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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

ON A PROPOSED LOAN

IN THE AMOUNT OF US\$7.0 MILLION

TO THE

REPUBLIC OF SEYCHELLES

FOR THE

THIRD SUSTAINABILITY AND COMPETITIVENESS  
DEVELOPMENT POLICY LOAN

AUGUST 29, 2014

GMFDR  
AFCS2 Country Management Unit  
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

### **ABBREVIATIONS AND ACRONYMS**

ADR	Alternative Dispute Resolution
AfDB	African Development Bank
AIDS	Acquired immune deficiency syndrome
ASP	Agency for Social Protection
BOEMRE	Bureau of Ocean Energy Management, Regulation and Enforcement
CBS	Central Bank of Seychelles
CIC	Investment Climate Department (CIC)
CPS	Country Partnership Strategy
DPL	Development Policy Loan
EEZ	Exclusive Economic Zone
EFF	Extended Fund Facility
EITI	Extractive Industries Transparency Initiative
EU	European Union
FDI	Foreign direct investment
FY	Fiscal year
GDP	Gross domestic product
GST	Goods and Services Tax
HFC	Housing Finance Company
HIV	Human immunodeficiency virus
IBRD/Bank	International Bank for Reconstruction and Development
IDA	International Development Association
ICF	International Classification of Functioning, Disability, and Health
IFC	International Finance Corporation
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
IT	Information technology
kWh	Kilowatt hour
kVA	Kilo-volt ampere
M&E	Monitoring and evaluation
MIS	Management information system
MoFTI	Ministry of Finance, Trade, and Investment
MSE	Micro and small enterprise

OCR	Office of the Company Registrar
ORG	Office of the Registrar General
PEFA	Public Expenditure and Financial Accountability
PEMC	Public Enterprise Monitoring Commission
PEMD	Public Enterprise Monitoring Division
PER	Public Expenditure Review
PFM	Public financial management
PPBB	Programme Performance Based Budgeting
PUC	Public Utility Company
SFA	Seychelles Fishing Authority
SPF	Seychelles Pension Fund
SR	Seychelles Rupee
SSI	Société Seychelloise d'Investissement
UNDP	United Nations Development Program
US\$	United States Dollar
VAT	Value added tax

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**REPUBLIC OF SEYCHELLES**  
**THIRD SUSTAINABILITY AND COMPETITIVENESS DEVELOPMENT POLICY LOAN**

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**SUMMARY OF PROPOSED LOAN AND PROGRAM  
REPUBLIC OF SEYCHELLES  
THIRD SUSTAINABILITY AND COMPETITIVENESS DEVELOPMENT POLICY LOAN**

Borrower	Republic of Seychelles
Implementing Agency	Ministry of Finance, Trade, and Investment
Financing Data	Terms: A IBRD Fixed Spread Loan with a commitment-linked repayment schedule, a final maturity of 25.5 years including a grace period of 10 years, and level principal repayments. Amount: US\$7 million.
Operation Type	Programmatic Development Policy Loan (DPL) (three operations); the proposed operation is the third and final in the series.
Pillars of the Operation and Program Development Objective(s)	<p>The development objectives of the DPL programmatic series are to enhance competitiveness and improve fiscal sustainability. To achieve those objectives, this series supports actions that will: (i) improve private sector business environment; (ii) improve transparency in key economic sectors; (iii) improve expenditure efficiency; (iv) improve targeting, automation and monitoring and evaluation in the social protection system; and (v) ensure cost recovery and long-term financial sustainability of utilities.</p> <p>The main policy areas of the operation are business environment, fiscal transparency and accountability, social protection, public expenditure efficiency.</p>
Result Indicators	<ul style="list-style-type: none"> <li>• Reduction in number of days required to register a business.</li> <li>• Increase in the percentage of businesses filing their taxes online.</li> <li>• Increase in the number of commercial cases resolved at the commercial court within 12 months as a share of all cases lodged.</li> <li>• Increase in the number of approved housing loans using the new subsidy policy.</li> <li>• More public disclosure of key information in the petroleum and fisheries sectors.</li> <li>• Reduction in the difference between voted and executed budget.</li> <li>• Increase in the percentage of public enterprises that submit their audited financial statements to the Minister of Finance and to the PEMC by March 31.</li> <li>• Reduction in the share of ineligible beneficiaries on welfare assistance.</li> <li>• Spending on reformed social assistance programs stabilizes.</li> <li>• Increase in contribution revenues to the Seychelles Pension Fund.</li> <li>• Reduction in operating losses incurred by the Public Utility Company before subvention by government.</li> </ul> <p>The details on the established baselines and targets for the results indicators can be found in the results matrix annex.</p>
Overall Risk Rating	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 support of the previous two operations, which has reduced the risk of political and social resistance to reforms. The remaining risks, such as the limited institutional capacity within the sector ministries, is moderate and is being overcome by substantial technical assistance. In addition, the government is taking measures to mitigate and better cope with the impact of natural disasters.
Operation ID	P146567.





# **IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN TO THE REPUBLIC OF SEYCHELLES**

## **1. INTRODUCTION AND COUNTRY CONTEXT**

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 actions that will: (i) improve private sector business environment; (ii) improve transparency in key economic sectors; (iii) improve expenditure efficiency; (iv) improve targeting, automation and monitoring and evaluation in the social protection system;; and (v) ensure cost recovery and long-term financial sustainability of utilities.

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 an Upper-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.<sup>1</sup> Poverty in Seychelles is relatively low, with less than 2 percent of the population living on less than US\$2 per day. However, inequality increased between 2000 and 2007 and 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.<sup>2</sup> Since 2008, the government has implemented a series of reforms to address public sector governance issues, which improved a number of governance indicators.<sup>3</sup>

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 a payment default in 2008, the Seychelles government energetically pursued reforms, with support of the International Monetary Fund (IMF) and World Bank,

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<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> Seychelles ranked at the 55<sup>th</sup> percentile on Rule of Law in the 2012 World Bank's Worldwide Governance Indicators, and it ranked 4<sup>th</sup> in the 2013 Ibrahim Governance indicators of African countries, in line with previous years.

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.

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 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>4</sup> while bottlenecks in infrastructure remain a critical constraint. In the social sectors, teen pregnancy is a major issue<sup>5</sup> as well as non-communicable diseases and the relatively poor quality of education outcomes, particularly in science.<sup>6</sup> Continued reforms and strong macroeconomic reforms are needed to address these challenges.

6. **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 and economic resilience. This is further reinforced by the parallel DPL with a Catastrophe Deferred Drawdown Option (CAT DDO) that will enhance preparedness and awareness to reduce vulnerability to disasters and provide liquidity to cope with immediate reconstruction needs should a natural disaster takes place. 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 not massive 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.

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<sup>4</sup> Seychelles is ranked 80 in the World Bank's Ease of Doing Business Index for 2014, a fall from 74 in 2013.

<sup>5</sup> Thirty-two percent of all first pregnancies occur among 15 to 19 year olds.

<sup>6</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.

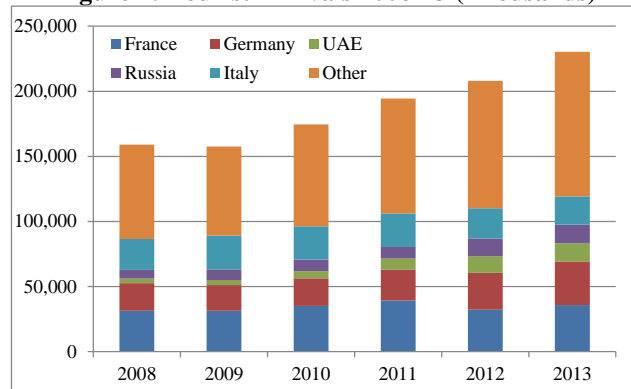
7. **The overall implementation risk is moderate.** Implementation has been substantially frontloaded, and the government has shown remarkable leadership in pursuing the reform agenda. The country has already achieved substantial results with the assistance of the previous two operations, which has reduced 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 external reserves and flexible exchange rate). Furthermore, the reforms supported by this operation are also aimed at increasing Seychelles' economic resilience.

## 2. MACROECONOMIC POLICY FRAMEWORK

### 2.1 Recent Economic Developments

8. **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.<sup>7</sup> Tourist arrivals from non-traditional markets (Russia, China, the Middle East, and Germany) also increased as a result of a consistent and 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. Also, the Seychelles Petroleum Company (SEYPEC) continued to incur losses in its tanker operations.<sup>8</sup>

**Figure 1: Tourist Arrivals 2008-13 (Thousands)**



Source: National Bureau of Statistics

9. **Fiscal performance continues to be strong 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<sup>9</sup>. This was partially compensated for by better than projected non-tax revenues (4.5 percent of GDP), mostly dividends from parastatal bodies. The government adjusted its public expenditure during the year in line with the deficit objective. This was mostly 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

<sup>7</sup> Air Seychelles was restructured in 2012 and entered into a strategic partnership with Etihad Airways.

<sup>8</sup> SEYPEC has now a new contract with German Tanker Shipping (GTS) that is expected to stop the losses.

<sup>9</sup> Despite successful introduction of the VAT in 2013, toward the end of the year VAT receipts began to fall a little short of projections in part because weaker activity amongst some industries (i.e. construction sector).

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.

10. **Debt reduction accelerated and the debt restructuring is almost completed.** The debt restructuring - launched in the aftermath of Seychelles' 2008 debt crisis, when total debt had reached 131 percent of GDP and external debt was 83 percent of GDP - is now almost completed, pending final resolution with Russia.<sup>10</sup> 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.

11. **The current account deficit improved in 2013, mainly due 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 an 11 percent growth in tourism earnings and a 25 percent increase in tuna exports. Import 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 GDP<sup>11</sup>, 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.

