

**PROGRAM INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: AB7591  
June 24, 2014

<b>Operation Name</b>	THIRD SUSTAINABILITY AND COMPETITVENESS DEVELOPMENT POLICY LOAN
<b>Region</b>	AFRICA
<b>Country</b>	Republic of Seychelles
<b>Sector</b>	Central government administration (60%); Public administration- Financial Sector (20%); General public administration sector (20%)
<b>Operation ID</b>	P146567
<b>Lending Instrument</b>	Development Policy Lending
<b>Borrower(s)</b>	GOVERNMENT OF SEYCHELLES
<b>Implementing Agency</b>	MINISTRY OF FINANCE - SEYCHELLES
<b>Date PID Prepared</b>	June 24, 2014.
<b>Estimated Date of Appraisal</b>	June 25, 2014.
<b>Estimated Date of Board Approval</b>	September 25, 2014.
<b>Corporate Review Decision</b>	Authorization to Appraise and Negotiate
<b>Other Decision</b> <i>{Optional}</i>	

**I. Key development issues and rationale for Bank involvement**

1. **This program document proposes a Third Sustainability and Competitiveness Development Policy Loan (DPL3) in the amount of US\$7 million equivalent to the Republic of Seychelles.** The proposed operation is the last in a programmatic series of three operations. The development objectives of the DPL programmatic series are to enhance competitiveness and improve fiscal sustainability. To achieve those objectives, this series 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 control over public enterprises.

2. **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 a payment default in 2008, the Seychelles government energetically pursued reforms, with support of the International Monetary Fund (IMF) and World Bank, among others. Its economic restructuring program focused on liberalizing the exchange regime, significantly 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.

3. **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 the 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 growth<sup>1</sup> while bottlenecks in infrastructure remain a critical constraint. In the social sectors, teen pregnancy is a major issue<sup>2</sup> as well as non-communicable diseases and the relatively poor quality of education outcomes, particularly in science.<sup>3</sup> Continued reforms and strong macroeconomic reforms are needed to address these challenges.

4. **This operation supports the government's sustained reforms to build up economic resilience.** This operation supports measures to maintain the strong fiscal discipline necessary to attain the goal of reducing the public debt ratio to 50 percent of GDP by 2018. The government's reforms are strengthening institutions to improve public financial management. Progress towards improving governance in the social protection system continues, as well as efforts to increase the sustainability of the Seychelles Pension System. The operation also supports the close monitoring of existing or emerging contingent liabilities from state-owned enterprise (SOEs) or the financial sector. The monitoring system of SOEs is being strengthened, and all SOEs will have to submit audited financial statements to an independent commission for supervising public enterprises. In the same spirit, the reforms are continuing to improve the fiscal performance of the Public Utility Company (PUC), including implementation of tariff reforms. Finally, the reforms supported by this operation aim to make the economy significantly more competitive. To further improve the business environment, a system for online payment of taxes is being introduced, and rules related to mediation are being enacted. Transparency and governance are being further enhanced in the petroleum and fisheries sectors, which have the potential to accelerate economic growth. While poverty is negligible in Seychelles, reforms supported by this program, particularly those aimed at improving the targeting of social assistance, are expected to share prosperity more equitably, as Seychelles has one of the highest Gini coefficients in the world.

5. **The overall implementation risk is moderate.** Implementation has been substantially frontloaded, and the government has shown remarkable leadership in pursuing the reform agenda. The country has already achieved substantial results with the assistance of the previous two operations, which has reduced the risk of political and social resistance to reforms. Any remaining risk, such as the limited institutional capacity within sector ministries, is low and is being overcome with substantial technical assistance. The risk that uncertain global developments may threaten Seychelles' macroeconomic stability is mitigated by the means and tools available to the government to cope with external shocks (such as the country's growing

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<sup>1</sup> Seychelles is ranked 80 in the World Bank's Ease of Doing Business Index for 2014, a fall from 74 in 2013.

<sup>2</sup> Thirty-two percent of all first pregnancies occur among 15 to 19 year olds.

<sup>3</sup> 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.

external reserves and flexible exchange rate). Furthermore, the reforms supported by this operation are also aimed at increasing Seychelles' economic resilience.

## **II. Proposed Objective(s)**

6. **The development objectives of the DPL programmatic series are to enhance competitiveness and improve fiscal sustainability.** To achieve those objectives, this series 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. This series is consistent with the World Bank Group's Country Partnership Strategy (CPS) for FY12–FY15, discussed by the Board on April 3, 2012, and supports areas of reforms identified in the CPS.

