

Republic of Seychelles
Ministry of Finance, Trade and the Blue Economy

The Minister

7th September, 2015

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

Dear Mr. Kim,

1. On behalf of the Government of Seychelles, I hereby write to request the approval for the Sustaining Reforms for Inclusive Growth Development Policy Loan to the Republic of Seychelles. The objective of this development policy loan is to raise efficiency of public expenditure and improve the business environment. To achieve these objectives, this operation supports actions that will: (i) raise efficiency of public expenditure; (ii) facilitate access to credit; and (iii) improve public investment.
2. In 2008 we started the reform process and it is encouraging to see that seven years later 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, thereby keeping our progress on the right trajectory. The international community, especially our development partners continues to equally extend their support to us through budget support and technical assistance in various areas.

I. SEYCHELLES REFORM PROGRAM

I.1 Overview

3. The core aim of Seychelles development remains the need to reduce its vulnerability and ensure 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.

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4. 2014 has been a very challenging year for us especially with regards to the macroeconomic performance, principally in the balance of payments area. An increase in public sector wage coupled with the acceleration in credit to private sector contributed to an increase in import in the third quarter while a decline in tourism earnings further contributed to the pressures in the foreign exchange market. The Central Bank of Seychelles (CBS) tightened its monetary policy during the second half of 2014, to mitigate some of the foreign exchange pressure. The 2014 real GDP growth rate, at 3.3 %, was to some extent higher than projected, while the decline in international petroleum prices resulted in an almost stable consumer price index in the 12 month to end- December 2014.
5. On the budget side, we achieved a higher primary surplus target than programmed (4.6% of GDP as against 4.4% programmed), driven by strong revenue collection.
6. We remain committed to our strategy of reducing public debt to build the country's resilience. Due to the strong fiscal performance and GDP growth forecast in the medium term, public debt is expected to be reduced below 50% of GDP in 2018. One of the key debt management goals is to smooth out the external debt service profile and shift public borrowing to local currency wherever possible.
7. In February 2015, Paris Club creditors with the participation of South Africa agreed to an early repayment scheme for the debts of Seychelles rescheduled by the Paris Club in 2009, in support of marine conservation efforts. The transaction will enable Seychelles to buy back a portion of the debt maturities falling due to the Paris Club between 2015 and 2021 at a 5% discount to face value.
8. We are pleased to report that the implementation of the program supported by the Extended Fund Facility approved by the Executive Board of the IMF in June 2014 is on track as we continue to perform well on our agreed reform program.

II. MAIN ELEMENTS OF POLICY REFORMS

9. To sustain the achievements of the economic reform program and address the remaining challenges we will continue strengthening the institutional and governance framework in critical areas such as public finance management, public enterprise monitoring, and the investment climate among others.

1. Fiscal Policy

10. The 2015 budget aims at achieving a primary surplus target of SR 720 million which is equivalent to 3.7% of projected GDP. Following the strong performance of consumption taxes in 2014, we aim to strengthen revenue performance in 2015, particularly in the area of business tax, and to that end we are taking a number of measures which include: (i) on line submission of tax returns and expanded e-payment facilities; (ii) strengthening capability to analyze transfer pricing; (iii) conducting 60 audits of large businesses, with the assistance of externally recruited auditors, and using a risk management

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process to prioritize audits (SB); (iv) improve collection of tax arrears; (v) improving customs compliance; (vi) simplifying procedures of excise tax collection at customs.

11. The Seychelles Revenue Commission (SRC) is undertaking a wide-ranging action plan for the improvement of compliance level and to enhance revenue collection for 2015. This includes the introduction of online submission of Business Tax Returns and expanding e-payment facilities, which became operational in April 2015.

2. Public Financial Management Reforms

Since 2008, when we started the reform process strengthening the Public Financial Management Framework and the budgetary process has been and remains one of our key objectives.

MTFF (Medium Term Fiscal Framework)

In November 2014, the Medium Term Fiscal Framework benchmark was approved by the Cabinet of Ministers and the 2015 budget was formulated on this basis for the first time. This will assist in establishing the indicative Budget ceilings over a five year period. A Fiscal working group has been established, comprising of members from the Ministry of Finance, Trade & the Blue Economy to ensure the consistent updating of the MTFF variables.

PPBB (Program Performance Based Budgeting)

In 2015, the Program Performance Based Budgeting (PPBB) has been adopted for the first two pilot Ministries. In addition three other pilot ministries and their related agencies have also joined the piloting process with continued technical assistance from the World Bank.