12. **Inflation continued on a downward path to reach 4.3 percent in 2013, and excess liquidity in the banking system is being mopped up.** Inflation reached a peak year-on-year (yoy) rate of 13.1 percent in 2012, before declining to lower levels, thanks to successful monetary tightening. The introduction of the VAT in the first quarter of 2013 and the rebalancing of utility tariffs in November 2013 caused a temporary uptick in inflation. Also, 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 mop up excess liquidity.

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<sup>10</sup> Russia signed the Paris Club agreed minutes but has to reach a bilateral agreement with Seychelles to implement the terms.

<sup>11</sup> IMF as revised the FDI numbers to include an estimate for the offshore sector in the BOP (US\$60 million in 2014).

13. **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 capital to risk-weighted assets ratio stood at 26.7 percent in 2013 in line with 2012 figures and above the minimum adequacy ratio of 12 percent. Also, the share of non-performing loans was 9.4 percent, still high but declining. Overall, the financial system is relatively small and underdeveloped, and the ratio of domestic credit to GDP is 35 percent.<sup>12</sup> 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-sized enterprises (SMEs) and by the lack of a coherent strategy for developing the integrated financial sector.<sup>13</sup> On the positive side, deposit accounts in Seychellois banks are high.<sup>14</sup> 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 lower rate than the rate of expansion of deposits, and average interest rate spreads dropping from an average 12.2 percent in 2010 to 8.2 percent in December 2013.

**Table 1: Selected Economic Indicators, 2011–16**

Indicator	2011	2012	2013	2014 (proj)	2015 (proj)	2016 (proj)
<b>National Income and prices (annual percent growth)</b>						
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
<b>Government Budget (percent of GDP)</b>						
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 <sup>a/</sup>	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
<b>External Sector and Gross Financing Requirements (in US million)</b>						

<sup>12</sup> Compared, for instance, to 88 percent in Mauritius.

<sup>13</sup> The World Bank is currently undertaking a comprehensive assessment of the financial sector to support the government in devising a Financial Sector Development Implementation Plan.

<sup>14</sup> 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, among which an estimated 40,000 are considered bankable by commercial bankers. In addition, there were also 12,726 commercial bank and credit union borrowers.

Indicator	2011	2012	2013	2014 (proj)	2015 (proj)	2016 (proj)
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
<b>Gross External Financing requirements</b>	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
<b>Memo Items</b>						
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 account balance, including 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

14. **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 remain 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.<sup>15</sup> 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.

15. **Fiscal policy is geared toward bringing down 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.<sup>16</sup> The government expects to reduce public expenditure as a share of GDP by 3.2 percent points in

<sup>15</sup> While penetrating new markets will certainly help, experience shows that this takes time. The policy of developing additional outer islands for tourism will also help in the longer term.

<sup>16</sup> Revenue efforts will focus on streamlining exemptions, improving excise management, enhancing audit functions, and strengthening compliance.

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 a freezing of recruitment and a reduction in non-priority expenditures. Also, 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.

**16. The 2014 Debt Sustainability Analysis (DSA) projects that the debt-to-GDP ratio will gradually be brought down to 50 percent by 2018 from 65 percent in 2013.**<sup>17</sup> 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 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 shocks<sup>18</sup> 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 and a depreciation of the Seychelles rupee but the external debt after the shock would have a declining trajectory.<sup>19</sup> Roll-over risks are partially offset by the significant government deposits (around 20 percent of total rollover needs). Also, 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.

**17. 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 EFF is broadly in line with fundamentals, will provide a buffer against 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.

**18. Overall, Seychelles' macroeconomic framework for 2014–16 is adequate for development policy lending.** This assessment is based on the country's broadly favorable

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<sup>17</sup> 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.

<sup>18</sup> 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.

<sup>19</sup> 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.

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, further reinforced by the contingent lending from the parallel Bank CAT DDO operation. Furthermore, reforms supported by this operation and by the IMF's Extended Fund Facility (EFF) are helping Seychelles to build up its economic resilience.

### 2.3 IMF RELATIONS

19. **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 has approved on June 4, 2014 a new three-year Extended Fund Facility (EFF) for US\$17.8 million. 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 SOEs. The EFF and Bank DPL have been closely coordinated to support the overall government reform program, particularly in areas such as pension and social assistance reform, SOEs supervision and 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. Also, the Bank and the Fund are jointly providing assistance for the Seychelles Medium-term Debt Strategy (MTDS).

### 3. THE GOVERNMENT'S PROGRAM

20. **The government's program is spelled out in the draft Medium-term National Development Strategy.** This operation supports some of the government's main goals, particularly: (i) maintaining a stable macroeconomic framework and securing a primary fiscal surplus by increasing public sector efficiency; (ii) accelerating private sector-led economic growth by improving the business environment; and (iii) improving basic infrastructure services that are progressively financed by end users.

21. **The government continues its efforts to increase public sector efficiency by improving transparency and governance, including public financial management.** Since 2008, the government has implemented a series of reforms to improve fiscal policy and increase public sector efficiency. The reforms also address public sector governance issues, including: (i) modernizing the public sector by ensuring institutions are operating in accordance with their policies or service delivery mandates; (ii) rolling back the role of government in commercial activities by reducing the role of State Owned Enterprises (SOEs) in the economy, improving their management, and introducing a new wage structure aligned with that of the private sector; and (iii) redefining the accountability structure of the different institutions in charge of service delivery. This effort also includes increasing the efficiency and improving the governance of the social protection system as well as the transparency and governance of the petroleum and fisheries sectors. The government has committed itself to



working with civil society and companies to enhance its role in promoting accountability and transparency in the petroleum sector through the Extractive Industries Transparency Initiative (EITI).

22. **The government is improving the business environment to enhance private sector-led growth.** This involves reducing red tape, streamlining business processes, eliminating unnecessary procedures, and increasingly making use of IT systems to reduce processing time. As such, the government has eliminated a number of export permits, introduced an online system for applying for trade licenses, improved the framework for foreclosures, streamlined the procedures for business entry and for obtaining construction permits, and moved toward implementing online systems for registering property titles and making tax payments. The government is also increasing transparency and competitiveness in the financial system.

23. **The government is seeking to progressively improve infrastructure services that are financed by user fees.** With the financial and technical support of the European Investment Bank and *Agence Française de Développement* as well as technical assistance from other partners, the government is increasing efficiency and sustainability in the water and energy sectors.<sup>20</sup> In the water sector, this effort will help to address challenges related to non-revenue water, the replacement of pipes, metering, and storage capacity. As a result, it is expected that water losses will be reduced from an estimated 40 to 60 percent to 25 to 35 percent. In the energy sector, efforts to increase energy efficiency and use of renewable energy are ongoing. The Bank has approved a SIDS DOCK grant<sup>21</sup> to support the preparation of grid codes, feed-in tariffs, and model energy supply purchase agreements for renewable energy technologies. The Abu Dhabi Development Fund has supported the installation of a 6-megawatt wind turbine. In addition, the government is raising tariffs and improving the tariff structure to increase the financial sustainability of the PUC.

## 4. THE PROPOSED OPERATION

### 4.1 Links to Government Programs and Operation Description

#### *Links to the Government's Areas of Reform*

24. **The programmatic series is aligned with the government's priorities.** Within the government program, the proposed operation supports a subset of actions that will enable the authorities to: (i) improve private sector business environment; (ii) improve transparency in key economic sectors; (iii) improve expenditure efficiency; (iv) improve targeting, automation and monitoring and evaluation in the social protection system; and (v) ensure cost recovery and long-term financial sustainability of utilities. The selection of these actions 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.

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<sup>20</sup> In the water sector, the government has secured a concessional loan of €27 million from the European Investment Bank; discussions for an additional loan of €30 million from the *Agence Française de Développement* are ongoing.

<sup>21</sup> <http://sidsdock.org/>

## ***Lessons Learned and Reflected in Operation Design***

25. **The DPL series has moved forward the reform process substantially across all areas.** The business climate has been improved, with easier business registration procedures, and mediation rules in place. Fiscal transparency has been enhanced with regular information on fisheries agreements and the participation in the EITI to ensure adequate dissemination of petroleum revenues. There have been decisive steps to improve the public financial management system with the introduction of performance budget systems. Social assistance and housing benefits are better targeted and pension calculations better reflect the entire work life. Fiscal oversight and control over public enterprises are strengthened through the introduction of monitoring units, and more stringent presentation of audited accounts, which combined with increased tariffs reduce the fiscal risks. Furthermore, the government and the Bank have adapted the program during implementation to balance institutional capacity constraints and the ambitious reform program of the government. This has been complemented when needed with additional technical assistance, often financed by the government.

26. **The first two operations of this series provided important lessons that have informed the preparation of this DPL3.** Previous operations before this DPL series offer limited insights and lessons as they were done in an emergency context (addressing the 2008 bankruptcy) while the on-going program deals with more long term challenges. The previous two operations of this series provided lessons that guide the design of DPL3. These lessons included the need to ensure: (i) a strong emphasis on knowledge and technical assistance to increase institutional capacity and support reform implementation; (ii) close coordination among development partners; and (iii) strong government leadership. Given the broad reform program that is being supported and the limited capacity of the public sector in a few areas where knowledge and highly specialized skills are required, a combination of analytical work and technical assistance has been critical. Throughout this programmatic series, the Bank has produced analytical reports, often financed by the government, to inform policy reforms, including program-based budgeting, pension sustainability, and tariff reforms. In addition, technical assistance, also often financed by the government, is supporting the implementation of all reforms supported by this program. Also, donor coordination and the harmonization of policy dialogue and support provided to the government has proved to be essential to prevent duplication and has reduced the government's transaction costs. Finally, leadership and political commitment have been critical factors in the successful implementation of reforms, complemented by strong institutional capacity at the Ministry of Finance, Trade, and Investment (MoFTI) in designing and monitoring the implementation of the reform agenda.