## **III. Preliminary Description**

7. **The proposed DPL, in an amount of US\$7 million is the third (and final) in a series of three annual programmatic Bank operations in support of the government's reform program.** The DPL series is the principal instrument identified in the Bank's CPS for supporting the government's reform program. The series envisages three annual DPLs over 2012-14, aligned with the budget cycle, which is the government's primary vehicle for introducing new policy initiatives. Within the government program, the proposed operation supports a subset of reforms that will enable the authorities to: (i) improve the business climate; (ii) enhance fiscal transparency; (iii) improve public financial management; (iv) improve the targeting of social assistance; and (v) increase fiscal oversight and controls over public enterprises. The selection of these areas was guided by upstream policy dialogue with the IMF, World Bank, and other development partners and underpinned by analytical work. This program takes a pragmatic approach that focuses on reforms that can be completed in the medium term while bringing also immediate results, while building the foundations for broader reform over the longer term.

## **IV. Poverty and Social Impacts and Environment Aspects**

8. **The proposed DPL series is expected to have a favorable impact on poverty and social indicators.** The policy focus of the operation addresses poverty in the following three ways: (i) social protection programs will protect the poor and help them to rise out of poverty; (ii) an improved investment climate will help to increase investment and create jobs; and (iii) enhanced efficiency in public expenditure is likely to yield savings that can be reallocated to support social programs. The actions supported under (ii) and (iii) are not expected to have any direct distributional impact on the poor. With regard to the reform of social protection programs, mitigation measures have been included to protect the most vulnerable. While reforms to social contributions (i.e. increase in pension contributions and new rule on sick leave) will improve fiscal sustainability they may have a short term impact on the cost of employment. This however is not expected to have a long term impact on Seychelles competitiveness that overall is expected to improve thanks to reforms in the business environment.

9. **This programmatic DPL series will improve the targeting of assistance to poor and vulnerable people.** One-third of welfare assistance recipients in Seychelles come from middle- or high-income brackets. This programmatic series supports the implementation of a robust,

automated management information system (MIS) to determine eligibility for benefits, thereby reducing management's discretionary power over the determination of eligibility. It is estimated that this reform will increase the share of beneficiaries in the poorest quintile from 56 percent to 64 percent, while the number of beneficiaries in other quintiles will fall commensurately.<sup>4</sup> Subsequently, the program will support legislative changes to include more sources of income in the eligibility calculation, which is expected to further enhance the targeting of benefits.

**10. The reforms to better target social assistance also include mitigation measures to ensure that those most vulnerable are not excluded from safety net programs.** First, information campaigns have been carried out to inform the general public about the reasons for the reforms and about the new eligibility criteria. Second, no beneficiary is being excluded from the program during the payment cycle as entitlements are being reassessed only during the regular recertification cycle. Third, a grievance redress mechanism (an independent Review Panel) has been set up to reduce the risk that the poor may be excluded from the Social Welfare Assistance Program.

**11. Reforms to the disability system supported by this programmatic DPL series are expected to improve equity.** Participants in a focus group conducted by the ASP noted that the previous assessment process for disability benefits (i) did not sufficiently promote the social integration of disabled individuals; (ii) lacked rehabilitation and job opportunities; (iii) created a perception that employment could result in a loss of disability income; (iv) did not respond to transportation challenges that prevented some individuals from accessing their disability benefits; and (v) did not effectively promote public awareness that disabled individuals can contribute to society. To address these challenges, new functional criteria for disability certification have been adopted, thereby improving the eligibility assessment.<sup>5</sup> The goal is to promote equity by identifying and targeting those who truly need the disability benefits. The revised eligibility assessment incorporates a return to work approach, promoting the social integration of disabled individuals and including non-medical professions on the medical board to identify the functional abilities of applicants and any need for rehabilitation. The functional criteria for assessment will be applied to all new beneficiaries. Meanwhile, the current beneficiaries will continue to receive their benefits until they are due for recertification when the new functional criteria for assessment will be applied to them.