PFM Action Plan (Public Financial Management)

The government has adopted a new PFM Action plan for the period 2015-2018. The updated plan is targeting improvement in capital project, cash and asset management and aid to an improved medium term budget framework (MTBF). One of the key objectives of the PFM Action plan is to enhance transparency and governance, enhance the efficiency of State Owned Enterprises in the delivery of public services, strengthen SOE credit worthiness and returns on investment and reduce SOE contingent liabilities on the state budget. A Public Expenditure and Financial Accountability (PEFA) also is also expected to be carried out in the second half of 2015.

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PIM

Although we have made considerable progress in the PFM area since 2008, we still lacked a systematic approach to capital budgeting and most areas and components of the capital expenditure process needed to be developed further. There has been a lack of project selection criteria, formal guidelines for preparation of feasibility studies of public projects and project appraisal.

In March 2015, a Development Committee was appointed in to ensure that all public sector capital projects over R10 m in the Public Sector Investment Program (PSIP) are coordinated and appraised before final Government approval and funding is catered. In addition to the establishment of the Development Committee we have adopted guidelines for public investment and maintenance (*prior action 7*). To improve service delivery, all project officers and decision makers will be given the appropriate training to ensure that there is a coordinated approach to capital project management.

Cash Management

The government will further re-enforce the Treasury single account (TSA) by improving the reporting of all balances of commercial bank accounts outside of the TSA. This will allow comprehensive reporting of all commercial bank balances held by the MDAs and subordinate agencies through Quarterly reconciliation of all government's budget dependent entities commercial bank accounts which is to be submitted to Treasury. This will facilitate annual reporting of the government financial statement as all such accounts will be captured and account balances disclosed.

Public Private Partnership (PPP)

Development of a Public Private Partnership Framework

The Government remains committed to putting in place a comprehensive Public Private Partnership (PPP) framework to support the transition of the Seychelles economy towards greater private sector participation and economic contribution. The framework also aims at ensuring value for money from PPPs as well as limiting fiscal risks. The first phase for the development of the framework which is the preparation of a PPP policy has been completed with the assistance of the Investment Climate Facility for Africa (ICF) in collaboration with the African Development Bank. The policy sets clear country definition of PPP, sectoral coverage as well as clear guidelines and principles for the implementation of PPP projects in Seychelles. The next phase is the development of the PPP Legal Regulatory and Operational framework with technical assistance from the Bank.

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3. Efficiency of Public Expenditure

12. In order to sustain the reforms implemented so far and achieve our target of 50% of GDP in 2018 we recognize the work that needs to be done to ensure efficiency of public expenditure. Since 2008 the Bank has assisted us on various occasions to carry out public expenditure reviews in the social sector more specifically focusing on education, health and social protection. Going forward the government will be focusing on public investment management which is one area of PFM which is still lagging behind and needs to reform. Currently there is weak budgeting that impacts the quality of overall PIM. There is low efficiency of public investment that has manifested in a number of dimensions including delays and incompleteness of projects.
13. In the area of social assistance, the Government remains committed to reforms which will contain cost and improve efficiency, in line with the engagements made in the previous DPL series the World. Going forward, we note that the overall spending on social assistance has been on the increase and the government is committed to controlling such cost and raise the efficiency of social assistance.

Further to technical assistance from the World Bank we have been able to identify the cost drivers and challenges. One such challenge is the significant fragmentation in the social assistance sector. There are numerous legislations and social assistance programs. In order to address this issue of fragmentation, the government has clarified ASP multiple reporting lines to reinforce accountability over social security and social assistance programs. The Social Security Act gave responsibility to the Minister responsible for Finance for oversight of the Social Security Act. The Agency for Social Protection Act established the ASP and mandated it to administer social security benefits (formerly contributory) and social welfare programs. The ASP Act gave portfolio responsibility for the agency and its welfare programs to the Minister in charge of Social Affairs. To clarify and streamline this and to improve the coherence and efficiency of social protection, the ASP ministerial responsibility has been transferred to the Minister responsible for Social Affairs and the Government has approved a strategic plan (2015-2018) and action plan for the ASP (*prior action 1*). The strategic plan will be implemented in broad areas (immediately, short term, long term arrangements) and operationalized through annual operational plans. A set of core indicators will be agreed for required monitoring and reporting.