## 4.2 Prior Actions, Results, and Analytical Underpinnings

**Table 2: DPL3 Proposed Triggers and Prior Actions**

<i>Actions taken to</i>	<i>DPL3: Indicative triggers</i>	<i>DPL3: Proposed prior actions</i>	<i>Has it changed significantly: Why?</i>
Improve private sector business environment	The government has introduced a system for e-payment of taxes for business tax payers, including for Banks which do not already have e-payments facilities.	The Borrower has developed an operational system for the e-payment of taxes.	No: The e-payment system will allow for the payment of all type of taxes not just business taxes.
	The government has enacted rules related to mediation and published a code of conduct for mediators.	The Borrower has: (i) enacted rules related to mediation, which establish rigorous and well-defined procedures, whereby cases are referred to a neutral, independent third party for out-of-court dispute resolution; (ii) published a code of conduct for mediation; and (iii) published supplementary guidelines to ensure that the mediation framework is operational.	No: The publication of supplementary guidelines has been added to the action to help to ensure effective functioning.
	The government has computerized the title registration system.		Dropped: The computerized title registration system will require more time than originally envisaged to be operational.
Improve transparency in key economic sectors	The government has joined the Extractive Industry Transparency Initiative (EITI) program by implementing the five EITI candidacy steps.	The Borrower has formally requested to join the EITI after complying with all the candidacy steps.	No.
	The Seychelles Fishing Authority has developed its Fisheries Information System, which has become operational for the production of statistics at regular frequency and these statistics are made available to the public to support fisheries management and inform decision-makers and civil society.	The Seychelles Fishing Authority: (i) has made operational the basic modules of a Fisheries Information System and (ii) discloses statistics on its website every quarter to support fisheries management and inform decision-makers and civil society.	No.
Improve expenditure efficiency	The government has piloted the implementation of programme performance-based budgeting (PPBB) in two ministries from January 2014.	The Cabinet has approved the financial regulation and accounting manual aligned with the new PFM Act (2012).	Yes: The government needs more time to complete the preparation work and build the capacity necessary to start the pilot.
	Each public enterprise has submitted audited financial statements to the Minister of Finance and to the Public Enterprise Monitoring Commission (PEMC) within three months of the end of its financial year.	Twelve Borrower's public enterprises (out of twenty-one) have submitted their audited financial statements for their last completed fiscal year to the Minister of Finance and to the Public Enterprise Monitoring Commission by June 15, 2014.	Yes: Additional time has been provided until mid-June (instead of March) for public enterprises to present their audited financial statements. Also, only half of the public enterprises will present their accounts in the first semester mainly due to the limited capacity of the auditor.
Improve targeting, automation, and M&E framework in the social protection system	The Recipient's Cabinet has approved a policy memorandum to revise the Social Security Fund Act to gradually make payments of sick leave compensation for a number of days (the number of days is yet to be defined) of sick leave compulsory for employers.	The Borrower's Cabinet has approved regulations limiting sick leave payments by the government to 15 days per person and per year.	Yes: government wants to accelerate implementation of sick leave reforms and rather than a policy memorandum, regulations have been adopted and implemented as from 2015 to limit government cost of sick leave policy.

<i>Actions taken to</i>	<i>DPL3: Indicative triggers</i>	<i>DPL3: Proposed prior actions</i>	<i>Has it changed significantly: Why?</i>
	The Recipient has increased the contribution rate for the Seychelles Pension Fund (SPF) to 4 percent from January 2014.	The Borrower has increased the contribution rate for the Seychelles Pension Fund from 3 to 4 percent from January 2014, with employers and employees contributing equally towards the 1 percent increase.	No
	The government has revised the benefit formula and qualifying conditions to strengthen link between benefits with wages and years contributions (currently being discussed but the details will depend on the results of the ongoing analytical work).	The Borrower has strengthened the link between contributions (work life time and wage valorization) and pension benefits in the Seychelles Pension Fund.	No
Ensure cost recovery and long-term financial sustainability of utilities	The Recipient's Cabinet has approved a simplified electricity tariff structure. This implies: (i) reducing the number of blocks for domestic consumers and (ii) splitting the commercial tariff into one for small businesses and one for large businesses.	The Borrower has approved a tariff rebalancing program to increase electricity and water tariffs to cost recovery levels and increased the domestic water tariff for consumption above 20 m3 and for commercial use by 40 percent.	Yes: The focus this year is on rebalancing rather than on restructuring tariffs as initially envisaged (reducing the number of tariff blocks). Also the rebalancing program has been less ambitious than originally envisaged in terms of tariff increase and adjustment period.

### ***Pillar 1: Enhance Competitiveness***

27. **This programmatic series supports regulatory reforms to enable private sector-driven growth.** These reforms will help to remove impediments to business and investment and to ensure transparency and accountability in key economic sectors.

#### *Objective 1.1 Improve the private sector business environment*

28. **The authorities have introduced a number of legislative and administrative amendments since 2009 to simplify the processes of registering a business and obtaining a business license and work permit.** With the support of the first operation of the series, a virtual one-stop shop for registering a business was implemented. Business processes have been automated, resulting in faster and more effective processing of documents and of electronic data exchange between businesses and the Office of the Registrar General (ORG). The process is almost fully automated, with the electronic payment of registration fees remaining the only outstanding issue.

29. **With the support of the second operation of the series, revisions to the 1972 Companies Act enabled the government to use the online one-stop shop and reduce the time and costs involved in registering a business.** This has allowed all investors to interact with regulators online without being physically present. The revisions also allow for a flat fee structure for various services associated with company registration and have eliminated the obligation for notaries or other third-party intermediaries to participate in the registration process, thus reducing time, costs, and procedures. Despite these reforms, some challenges associated with the outdated legal framework governing business entry remain.

30. **With the support of this operation, the government is introducing electronic payment facilities for all taxes.** The availability of electronic payment services is a milestone

on the government's agenda to increase the transparency and fairness of government processes and ensure the rapid delivery of services. It will also enable regulators to shift from providing services in person to individual clients and move toward business facilitation functions. Electronic tax payments will be introduced as one of the first e-payment services, and the Seychelles Revenue Commission has also introduced an e-banking declaration submission system (e-filing). Currently most of the population pays their taxes in person, and the electronic tax payment will improve the quality of service and make it possible to reallocate resources from tax administration to tax auditing. The system will be operational first with clients who have accounts in the same commercial bank as the Seychelles Revenue Commission and will progressively be extended to any commercial bank operating in Seychelles. Furthermore, a new indicator has been added to improve the monitoring of this reform, especially the increase in the percentage of businesses filing taxes online. The aim is to reach more than 5 percent in 2015, compared to less than 1 percent in 2011.

**Prior Action 1:** *The Borrower has developed an operational system for the e-payment of taxes.*

31. **With the support of the last two operations, the authorities have established and operationalized a specialized Commercial Division (the Commercial List) at the Supreme Court and improved the economy's insolvency regime.** The 2013 Insolvency Act aims to facilitate the exit of non-viable businesses and the rescue of viable businesses that are experiencing short-term financial distress. This modern legislative framework for insolvency is the first step towards facilitating business rescue and bankruptcy through the newly created Commercial Division at the Supreme Court. The Commercial List at the Supreme Court has helped to address the problems of large backlogs and the slow pace of litigation. Since the Commercial List was first introduced in April 2012, 71 commercial cases have been filed. As of March 12, 2014, 37 cases had been completed, with 34 cases pending. Although this is still below the 2015 target of 85 percent of commercial cases resolved at the commercial court within 12 months, it is considerable progress considering Seychelles' limited court resources and the fact that a Court Registrar had been appointed only in November 2013. Moreover, developing Seychelles' mediation framework will help to alleviate pressure on the Commercial List and encourage the cases to be resolved more efficiently.

32. **The government is strengthening the commercial law framework by developing an Alternative Dispute Resolution (ADR) regime.** Investors will have more flexible, amicable tools for resolving commercial disputes, which will ease pressure on the courts. ADR is cheaper than more formal legal channels, and it is effective for dealing with commercial cases that may not involve the public interest and therefore do not necessarily need to be heard in open court. The ADR regime is particularly important in light of the backlog of court cases and the country's efforts to attract more foreign investment. In this context, the Supreme Court (Mediation) Rules 2013 ("Mediation Rules"), which regulate the mediation process, came into force in October 2013.<sup>22</sup> The mediation rules are a detailed adjunct to the Seychelles Supreme Court (Commercial List) Rules 2012, which already provide for the court to hold a preliminary hearing to determine whether the dispute is suitable to be submitted to mediation, thus relieving some case-management pressure on the Commercial List. The Mediation Rules set out the procedure that the judge should follow in referring the case to mediation, as well as detailed provisions regarding the mediation process.

<sup>22</sup> The rules are consistent with the Seychelles Code of Civil Procedure Act.

33. **Supported by this operation, the mediation rules are being implemented through supplementary guidelines, outreach, and training.** The mediation rules are the backbone of the mediation framework, but additional guidelines and training are required to ensure that the mediation framework can operate effectively. The Chief Justice has published the guidelines and standard forms to support the new Mediation Rules.<sup>23</sup> Significant sensitization training and marketing has also been undertaken over the last months to ensure that the private sector is willing and able to make use of the new mediation framework. The Chief Justice and the Attorney General’s Office have also developed and published a stand-alone code of ethics for mediators as part of this operation.