**12. Reforms supported by this DPL3 to better link contributions and pensions paid are expected to have a positive impact on equity, and a transition period is put in place to protect those close to retirement.** As discussed, the reforms promote equity among SPF beneficiaries by ensuring that benefits are linked to the length of the contribution period as well as to the amount of contributions paid. Contributions will be linked directly to benefits, and SPF pension benefits will continue to serve as an income replacement tool in retirement. The current non-contributory social pensions will complement the SPF benefits and help to protect retirees from falling into poverty. At the same time, the reforms of the SPF aim to increase the long-term fiscal sustainability of the pension system and thus protect all future generations of elderly people. The real income of current and future retirees will be maintained because increases in

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<sup>4</sup> These estimates are based on an assessment of "pre-transfer" income and therefore differ slightly from estimates presented in the section discussing the policy reform, which are based on "post-transfer" income levels.

<sup>5</sup> Also, Seychelles has ratified the UN Convention on the Rights of People with Disabilities, and consequently the government is gradually removing barriers to the effective participation of people with limited functional ability in society on an equal basis with others (including changes in the workplace, sidewalks, public transportation, and other facilities).

pensions will be linked to inflation. Those individuals who are close to retiring and currently have relatively short contribution periods will not have the chance to build up a longer contribution period before retirement and therefore their benefits will be lower post-reform compared to pre-reform. However, the SPF is putting transitional arrangements in place to apply the pre-reform eligibility rules to these individuals through to the end of 2017.

13. **The increase in utility tariffs supported in this DPL3 will be accompanied by measures to shield the poor.** Measures to increase efficiency are not expected to affect employment in utilities, but they will affect the utility prices paid by consumers. The effect of the tariff increase on the poverty and vulnerability of households is likely to be moderate, mainly because it will be phased in gradually from now until 2022 and the government will mitigate it through the existing social assistance system. The cost of utilities is a defined component in the measurement of welfare assistance, and the government has decided that households will be compensated for the tariff increase through the Social Welfare Assistance Program. The number of eligible people in 2020 will reach 3,664, and the total annual budget required to extend benefits to them will be nearly SR 20 million (compared to 2,794 people receiving welfare assistance in 2011 and SR 15 million respectively). The improved targeting of social protection services supported under this operation will also improve the identification of vulnerable households and protect them from additional tariff increases in the future.

14. **Policy actions supported by this DPL series are unlikely to have any negative effects on the country's environment and natural resources.** Reforms supported by the proposed DPL3 are expected to facilitate the creation of formal businesses that are likely to comply with environmental regulations. Improvements in accountability and governance in the fisheries and oil sectors will have a positive long-term impact on the environment and natural resources. Greater transparency in these sectors may also strengthen the oversight role played by civil society. It may also step up participation by civil society and stakeholders in the debate on sound sector policies. The implementation of cost recovery utility tariffs and adjustment mechanisms will help to reduce energy consumption and will foster incentives to promote the use of clean, renewable energy.

15. **Adherence by Seychelles to EITI principles in the oil sector is supporting improved governance as the EITI principles require the full publication and verification of company payments and government revenues from natural resources.** The government recognizes that the risk of environmental impact is inherent in the oil sector and would like to develop the legal and institutional capacity to better manage these environmental concerns. The United States Bureau of Ocean Energy Management, Regulation, and Enforcement (BOEMRE) is providing technical assistance to Seychelles to build its capacity to manage the environmental effects of oil extraction.<sup>6</sup>

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<sup>6</sup> To date, this assistance has been delivered in the form of workshops and seminars held in Victoria. Topics have included: (i) authorizing and inspecting exploration and production infrastructure; (ii) oil spill response planning; (iii) environmental review and compliance; and (iv) platform safety and inspections. The BOEMRE plans to continue its capacity-building engagement with Seychelles in these and other petroleum regulatory areas.

## V. Tentative financing

Source:	(\$m.)
BORROWER/RECIPIENT	0
International Development Association (IDA)	0
Borrower/Recipient	0
IBRD	7 million
Others (specify)	
Total	7 million

## VI. Contact point

### World Bank

Contact: Rafael Muñoz Moreno

Title: Senior Economist

Tel: 5259+2521 / 230 203 2521

Fax: 230 208 0502

Email: [rmunozmoreno@worldbank.org](mailto:rmunozmoreno@worldbank.org)

Location: Port Louis, Mauritius (IBRD)

### Borrower

Contact: Honorable Pierre Laporte

Title: Minister for Finance, Trade and Investment

Tel: + 248 438 2120

Email: [minister@finance.gov.sc](mailto:minister@finance.gov.sc)

## VII. For more information contact:

The InfoShop

The World Bank

1818 H Street, NW

Washington, D.C. 20433

Telephone: (202) 458-4500

Fax: (202) 522-1500

Web: <http://www.worldbank.org/infoshop>