

Continuation

Conclusion

39. As the above indicate, the Government of the Republic of Seychelles is strongly committed to undertaking necessary reforms to promote economic growth modernize our country and build resilience against natural disasters. In this context, the support of The World Bank through approval of the Development Policy Loan and the Development Policy Loan with a Catastrophic Deferred Drawdown option would be important to successful implementation of the government's continued reform agenda and its quest to become more resilient.
40. Accordingly, the Government of the Republic of Seychelles requests that Development Policy Loans be approved.

Yours Sincerely



Pierre Laporte
Minister



International Year of Small Island Developing States:
Seychelles A Determined Island Nation

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ANNEX 4 - Map of Seychelles