***Prior Action 2:** The Borrower has: (i) enacted rules related to mediation, which establish rigorous and well-defined procedures whereby cases are referred to a neutral, independent third party for out-of-court dispute resolution; (ii) published a code of conduct for mediation; and (iii) published supplementary guidelines to ensure that the mediation framework is operational.*

34. **To reduce price distortions and increase competition in the housing finance market, the government has reviewed the Housing Finance Company’s (HFC’s) mode of operation.** With the support of the previous operations and technical assistance from the FIRST, the HFC’s functions have been split into two areas. While the HFC continues to offer housing finance, the management of social (rental) housing has been transferred to the Property Management Company. This new structure has helped to address challenges related to the HFC’s formerly conflicting mandates and has enabled the CBS to regulate the HFC as a financial institution under the Financial Institutions Act. Also, the previous operations have supported a review of subsidies targeted to deserving households. The new subsidy system seeks to differentiate between those households that require public housing and those requiring assistance to access affordable housing and housing finance. The First-time Homebuyer Subsidy takes the form of a cash grant, available to first-time buyers earning less than SR 20,000 per month,<sup>24</sup> paid as a down payment on a mortgage loan to build or buy a house. To benefit from this scheme, the grant recipients must have contributed at least 10 percent of the value of the loan towards the Home Saving Scheme.

35. **The government is actively working towards substantially increasing private sector participation in the provision of housing finance.** It is providing tax incentives to encourage commercial banks to participate in the Home Saving Scheme and extend mortgage financing.<sup>25</sup> In parallel, the government is seeking to remove bottlenecks and is exploring measures to increase the stock of affordable housing. Options considered include public-private partnerships between property developers/construction companies, financial

<sup>23</sup> The Mediation Rules consist of: Nomination Form; Commencement of Mediation Form; Notice of Mediation Session; Request to Third Party to Attend Mediation; Notice of Appointment of Expert; Memorandum of Issues; Memorandum of Settlement; Memorandum of Referral; Referral Back to Trial Form; and Declaration of Mediator.

<sup>24</sup> The subsidy decreases steadily as income level increases. The SR5,000–10, 000 income group will receive a subsidy of SR100,000; the SR10,001–15,000 income group will receive a subsidy of SR75,000; and the SR15,001–20,000 income group will receive a subsidy of SR50,000.

<sup>25</sup> Consisting of a 50 percent rebate on business tax liability on profits made on lending directly to clients and a 60 percent rebate on business tax liability on profits made on lending to other lending institutions. The rebates will apply only to the portion of housing loans that falls under this scheme (that is, loan amounts not exceeding SR1 million).

institutions, and government and making public land available. The government will be reviewing these and other options with the FIRST technical assistance.

**36. The authorities continue its on-going efforts to increasing the efficiency of title registration to alleviate a major constraint on the housing finance market.** The authorities are working to develop a computerized title registration system. While progress has been achieved (i.e. land search on-line is available), the system is expected to be fully operational only in 2015 as substantial work is required to review all the existing land files. Moving forward, the government has also decided to revise the Land Registration Act (1972), which is outdated and requires a long time to process land registration (currently around 30 days), which is deterring commercial banks from providing more mortgages. Also, the indicator of this operation – an increase in the share of mortgage loans held by the private sector – has been revised to better capture the reforms supported by this operation, associated to targeting housing assistance. The new indicator tracks the number of approved housing loans using the new subsidy policy introduced in 2013. 63 new loans were approved in 2013 (for around SR 21.4 million) and are expected to reach 195 new loans in 2015 (for around SR 73 million).

*Objective 1.2 Improve transparency in key economic sectors*

**37. With the support of the last two operations, Seychelles has strengthened its governance structure and modernized its legal framework for the petroleum sector.** Previously, SEYPEC was overseeing upstream petroleum activities on behalf of the government while participating in the companies that hold the two current petroleum exploration contracts, which represented a potential conflict of interest. With the support of the previous operations, Petro-Seychelles, a state-owned company created in March 2012, now supervises, monitors, and promotes upstream activities, while SEYPEC retains responsibility for the government’s investment in downstream activities. Furthermore, the Petroleum Mining Act (1976) and the Petroleum Tax Act (2008) were revised to improve the legal and fiscal framework for awarding and administering Petroleum Agreements. With assistance from the World Bank, in 2013 Petro-Seychelles launched the Seychelles Upstream Petroleum Licensing Initiative, a transparent process to encourage suitably qualified oil companies to sign with Seychelles’ “royalty-tax” petroleum agreements for: (i) exploration in areas located within Seychelles’ exclusive economic zone<sup>26</sup> and (ii) the production of oil and/or gas arising from any commercial discoveries. Also, the Model Petroleum Agreement adopted in 2013 details the framework for petroleum operations.<sup>27</sup>

**38. Supported by this operation, the government has adopted the EITI principles to strengthen transparency in financial reporting in the petroleum sector.** The government informed the EITI International Secretariat in July 2012 that Seychelles plans to join the EITI. As a first step, on June 19, 2013, the Minister of Finance issued a press release announcing an unequivocal public statement of the government’s intention to implement the EITI. In March 2014 the government adopted a scoping report for the 2005-2013 EITI Report and the road map to ensure full EITI compliance, both prepared with World Bank support. The Minister of Finance was appointed to lead the EITI implementation and has convened the Petroleum

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<sup>26</sup> Any islands located within a contract area will have an exclusion zone of 5 kilometers around them within which petroleum operations will not be permitted.

<sup>27</sup> Including the contractual terms, environmental obligations, and revenue transparency consistent with the EITI.

Multi-stakeholder Group (MSG), including representatives of civil society and private companies, to oversee the process. The Principal Secretary for Finance has been appointed as the MSG Chair. The MSG prepared a fully costed work plan with policy objectives, measurable targets, and a timetable for implementation, which was further discussed with a broader stakeholder group to get additional comments. Once the work plan was finalized and endorsed by the MSG, the government submitted the application for the Seychelles' EITI candidacy on June 11, 2014. In line with these efforts to increase transparency in key economic sectors, and as an indicator for this operation, the MSG will finalize an EITI Report by December 2015 for evaluation by the EITI Secretariat.<sup>28</sup>

***Prior Action 3:** The Borrower has formally requested to join the EITI after complying with all the candidacy steps.*

39. **With the support of previous operations, the authorities enhanced regular disclosure of information related to fishing access to increase transparency in the fisheries sector.** In 2012, a list of Seychelles-flagged fishing vessels was published and revealed the existence of 22 locally flagged vessels that were largely unknown outside the fisheries administration. In addition, when confidentiality clauses do not prevent it, information on fishing agreements and fishing licenses in force during the previous 12 months are updated bi-annually on the Seychelles Fishing Authority (SFA) website (www.sfa.sc). The Cabinet has also approved a policy to publicly disclose all agreements and licenses that will be signed in the future. The first publication of fishing agreement and license information in 2013 further enhanced discussions of the sector's contribution to the national economy and government revenues. As a result, with the support of the World Bank, the government will analyze the fisheries value chain to identify ways to increasingly harness the sector's economic potential.

40. **Moving forward, and once authorization has been obtained from the parties, the authorities will disclose additional information.** The following information will be disclosed: (i) fees, payment date, and currency of payment of the licensed fishing vessels that has been published; (ii) fishing agreements with foreign and national entities but whose content cannot be disclosed owing to confidentiality provisions;<sup>29</sup> and (iii) fishing and aquaculture licenses and authorizations to foreign and national entities whose content cannot be disclosed owing to confidentiality provisions.<sup>30</sup>

41. **With the support of this operation, the SFA will produce and disseminate tuna bulletins and other fisheries statistics regularly.** The SFA has made operational the basic modules of a Fisheries Information System and discloses quarterly key information and regular statistical bulletins on its website. This will contribute toward the achievement of the target of this operation in terms of disclosing comprehensive information in the fisheries sector.

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<sup>28</sup> The scope of the report includes: beneficial ownership, contract transparency, revenue management and expenditure, and discretionary social expenditure.

<sup>29</sup> At least the agreement between the SFA and the Taiwan Deep Sea Tuna Boat owners and Exporters Association for the Asiatic long-line vessels.

<sup>30</sup> At least vessels licensed under the agreement between the SFA and the Taiwan Deep Sea Tuna Boat owners and Exporters Association.



**Prior Action 4:** *The Seychelles Fishing Authority: (i) has made operational the basic modules of a Fisheries Information System and (ii) discloses statistics on its website every quarter to support fisheries management and inform decision-makers and civil society.*

## ***Pillar 2: Improve fiscal sustainability***

42. **This programmatic series supports reforms to improve fiscal sustainability through better planning, increased fiscal discipline, and an improved budget monitoring framework.** This program supports: (i) improving expenditure efficiency; (ii) improving targeting, automation, and the monitoring and evaluation (M&E) framework in the social protection system; and (iii) ensuring cost recovery and the long-term financial sustainability of utilities.

### *Objective 2.1 Improve expenditure efficiency*

43. **The government continues to improve accountability and predictability in the use of public funds.** Since 2008, Seychelles has substantially improved its management of public finances, as evidenced by its better Public Expenditure and Financial Accountability (PEFA) ratings in 2011. The government adopted a new PFM Act in 2012 that introduced Programme Performance Based Budgeting (PPBB). The previous operations supported the government in introducing a new Chart of Accounts (CoA) that features a functional classification to facilitate fiscal reporting in compliance with the 2001 Government Finance Statistics Manual. The previous operations also supported the development of a policy framework that sets out the benefits of adopting PPBB and implementation guidelines for the PPBB, which describe the key policy and institutional changes and the phased approach required to implement PPBB. The framework has served to inform and build consensus among sector ministries, which are now in the process of introducing PPBB. The government's original plans were to pilot the PPBB reform in 2014 with full implementation in the 2015 budget, but existing infrastructure and institutional capacity made difficult to achieve this ambitious target. As a result, the government has implemented, with the support of the World Bank, a capacity-building program and has revised the implementation plan. The new timeline foresees that the Ministry of Education and the Ministry of Natural Resources, including the SFA, will be the pilots for the 2015 budget and three more ministries will pilot PPBB in 2016 before it is fully implemented in 2017.

44. **With the support of this operation, the government has adopted a revised financial instruction and accounting manual.** These revisions will further strengthen internal control policies and procedures as well as the accountability processes of ministries and budget-dependent entities in line with the 2012 PFM Act. This will impose a more stringent budget implementation in line with the voted budget. As a result of these ongoing reforms, the difference between voted and executed expenditures as a whole has diminished from 4.2 percent in 2011 to 2.5 percent in 2013 in line with the target set for the DPL series.