14. In continuing to improve control of social assistance the monitoring and evaluation (M&E) capacity of the ASP will be upgraded. The ASP currently has limited capacity to monitor and evaluate programs and to use this information for policy making. As you will recall, one reform supported by the past DPL series is the reduction in the number of sick leave days reimbursed by ASP. The implementation process has been challenging due to the fact that ASP lacked an automated database of applicants and beneficiaries. I am pleased to confirm that the coverage of ASP's Management Information System (MIS) has been broadened to include the sickness benefit, which will facilitate monitoring of the sick leave program (*prior action 2*).
15. To date the World Bank has assisted us with two public expenditure review exercises in the health sector. While the review exercises shows that the health system has delivered for what it is designed (i.e. primary health care), further reforms to address the new emerging needs are required. In addition, there

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is a need to put in place strategies to contain cost as health sector spending continues to substantially increase and pressure will continue given the expensive tertiary care for aging population and treatments for non-communicable disease.

16. To address these challenges and ensure sustainability there is a major modernization effort in the health sector and to this end government has adopted a National Health Policy (*prior action 3*).
17. Similarly in the education sector substantial progress has been made over the years although major challenges remain with regards to quality. In order to address this challenge it is imperative that we address the issue of teacher capacity and retention. This is also a key priority in the medium term strategy for the education sector. As a first step the government has approved a Memorandum establishing the principles of a comprehensive teacher management policy (*prior action 4*). The policy framework once developed will detail priority measures and interventions to address the many inter-related dimensions in the teaching profession in a more coherent and systematic manner. It will also consider other emerging issues and internal instruments that have a bearing on the teaching profession. The policy framework will be implemented over a 3 year period, 2015-2017.
18. SOE governance remains a priority on our agenda of reforms. We have received support from the World Bank in previous DPL and I am pleased to advise that we have made progress in addressing SOE governance. However we recognize the need to further clarify and reinforce SOE supervision. The mandate of the Societé Seychellois d'investissement (SSI) has now been clarified through its mission statement (*prior action 8*). With a revised mandate SSI will now be able to better manage fiscal risks by close monitoring of and independent analysis of companies in the portfolio.
19. Going forward the Government will further focus SSI mandate by developing a shareholder policy, an investment strategy and operating guidelines.

4. Private Sector Developments

20. The promotion of competition and increased private sector involvement in key sectors remain one of our key priorities, in line with the government's commitment to sustained and inclusive growth and improvement in the investment climate. The development of e-services remains high on our agenda as we keep striving to improve the investment climate, increase efficiency and improve service delivery. One of the measures identified to assist in the process is the creation of a centralized electronic collateral registry. The absence of a secured lending system and the necessary legal framework is a major constrain for additional lending to the private sector.
21. The Central Bank of the Seychelles (CBS), with the assistance of the World Bank, has embarked on a comprehensive reform to put in place a modern secured lending system and a collateral registry for movable property. The government has recently approved a Secure Transaction Bill which will now be submitted for submission to the National Assembly (*Prior Action 6*).
22. In pursuing the improvement of the investment climate, we note that access to credit has been one of

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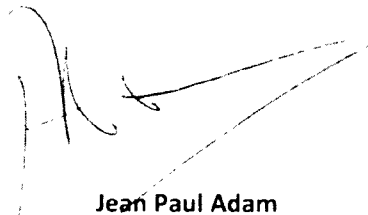
the most challenging issues. In 2012, the Central Bank of Seychelles launched the Credit Information System, which is the only credit reporting mechanism in Seychelles. The on-line system provides for licensed commercial banks and other regulated financial entities to access credit reports. However the CIS is still incomplete and only caters for the introduction of credit reporting. While this is useful for lending as well as for loan classification and provisioning, there is the need to upgrade it to improve data quality and completeness, and enable wider participation to effectively assist banks and other lenders in their credit risk assessments.

23. In order to address some of the limitations of the current system, the CBS has adopted regulations to ensure that institutions under its purview report more frequently to the CIS. Reports is now event-based rather than monthly (*prior action 5*) and the reports will also show specific repayment features.

Conclusion

24. 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 raise efficiency of public expenditure and improve the business environment. In this context, the support of The World Bank through approval of the Development Policy Loan would be important to successful implementation of the government's continued reform agenda and its quest to become more resilient.
25. Accordingly, the Government of the Republic of Seychelles requests that Development Policy Loans be approved.

Yours sincerely



Jean Paul Adam