**Prior Action 5:** *The Cabinet has approved the financial regulation and accounting manual aligned with the new PFM Act (2012).*

45. **The government is strengthening its capacity to monitor public enterprises.** The unexpected losses from Air Seychelles and SEYPEC's tanker business in 2010 and 2011

respectively showed the inadequacy of the public enterprises' monitoring system.<sup>31</sup> With the support of the previous operations, The Public Enterprises (Monitoring) (PEMC) Act was revised in 2013 to strengthen the monitoring and governance framework for public enterprises. The Act gives more authority to responsible ministers (vis-à-vis the president of the Republic) in consultation with the board of the public enterprises over the appointment of chief executive officers of public enterprises. More responsibility and autonomy have been given to the boards of public enterprises, and the boards' duties have been clearly outlined. Also, the legislation requires that all public enterprises adopt International Accounting Standards from the financial year beginning after July 1, 2016 to ensure the quality of reporting and facilitate monitoring. In the future, the reform will need to strengthen the governance framework further by giving the board full authority to appoint the chief executive officer.

**46. Also, with the support of the previous operations, a Public Enterprise Monitoring Commission (PEMC) has been created to monitor financial, governance, and transparency issues related to public enterprises.** As part of the reform, the board of each public enterprise has submitted to the PEMC a statement of corporate intent, which will be updated every three years. Public enterprises have been mandated to report not later than one month after the commencement of each consecutive third year to the PEMC on four standard performance targets.<sup>32</sup> The PEMC, in collaboration with each public enterprise, will design a set of specific basic metrics to be used as benchmarks to measure performance. This exercise will help each entity to clarify its long-term vision and overarching goals and will serve as a way to assess their progress toward their targets in discussion with the MoFTI and the PEMC. Also, to improve government oversight of investments made by public enterprises, a high-level committee will review all potential public projects of a magnitude greater than SR 25 million and assess their macroeconomic and fiscal risks. These reforms to strengthen SOEs oversight are expected to improve their performance and reduce public sector costs over time.

**47. This operation supports the requirement that public enterprises must present audited accounts to the PEMC.** Each public enterprise is required to submit an annual report on its operations to the Minister of Finance, the responsible Minister, and the PEMC, with a copy of its annual audited accounts and any report by the auditors on its management and accounting practices three months after year end.<sup>33</sup> With the support of this operation, twelve public enterprises (out of 21 public enterprises) will present their audited financial statements to the Minister and the PEMC by June 15, 2014.<sup>34</sup> Over the years, there have been constant

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<sup>31</sup> Air Seychelles losses in 2012 required capital injections of US\$10 million by the government and US\$20 million by a private operator against a 40 percent stake in the company. Another US\$10 million capital injection from the government is scheduled in 2014.

<sup>32</sup> The standard performance targets are: (i) percentage increase in turnover; (ii) percentage increases in return on assets; (iii) percentage increase in returns on capital employed; and (iv) percentage increase in profit after tax.

<sup>33</sup> In turn, the Minister of Finance will present the annual report to the National Assembly within six months after the end of the public enterprise's financial year.

<sup>34</sup> The public enterprises that will not present their audited accounts are: (i) Prasline Transport Company, which is being merged with the Seychelles Public Transport Corporation; (ii) The Island Development Company Limited, whose fiscal year ends in March; (iii) L'Union Estate Company Limited, with an ongoing enquiry that requires additional investigation; and (iv) *Société Seychelloise d'Investissement* Limited, which is assessing the tax impact of some government transactions that is delaying the closing of its books; (v) the National Information Services Agency, which has a backlog for the fiscal accounts 2011 and 2012; (vi) the Seychelles Ports Authority due to delays related to the auditor; (vii) the Property Management Corporation due to delays related to the auditor; (viii) the Seychelles Public Transport Corporation due to delays related to the auditor; and (ix) the Seychelles Savings Bank due to delays related to the introduction of a new IT system.

delays in public enterprises submitting their audited financial statements by the stipulated deadline, which was three months after the end of the financial year. To improve enforcement moving forward, the indicator of the operation has been changed to measure the number of public enterprises submitting their audited financial statements on time, with the aim of increasing it from 33 percent in 2011 to 60 percent by March 2016. This is expected to reduce the financial risks faced by the government, putting pressure in those SOEs (often the smaller ones) that have faced substantial delays in the presentation of their audited accounts.

**Prior Action 6:** *Twelve Borrower's public enterprises (out of twenty-one) have submitted their audited financial statements for their last completed fiscal year to the Minister of Finance and to the Public Enterprise Monitoring Commission by June 15, 2014.*

*Objective 2.2 Improve targeting, automation, and the monitoring and evaluation framework in the social protection system*

48. **Seychelles has a comprehensive and generous social protection system.** The system comprises universal and means-tested programs, including a targeted cash transfer (Social Welfare Assistance) and a non-contributory universal retirement pension. In 2013, spending on these social protection programs was estimated to be 3 percent of GDP, of which the universal retirement pension represented 1.6 percent of GDP. In addition, the Seychelles Pension Fund, financed by mandatory contributions, provides old-age, disability, and survivors' pensions to formal sector workers. Estimates based on the 2011 Living Conditions Survey show that 45 percent of the beneficiaries of Social Welfare Assistance belong to the poorest quintile.<sup>35</sup> Nevertheless, about one-third of beneficiaries belong to the middle- and high-income groups (the wealthiest 60 percent of the population), a share that the government seeks to reduce to 20 percent by 2015.

49. **With the support of previous operations, the government has strengthened the targeting and monitoring of the social protection programs.** First, the previous operations supported the creation of the Agency for Social Protection (ASP) and the revision of the methodology for assessing applicants' income to determine eligibility for benefits.<sup>36</sup> Second, to further improve the system for determining eligibility for social assistance, the operations provided support to the ASP to link its databases with those of five other relevant government agencies to make it possible to perform automated cross-checks to verify beneficiaries' claims about their circumstances. Third, they funded the introduction of a Review Panel to handle clients' appeals against the ASP's decisions with clear guidelines to ensure objectivity and transparency.<sup>37</sup> The Review Panel is serving as an effective channel for clients to seek resolution of ASP decisions. Fourth, regulations associated with the implementation of the Social Security Act were revised to include mental health conditions and injuries in the coverage of the social security disability benefits. Fifth, regulations regarding the certification process for disability and sickness benefits were revised to include a functional capacity assessment to encourage partially disabled workers to return to work and to improve

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<sup>35</sup> These figures are based on beneficiaries' post-transfer income.

<sup>36</sup> Retirement pension and other social benefits are now taken into account when total household income is computed.

<sup>37</sup> Progress has been made in the implementation of these reforms. The number of beneficiaries of social welfare assistance decreased from 2,870 in 2011 to 1,782 in 2013. The ASP does not expect any further decrease in the number of beneficiaries.

monitoring. Sixth, the government consolidated the Family Support Program and Home Carers Program into one means-tested program with well-defined eligibility rules.

50. **With the support of this operation, the government is further strengthening the monitoring of the sickness benefit.** The government is concerned about the burden of the sick leave policy on the Agency for Social Protection (ASP) budget, particularly given that all expenses are presently financed from the general government budget. Employees are currently entitled to a maximum of 30 days of paid sick leave per year. The ASP is responsible for payments of 80 percent of the compensation (up to a maximum limit), while the remaining 20 percent are to be paid by the employer. The administrative data on sick leave suggest that most sick leave benefits are short-term, meaning that the ASP actually pays for most of the sick leave that is supposed to be financed by employers in accordance with the Employment Act. The implication is that the government effectively subsidizes employers' sick leave obligations under the Employment Act. The regulations adopted will limit the government contributions to sick leave payments and will shift part of that cost to the employer.<sup>38</sup> Moving forward, the government will continue reforms on this area to improve the monitoring system at the ASP and ensure more effective control of sick leave.

***Prior Action 7:** The Borrower's Cabinet has approved regulations limiting sick leave payments by the government to 15 days per person and per year.*

51. **The pension system provides good coverage for the elderly but faces challenges.** Seychelles has a multi-pillar pension system comprising the non-contributory universal pension and a contributory defined benefit scheme. The contributory defined benefit scheme (Seychelles Pension Fund or SPF) faces two main challenges. First, it is not fiscally sustainable in light of the aging population. Second, the calculation of pensions is not equitable as it is not tied directly to years of contributions and contributions paid. As a result, all vested workers at a particular income level receive similar benefits (replacement rate) regardless of their number of years of service at the time of their retirement. Also, only the last five years of contributions are taken into account in calculating the pension level and past contributions are not adjusted to account for changes in the value of contributions between the time when they are paid and the time when the pension is claimed and calculated. This creates a disincentive for workers to contribute beyond the vesting period and to declare their correct earnings. To protect retirees from inflation, the last operation supported linking pension adjustments to the consumer price index (CPI) subject to a 5 percent cap.

52. **To improve the fiscal sustainability of the SPF, the government is increasing the contribution rate.** The previous contribution rate of 3 percent generated a cash flow surplus in the short term because the SPF scheme was established in 2006 and because pension spending is relatively low as there are currently few pensioners relative to contributors. With the support of this operation, the contribution rate is being increased by 1 percent effective from 2014. Estimates show that, by the end of this programmatic series in 2015, SPF revenues will increase by 0.3 percent of GDP.<sup>39</sup> However, larger increases will be required in the future

<sup>38</sup> Most countries in the world have this provision; in some countries, the employer's obligation is much higher (104 calendar weeks in the Netherlands, for example).

<sup>39</sup> Actual contribution revenue to the SPF in the first quarter of 2014 is in line with the 0.3 percent of GDP increased contributions target for 2014.

as, despite the 1 percent increase in contribution rate, the SPF is projected to be in deficit in the medium term as the population ages. The SPF will start running a deficit of 0.1 percent of GDP in 2027, which is projected to reach 2.4 percent of GDP in 2050 and 3.1 percent of GDP in 2080.<sup>40</sup>

**53. This operation supports a parametric adjustment of the benefit formula to improve the equity of the SPF.** The benefit calculation will be reformed to strengthen the link between benefits and the contribution period as well as the amount of contributions paid. As a result, the Seychelles Pension Fund Regulations will be amended to (i) introduce an accrual rate through a benefit formula; (ii) gradually increase the averaging period taken into account in the calculation of pensions; and (iii) adjust past earnings by wage growth at the time of retirement (i.e. wage valorization). This is expected to reduce the disincentives to contribute beyond the vesting period and to declare correct earnings and improve the equity of the SPF benefit calculation.

***Prior Action 8:** The Borrower has increased the contribution rate for the Seychelles Pension Fund from 3 to 4 percent from January 2014, with employers and employees contributing equally towards the 1 percent increase.*

***Prior Action 9:** The Borrower has strengthened the link between contributions (work life time and wage valorization) and pension benefits in the Seychelles Pension Fund.*

#### *Objective 2.3 Ensure cost recovery and long-term fiscal sustainability of utilities*

**54. Tariff reforms to cope with rising fuel costs are reducing the PUC's losses.** The PUC's profitability increased between 2009 and 2011 but remained fragile, as illustrated by drastic rise in fuel cost in 2011 that required SR 27 million of government fuel subsidies. To increase the financial viability of the PUC, reduce the investment subsidies, and eliminate *ad hoc* tariff increases, previous operations supported the government in: (i) passing on to consumers at least 70 percent of future increases in the fuel prices<sup>41</sup> and (ii) adopting quarterly automatic tariff adjustments to reflect changes in key variables like the exchange rate and fuel prices. The PUC's losses in 2012 decreased to SR 12,978 compared to SR 123,511 (prior to government subsidies) in 2011. This is in line with the target of this operation that foresees the PUC having no operational losses by 2015.

**55. With the support of this operation, the government is rebalancing household and commercial consumer electricity tariffs to ensure cost recovery and encourage greater energy efficiency.** The production and distribution cost per kilowatt hour (kWh) is SR 2.80, whereas the tariff paid by most households is SR 1.25<sup>42</sup> and the commercial tariff is SR 3.74. This high cross-subsidy between household and commercial consumption undermines energy efficiency. The government has adopted a road map to rebalance electricity tariffs, removing cross-subsidization and gradually increasing electricity tariffs to cost recovery levels over

<sup>40</sup> According to projections carried out using the World Bank Pension Reform Options Simulation Toolkit (PROST) for Seychelles.

<sup>41</sup> Funds have been transferred by the Government to the ASP to compensate the most vulnerable households for the tariff increase.

<sup>42</sup> For the 0 to 200 kWh range, for example, the tariff is 1.25/kWh; for the 201 to 300 kWh range, it is SR 1.51/kWh. The average household uses 250 kWh; 73 percent of households fall below 300 kWh.

eight years for households using less than 200 kWh and commercial consumers using 200 to 400 kWh. Also, tariffs for households using more than 300 kWh will increase by more than those for commercial consumers.<sup>43</sup> The first rebalancing exercise started in November 2013 when household tariffs were raised while commercial tariffs remained unchanged.

**56. With the support of this operation, the government has started to increase water tariffs to finance at least the marginal cost of water production over the next decade.** Production costs per cubic meter (m<sup>3</sup>) are SR 14, but more than 40 percent of households pay just SR 6.9 per m<sup>3</sup>. The government plans to increase the household water tariff progressively over 10 years to reach the marginal cost of production for users consuming in the range of 0 to 10 m<sup>3</sup>, the tariff used for 47 percent of households. The first tariff increase was implemented in November 2013, with an increase of at least 6 percent for households in the 0 to 10 m<sup>3</sup> bracket, around 9 percent for households in the 11 to 20 m<sup>3</sup> bracket, and 43 percent for other types of consumers and for households who use more than 20 m<sup>3</sup>.<sup>44</sup> To reduce the impact of these increases on the most vulnerable households, the welfare agency will subsidize the water and electricity utility bills for the most vulnerable consumers, who will be selected by means testing. Also, government will absorb tariff increases for households using less than 400 Kwh per month.

***Prior Action 10:** The Borrower has approved a tariff rebalancing program to increase electricity and water tariffs to cost recovery levels and increased the domestic water tariff for consumption above 20 m<sup>3</sup> and for commercial use by at least 40 percent.*

**57. Moving forward, the government will need to simplify the unnecessarily complex tariff structure by reducing the number of tariff blocks, shortened the rebalance period and increase further consumer tariffs.** The PUC's complex tariff grid consists of 10 categories. The household tariff has five increasing blocks for variable charges that reflect: (i) the assumption that higher electricity consumption indicates a greater ability to pay and (ii) the rising cost of providing the service. However, the five-block structure is unnecessarily complex, and there is no clear relationship between the size of the blocks and the charge variation, which does not substantially contribute to equity and allocative efficiency.<sup>45</sup> To address problems regarding price signaling and incentives for allocative efficiency in the current structure for the commercial segment, the government plans to restructure the commercial segment into two groups in the medium term. Also, moving forward, there is need to progressively remove the cross-subsidization between services (and not only between customers of the same service). Currently electricity cross-subsidizes sewerage usage, which gives households no incentive to control water waste, which is a key consideration given the

<sup>43</sup> For commercial consumption in the 501 to 1000 kWh range, the tariff will increase to SR 4.10; for consumption above 1000 kWh, the tariff will increase to SR 4.67.

<sup>44</sup> In November 2013 the household tariff increased from SR 16.56 to SR 17.98 in the 11 to 20 m<sup>3</sup> range; from SR 20.70 to SR 29.58 in the 21 to 100 m<sup>3</sup> range; and from SR 23.46 to SR 33.53 for consumption above 100 m<sup>3</sup>. For commercial water consumption below 100 m<sup>3</sup> (90 percent of total commercial consumers), the tariff increased from SR 19.32 to SR 27.61. For commercial water consumption above 100 m<sup>3</sup>, the tariff increased from SR 24.85 to SR 35.51.

<sup>45</sup> This is also the case for the commercial tariff, which has a three-block increasing structure and a demand charge. However, basing the demand charge on the amount of energy consumed does not reflect the costs of providing the service, as higher consumption levels can be associated with a flatter load curve that does not affect demand charges. Such a structure is complex and may lead to price discrimination based on type of use. For instance, for a user with a demand capacity of 100 kilovolt amperes (kVA) who increases consumption from 200 kWh a month to 201 kWh a month, the average tariff goes from SR 8.3 to SR 11.83. This jump does not reflect any underlying change in service costs and is controversial with users, who find it difficult to understand that a slight increase in consumption can yield such an abrupt increase in the bill.

scarcity of water resources in Seychelles.<sup>46</sup> Also, electricity and water tariffs should be re-balanced over a shorter time period and tariffs should not be reduced, even if the adjustment mechanism leads to that result. Finally, commercial tariffs should not increase but rather tariffs for domestic consumers should be raised.

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<sup>46</sup> The sewerage tariff is more than 200 percent below cost and an annual increase of 10 percent will be applied. It will require a longer period to reach cost recovery levels and electricity tariffs will continue to cross-subsidize sewerage.

## *Analytical Underpinnings*

**Table 3: Analytical Underpinnings Informing this DPL Series**

<b>Informed reform areas supported by this series</b>	<b>Analytical underpinnings</b>	<b>Informed other reforms</b>
PFM reforms: (i) PFM Action Plan 2012-14 and (ii) revised Chart of Accounts to incorporate functional and programmatic classifications.	<b>Public Expenditure and Financial Accountability (PEFA) assessment of 2011.</b> This assessment showed improved performance in public financial management (PFM) compared to the 2008 PEFA. It also identified some other weaknesses.	(i) Revised 2012 Public Finance Act to enhance fiscal policies, efficient resource allocation, and effective performance (service delivery); (ii) improvement in multi-annual budgeting; (iii) implementation of Programme Performance Based Budgeting.
Expenditure efficiency and sustainability: (i) governance in the area of social protection and (ii) efficiency in resource allocation for capital spending.	<b>Public Expenditure Reviews (PERs) of 2009 and 2010 and the PER Policy Notes of 2013.</b> They examined issues of financial sustainability, efficiency in the allocation of funds, and productivity.	(i) Efficiency in health budget and (ii) modernization and adaptation of the health care system.
Improving the business environment: (i) revised companies Act; (ii) the introduction of Insolvency Act and Commercial Court.	<b>Administrative Barriers to Private Sector Development and Business Environment in the Seychelles (2009); Review of the Policy, Regulatory, and Administrative Environment for Investment (2004); and World Bank Development Policy Review (unpublished, 2005).</b>	(i) Land registration; (ii) the competition policy.
Introduction of “smart” subsidy to improve the targeting of the needy.	<b>Review of Publicly Owned Financial Institutions (2010) and Housing Finance TA (2013).</b> Policy recommendations were made for three institutions: the Development Bank of Seychelles, the Housing Finance Company (HFC), and the Concessionary Credit Agency.	Increase private sector participation in mortgage lending.
(i) Pension indexation; (ii) increasing the pension rate; and (iii) better linking contributions to benefits.	<b>Pension Policy Note in collaboration with the Government of Seychelles (2013):</b> This made recommendations to increase the long-term fiscal sustainability of the PUC by: (i) strengthening the link between contributions and benefits and adjusting qualifying conditions; (ii) increasing the contribution rate; and (iii) putting in place a transparent rule for the indexation of pensions.  <b>Pension projections using Pension Reform Options Simulation Toolkit (PROST) in collaboration with the SPF.</b>	
(i) Increase in utility tariff rates; (ii) utility tariff adjustment mechanism; and (iii) tariff structure rebalancing.  Impact on poverty and additional cost on social assistance of proposed tariff increases.	<b>Utility tariff study (2013):</b> Improved understanding and built capacity in the area of utility tariffs.  <b>Poverty and Social Impact Analysis (2014):</b> Improved understanding of distributional impact of tariff changes proposed.	

### **4.3 Link to CPS and Other Bank Operations**

#### *Link to Country Partnership Strategy*

58. This programmatic DPL series and the World Bank’s Country Partnership Strategy (CPS) for 2012-15 are closely linked to each other and to the government’s program. The CPS presented to the World Bank’s Executive Board in April 2012, is



organized in two pillars and one foundation: competitiveness and employment, vulnerability and resilience, and governance and public sector capacity. The CPS emphasizes that this DPL series will be the Bank's main vehicle for further supporting the government's broad reform program. The DPL series supports the CPS as follows: (i) competitiveness and employment pillar, through the improvement of the business environment; (ii) vulnerability and resilience pillar, through the improvement of efficiency of SOEs, enhancement of the social protection system, and the consolidation of fiscal discipline; and (iii) governance and public sector capacity foundation, through the establishment of institutions to prepare for the development of the country's petroleum resources, and improve transparency and accountability in the fisheries sector. The DPL series is also well aligned with the Africa Region Strategy as the pillars of the DPL correspond to the two pillars and foundation of that strategy.

59. **The DPL series complements other World Bank Group operations that support private sector development, social protection, renewable energy, and fisheries development.** In collaboration with the World Bank and the IFC, this program promotes private sector development, including activities to improve the investment climate by simplifying administrative processes, reducing the costs of doing business, and further attracting FDI. Through a reimbursable advisory services project, the Bank is providing technical assistance to analyze options for pension reform and a framework for co-responsibilities, the development of a policy guide on PPBB and the development of tools to ensure cost recovery and long-term sustainability of the PUC. A SIDS DOCK grant supports the development of a grid code, the design of feed-in tariffs, and the preparation of power purchase agreements for renewable energy. A FIRST Initiative<sup>47</sup> grant provides assistance to the government to develop a targeted housing subsidy system, and an Extractive Industries Technical Advisory Facility supported the review of the Petroleum Acts with respect to the tax and fiscal regime. This series also complements the Fisheries Development and Shared Growth lending operation for which the main components are strengthening governance, creating opportunities to capture greater benefits from "offshore" fisheries and value added from fish products, promoting regional collaboration on shared fisheries management, and sharing knowledge.

#### **4.4 Consultation and Collaboration with Development Partners**

##### ***Consultation***

60. **The government uses a participatory approach in its reform program to gain maximum cooperation from all stakeholders in its implementation.** The success of the reforms undertaken so far testifies to the success of this approach. During his State of the Nation Addresses in 2012 and 2013, the President of the Republic of Seychelles discussed the status of the ongoing reforms and outlined the measures likely to be implemented in the coming years. The Minister of Finance used recent budgets to announce budgetary measures that could affect the population in advance of their implementation. For example, the increase in the contributory pension rate was announced a year in advance.

61. **These consultations involve a wide range of stakeholders, and communication with the public is ongoing.** The National Economic Council draws members from the public sector, private sector, and civil society to advise the government on the best economic policy

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<sup>47</sup> See <http://www.firstinitiative.org/>.

for sustainable national growth and development. The government's communication efforts on the reforms continue in the form of press conferences by ministers, newspaper articles, television, government websites, and newsletters. Wide consultations have been held with stakeholder groups for reforms in the following areas: PPBB, disability, revisions to company legislation, and insolvency reforms. On disability, for example, the ASP conducted workshops with relevant stakeholders, including the Council for People with Disabilities, the Medical Board, and the Ministry of Education, to involve them in the process and solicit their support for the reforms.

### ***Collaboration with Other Development Partners***

62. **This program supports reform areas that complement programs being implemented by other development partners in Seychelles.** The African Development Bank (AfDB) is providing support, including a budget support operation, to enhance the environment for private sector activity. This operation has three complementary subcomponents: (i) infrastructure development; (ii) the creation of an enabling financing and regulatory environment; and (iii) human capacity development. The United Nations Development Programme (UNDP) is providing the government with support to develop and strengthen the capacity of institutions and individuals in the public sector and civil society to promote good governance, environmental protection, energy efficiency, water resource management, climate change adaptation, and poverty alleviation. The EU supports the government's PFM reform agenda and the Education sector, through a sector budget support operation. Coordination is ensured by the Ministry of Finance, with allocates responsibilities to the development partners in different sectors.

## **5. OTHER DESIGN AND APPRAISAL ISSUES**

### **5.1 Poverty and Social Impact**

63. **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.

64. **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>48</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.

**65. 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.

**66. 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>49</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.

**67. 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 pensions will be linked to inflation. Those individuals who are close to retiring and currently have relatively short contribution periods will not have the

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<sup>48</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>49</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).

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.

68. **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.

## 5.2 Environmental Aspects

69. **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.

70. **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>50</sup>

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<sup>50</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.

### 5.3 PFM, Disbursement, and Auditing

71. **Seychelles' fiduciary framework is adequate for supporting the proposed operations.** The 2011 PEFA results noted that Seychelles' PFM performance had improved since the 2008 PEFA assessment. It confirmed that Seychelles' budget information is transparent and that access to key fiscal information, such as budget documents, is freely available to the public on a timely basis. To address the weaknesses identified in the report, the government designed and is implementing a 2012-2014 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 CBS concluded that the CBS's internal controls, financial reporting, and external audit and internal audit systems were adequate and aligned with international standards.<sup>51</sup> The report called for CBS to pay 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.<sup>52</sup>

72. **Loan disbursement will follow the World Bank's disbursement procedures for development policy lending.** Specifically, the loan will be disbursed in a single tranche upon effectiveness of the Loan Agreement and provided the World Bank is satisfied with the program being carried out by the Borrower, and with the appropriateness of the Borrower's macroeconomic policy framework. The loan proceeds from the World Bank will be credited to an account that forms part of the country's official foreign exchange reserves at the Central Bank of Seychelles (CBS). The CBS will credit the Seychelles rupee equivalent to the MoFTI Treasury Single Account to finance budgeted expenditures. The CBS will not impose any charges or commission on the government for these transactions. 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 the government that is part of the country's foreign exchange reserves, indicating the date and the name/number of the government's bank account in which the amount has been deposited; (ii) an amount equivalent to the credit proceeds from the World Bank has been credited to the treasury account along with an indication of the exchange rate applied; and (iii) the Seychelles rupee equivalent of the credit proceeds was recorded as financing the government budget (including the CoA name/account number, the date, and the exchange rate used). The conversion from US dollars to Seychelles rupees will be based on the prevailing exchange rate on the date that the funds are credited to the treasury account. The loan proceeds shall not be used to finance excluded expenditures as defined in the Appendix of the Loan Agreement. If any portion of the loan is used to finance ineligible expenditure as so defined, the World Bank shall require the government to promptly refund the amount upon notice from the World Bank. Amounts refunded to the World Bank upon such a request shall be cancelled. The accounting of the loan proceeds will be the responsibility of the Comptroller General at the MoFTI. Government procedures will be followed to administer, record, and audit transactions relating

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<sup>51</sup> 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 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.

<sup>52</sup> 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.

to the loan proceeds and related payments. Since the control environment in the CBS is considered to be adequate, no additional fiduciary requirements shall apply.

#### 5.4 Monitoring and Evaluation

73. **The results framework presented in Annex 1 of this document will be used as a monitoring tool by both the Government of Seychelles and the World 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 series 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.

### 6. SUMMARY OF RISKS AND MITIGATION

74. **The overall program risk rating is moderate, especially when considering that its implementation has been substantially frontloaded.** The government has shown remarkable leadership in pursuing the reform agenda, and the country has already achieved substantial results with the support of the previous two operations, 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.

75. **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, mostly through high FDI.<sup>53</sup> However, gross financing needs will remain high due to growing debt service and high current account deficits. Also, the concentration of exports on a few markets (in Europe) and products (tourism, fisheries, off shore banking) and the large import bill for fuel and commodities heighten the country's vulnerability to external shocks. With regards to the offshore financial sector in

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<sup>53</sup> FDI is expected mainly in the tourism, port and off-shore sectors. Delays in FDI in the tourism and port sector would also be accompanied by lower current account given the considerable import content of these investments.

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.

**76. The government seems to have 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 materialize. In the medium term, fiscal space remains limited, given the government's goal of bringing down public debt 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.

**77. Risks associated with limited capacity, especially in sector ministries, is being overcome by substantial technical assistance provided parallel with the DPL3.** Implementation of the last two operations has shown that the risk related to limited capacity is low. In most of the areas covered by this program, parallel technical assistance and knowledge development and dissemination, often financed by the government in collaboration with other partners, has helped to implement the reforms while also building institutional capacity.

**78. With much of the reform program already being implemented, the risk of political and social resistance to reforms is low.** Some contentious reforms, such as more narrowly targeting of housing finance and welfare assistance to households are now implemented. Others, such as increasing pension contributions, linking benefits and contributions to the SPF, and increasing utility tariffs may pose some political risks. However, the government has built a consensus around these politically sensitive reforms, phasing out those that may not be currently feasible (such as restructuring the tariff block system). Also, the program has built bridges between ministries and enhanced coordination among stakeholders, both of which have broadened the consensus around the reform agenda. In addition, effective communication strategies—including press interviews with the President of the Republic and the Minister of Finance and announcing measures well ahead of time (for example, during the budget speech)—have increased public awareness and understanding of the reforms.

79. **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. Also, to strengthen its capacity to respond to and evaluate the impact of natural disasters, the government has created a National Emergency Operation Centre and has developed a Master Plan for Disaster Risk Management. Furthermore, to increase the country's resilience, the World Bank is supporting the government with a CAT-DDO, a risk-financing tool to protect fiscal stability during an emergency.



### Annex 1: Policy and Results Matrix

Prior Actions & Triggers			Results
Prior Action under DPL 1	Prior Action under DPL 2	Prior Action under DPL 3	
<b>Pillar 1: Enhance Competitiveness</b>			
The Borrower has established an operational online system for registration of companies.	The Recipient has submitted to its National Assembly, for second reading, a revision of the Recipient's Company Act (1972), which supports enhancements to eases starting a business.	The Borrower has developed an operational system for the e-payment of taxes.	<p>Indicator: Reduction in number of days required to register a business. Baseline: 39 days in December 2011 Target: 3 days by December 2015</p> <p>Indicator: Increase in the percentage of businesses filing their taxes online. Baseline: Less than 1% (2011) Target: more than 5 % (2015)</p>
The Borrower has established and started to operate a commercial division at the Supreme Court: (i) the Supreme Court (commercial list) rules have been published in the Borrower's official gazette; (ii) a trained and experienced judge has been nominated to head the commercial division of the Supreme Court; (iii) administrative staff has been posted in the commercial division of the Supreme Court to record the commercial cases and process them; and (iv) a budget has been allocated to the commercial division of the Supreme Court.	The Recipient has submitted to its National Assembly, for second reading, a unified Insolvency Bill, which establishes a modern framework to save viable businesses and enable non-viable businesses to exit the market quickly.	The Borrower has: (i) enacted rules related to mediation, which establish rigorous and well-defined procedures whereby cases are referred to a neutral, independent third party for out-of-court dispute resolution; (ii) published a code of conduct for mediation; and (iii) published supplementary guidelines to ensure that the mediation framework is operational.	<p>Indicator: Increase in the number of commercial cases resolved at the commercial court within 12 months as a share of all cases lodged. Baseline: No case solved within 12 months by December 2011 Target: 85% by December 2015</p>
The Borrower has sought and obtained its President's approval of its new strategy on housing finance, which increases private sector participation.	The Recipient's Cabinet has approved a housing subsidy policy that better targets low-income households in need of assistance.		<p>Indicator: Increase in the number of approved housing loans using the new subsidy policy. Baseline: 0 in 2011. Target: 195 in 2015.</p>
The Borrower has: (i) mandated Petro Seychelles to undertake supervisory and promotional activities and (ii) allocated	The Recipient has submitted to its National Assembly a revision of the Recipient's Petroleum Income Tax Act	The Borrower has formally requested to join the EITI after complying with	Indicator: More public disclosure of key information in the petroleum and fisheries sectors.

Prior Actions & Triggers			Results
Prior Action under DPL 1	Prior Action under DPL 2	Prior Action under DPL 3	
to Petro Seychelles a budget and key technical and administrative staff to carry out this new mandate.	(2008) to establish an improved legal and fiscal framework for awarding and administering petroleum agreements, including safety, environmental, and operational standards and fiscal terms.	all the candidacy steps.	Baseline: No report in 2011. Target: EITI report submitted to EITI Secretariat for evaluation (2015) and quarterly information bulletins prepared by the Seychelles Fishing Authority and disclosed on the Seychelles Fishing Authority website (2015).
The Borrower has disclosed the list of Seychelles-flagged fishing vessels (including both industrial and semi-industrial vessels) in a newspaper of national coverage and on the website of the Seychelles Fishing Authority.	The Recipient's Cabinet has approved a policy for bi-annual disclosure by the Seychelles Fishing Authority of the contents of all existing fishing agreements, fishing and aquaculture licenses and authorizations issued (foreign and nationals) which have been in force the previous twelve (12) months (but without infringing any confidentiality clause by disclosing), and for mandatory disclosure of all new agreements.	The Seychelles Fishing Authority: (i) has made operational the basic modules of a Fisheries Information System and (ii) discloses statistics on its website every quarter to support fisheries management and inform decision-makers and civil society.	
<b>Pillar 2: Improve Fiscal Sustainability</b>			
The Borrower has revised its Chart of Accounts.	The Recipient's Cabinet has approved a policy framework for Programme Performance Based Budgeting (PPBB) and agreed on its progressive implementation involving first as pilot in selected ministries for the 2014 budget and, if successful, its extension to all ministries for the 2015 budget.	The Cabinet has approved the financial regulation and accounting manual aligned with the new PFM Act (2012).	Indicator: Reduction in the difference between voted and executed budget. Baseline: 4.2% in December 2011 Target: 2.5% by December 2015
The Borrower has sought and obtained Cabinet approval of the draft revision of the Public Enterprise (Monitoring) Act 2009/19, SI 2010/53, SI 2011/29 to, inter alia, strengthen the monitoring and improve the governance framework of public enterprises.	(i) The Recipient's National Assembly has enacted the PEMC Act 2013 (Act no. 3 of 2013), and (ii) all public enterprises have submitted to PEMC a statement of corporate intent and at least one monthly statements of financial and operational performance, including details of debt performance.	Twelve Borrower's public enterprises (out of twenty-one) have submitted their audited financial statements for their last completed fiscal year to the Minister of Finance and to the Public Enterprise Monitoring Commission by June 15, 2014.	Indicator: Increase in the percentage of public enterprises that submit their audited financial statements to the Minister of Finance and to the PEMC by March 31. Baseline: 33% by March 31, 2011 Target: 60% by March 31, 2016
The Borrower has obtained approval from the Board of the Agency for Social Protection of the action plan to	(i) The Recipient's Cabinet has approved a policy memorandum to include mental health related	The Borrower's Cabinet has approved regulations limiting sick leave payments by the government to 15	Indicator: Reduction in the share of ineligible beneficiaries of welfare assistance (the ineligible are those who

Prior Actions & Triggers			Results
Prior Action under DPL 1	Prior Action under DPL 2	Prior Action under DPL 3	
implement the upgrade of the Agency for Social Protection's management information system and its integration with other administrative databases for cross-checks of applicants' declared income and assets, and Memoranda of Understanding have been signed between the Agency for Social Protection and five (5) other sector agencies to enable the functioning of the automated cross-checks.	disabilities into the Social Security Act and (ii) The Recipient's Agency for Social Protection Board has approved revised regulations regarding the certification process for disability and sickness benefits, including roles and responsibilities of the Medical Board. The revised regulations will include: (a) written procedures for the Medical Board to guide assessments consistent with the WHO international classification of functioning; (b) tightened monitoring and control (including sanctions) of both medical doctors certifying sick leave as well as workers on sick leave; (c) any sick leave over three months should be required to be approved by the Medical Board.	days per person and per year.	are in the 3 <sup>rd</sup> , 4 <sup>th</sup> , and 5th quintiles) i.e., errors of inclusion. Baseline: 33% in December 2011 Target: 20% by December 2015  Indicator: Spending on reformed social assistance programs stabilizes. Baseline: Total spending on disability (invalidity), sickness benefit, home carers program and social welfare assistance accounts for 1.1% of GDP in 2011. Target: Total spending on disability (invalidity), sickness benefit, home carers and social welfare assistance programs accounts for 1.1% of GDP in 2015.
(a) The Borrower has obtained Cabinet approval of regulations that: (i) effectively limit discretion regarding the level of benefit and duration of the social welfare assistance; and (ii) include all income in the calculation of social welfare assistance benefits; and (b) the Borrower has agreed to establish clear procedures of the review panel established under the Borrower's Agency for Social Protection Act 2011, which effectively limit the review panel's discretion.	The Recipient's Cabinet has approved a policy to consolidate Home Carers and Family Support Programs into one means tested program with well-defined eligibility rules.		
	The Recipient's Minister of Finance of Finance, Trade, and Investment has revised the Seychelles Pension Fund Regulations (January 07, 2013) to link yearly increase in pension benefits to	The Borrower has increased the contribution rate for the Seychelles Pension Fund from 3 to 4 percent from January 2014, with employers and employees contributing equally	Increase in contribution revenues to the Seychelles Pension Fund. Baseline: Before the reforms, Seychelles Pension Fund contribution revenues were expected to be 0.8% of GDP in 2015.

Prior Actions & Triggers			Results
Prior Action under DPL 1	Prior Action under DPL 2	Prior Action under DPL 3	
	consumer price index and to limit the increase to a yearly maximum of 5 percent.	towards the 1 percent increase.	Target: Seychelles Pension Fund contribution revenues after the reforms are expected to be 1.1% of GDP in 2015.
		The Borrower has strengthened the link between contributions (work life time and wage valorization) and pension benefits in the Seychelles Pension Fund.	
The Borrower has passed through to customers at least 70% of the May 2012-15 percent fuel price increase	The Recipient's Cabinet has approved: (i) an adjustment mechanism for electricity tariffs effective from July 2013; and a policy Memorandum on rebalancing tariffs from July 2013.	The Borrower has approved a tariff rebalancing program to increase electricity and water tariffs to cost recovery levels and increased the domestic water tariff for consumption above 20 m3 and for commercial use by 40 percent.	Indicator: Reduction in operating losses incurred by the Public Utility Company before subvention by government. Baseline: SR 123,511 in December 2011 Target: 0 by December 2015

## Annex 2: Letter of Development Policy



*Republic of Seychelles*

Ministry of Finance, Trade and Investment

*The Minister*

27<sup>th</sup> June 2014

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

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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 Governments' 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.

## 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.

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.

**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.



### 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).

#### 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*)

## 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 Felling 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*

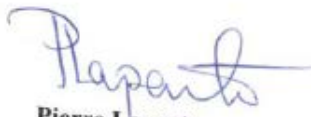
33. Developing a culture of safety and resilience. The targeted provision of information to decision-makers, planners, and technicians, public agencies, the private sector and the general public is central to empowering society as a whole to make informed choices and foster a culture of disaster risk 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 3: Fund Relations Annex**

#### **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.”

#### **ANNEX**

##### **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.

# MAP IBRD 33477

