



The World Bank

Seychelles First Fiscal Sustainability and Climate Resilience Development Policy Financing (P176420)

Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 14-Oct-2021 | Report No: PIDA32861

**BASIC INFORMATION****A. Basic Project Data**

Country Seychelles	Project ID P176420	Project Name Seychelles First Fiscal Sustainability and Climate Resilience Development Policy Financing (P176420)	Parent Project ID (if any)
Region AFRICA EAST	Estimated Board Date 09-Dec-2021	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Ministry of Finance, Trade, Investment and Economic Planning	Implementing Agency MINISTRY OF FINANCE, TRADE, INVESTMENT AND ECONOMIC PLANNING		

Proposed Development Objective(s)

The Program Development Objectives are to support the government's effort to: (i) strengthen medium-term fiscal sustainability; (ii) build resilience and (iii) strengthening policies for inclusive and sustainable growth

Financing (in US\$, Millions)**SUMMARY**

Total Financing	35.00
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DETAILS

Total World Bank Group Financing	35.00
World Bank Lending	35.00

Decision

The review did authorize the team to appraise and negotiate



B. Introduction and Context

Country Context

1. **The Covid-19 pandemic has caused significant disruptions in economic activities in Seychelles.** Economic growth dropped from 1.9 percent in 2019 to -12.9 percent in 2020, driven by more than 60 percent decline in tourism – the mainstay of Seychelles' economy. In addition to the decline in economic activity in 2020, the fiscal deficit widened to -19.5 percent of GDP (from -0.9 percent of GDP in 2019) on account of lower revenues and higher COVID-related spending. To finance the deficit, the GOS resorted to external finance from international organizations such as the World Bank, the International Monetary Fund (IMF), and the African Development Bank (AfDB) as well as increase domestic debt issuance. The increase borrowing, along with the decline in GDP and the depreciation of the exchange rate led to an increase in the debt to GDP ratio to 100.8 percent of GDP. Economic activity is projected to recover in 2021 as tourist arrivals rebound. The fiscal balance is also expected to narrow, the government withdraws COVID-19 measures such as the Financial Assistance for Job Retention scheme and the Unemployment Relief scheme 2021 and embark on a fiscal adjustment program. The government is also committed to returning to a positive fiscal balance and aims to begin rebuilding fiscal buffers by 2024.
2. **The proposed operation of US\$ 30 million provides financing to the Government of the Republic of Seychelles to cover the financing gap that has arisen due to the impact of the COVID-19 pandemic.** The financing will support post-COVID recovery and policies aimed at reducing the risks to fiscal and debt sustainability. Prior to the COVID-19 pandemic, Seychelles demonstrated a track record of prudent macroeconomic management and reforms that led to strong economic growth and continuous debt reduction since the financial crisis in 2008/9. This record, together with a recovery in tourism activities is expected to lead to a gradual reduction of the fiscal deficit in 2021-2023.
3. **The macroeconomic policy framework is adequate for the proposed operation.** The medium-term outlook is broadly positive with the economy expected to gradually recover, driven by a pickup in tourist arrivals as vaccine roll out in traditional tourist markets such as France and Germany improve. The government is committed to reverting fiscal deficit and achieving debt sustainability. Although the public debt is sustainable, risks are high and the GOS is working with the support of the IMF and the World Bank to implement policies to strengthen macroeconomic stability.

Relationship to CPF

4. **The structural reform agenda supported by the DPO series addresses fiscal sustainability, resilience and strengthening policies to create the enabling environment for sustained and inclusive growth.** The series selectively addresses 3 binding constraints identified in the 2017 Systematic Country Diagnostic (SCD): macroeconomic and fiscal policy stability; addressing the sustainability of the resource base of the economy as well as financial stability and creating an environment for growth in non-traditional sectors (information and communications technology (ICT) and the blue economy). Addressing these constraints would help foster inclusive growth and reduce the vulnerability to external shocks. The DPO is also directly related to the CPF for FY18-FY23, which acknowledged that Seychelles' isolation increases costs and limits opportunities, thus weakening the capacity to absorb shocks. The proposed operation also supports the Government in achieving its social and economic vision of a sustainable and inclusive future as outlined in its National Development Strategy 2019-2023.



C. Proposed Development Objective(s)

5. **The Program Development Objectives are to support the government's effort to: (i) strengthen medium-term fiscal sustainability; (ii) build resilience and (iii) strengthening policies for inclusive and sustainable growth.** The financing of US\$30 million provided by this first operation will address Seychelles' immediate funding needs that arose due to the prolonged impact of the pandemic on the economy. The proposed approach is a programmatic series of three operations focused on strengthening the government's medium to long-term reforms.

Key Results

6. **The key result for this operation is reducing fiscal risk and strengthening debt sustainability, building resilience and supporting a post COVID-19 recovery.** It is expected that prior actions under Pillar 1 will strengthen medium-term fiscal sustainability by: improving debt transparency; enhancing revenue mobilization by ensuring fair levels of taxing multinational companies and high net worth individuals; and reducing debt sustainability risks by tackling state-owned enterprise (SOE) management. Prior Actions under Pillar 2 are expected to contribute to building resilience to climate change (through the adoption of an updated physical planning bill) and financial crisis (improvement in the AML/CFT regime). Pillar 3 supports sustainable and inclusive growth by laying the foundations for the development of the digital economy (approval of measures to increase access to e-services) and the ocean economy (adoption of aquaculture). These reforms will lay the foundation for sustained and resilient economic recovery.

D. Project Description

7. **The proposed operation focuses on accelerating reform actions to tackle the challenges that have been triggered by the COVID-19 crisis and implementing structural reforms that are critical for a strong recovery.** The crisis has demonstrated the inadequacy of Seychelles' current growth model and has opened a window of opportunity to advance reforms where consensus has strengthened or that have become more critical for Seychelles' resilience. The reforms build on policies supported by previous DPFs and complementary advisory services and analytics (ASA). These ASAs have allowed the identification of prior actions and phasing of reforms during intensive dialogue between the government and the World Bank.

Pillar A aims to strengthen medium-term fiscal sustainability by reducing fiscal risks from SOEs; strengthening debt management and enhancing domestic revenue mobilization. As fiscal consolidation is expected in the next few years to reign in the additional spending in response to COVID19, additional revenue will be essential to ensure fiscal sustainability with adequate levels of productive and pro-poor public spending. Strong fiscal and debt management will provide the basis for macroeconomic stability needed for economic growth. This has raised the urgency of measures to reduce fiscal risks and strengthen fiscal management. Consequently, enhancing revenue performance, and reducing fiscal risks are a priority for maintaining medium-term fiscal and debt sustainability and cementing the public debt ratio on a declining path.

Pillar B aims to strengthen resilience. As a Small Island Developing State Seychelles is exposed to the adverse effects of climate change. In addition, the pandemic has posed significant risks to the financial sector. As a result, the government has shown strong leadership to better understand the sources of vulnerabilities and to build greater resilience against climate change, natural disasters and financial sector risk.



Pillar C supports strengthening policies for inclusive and sustainable growth by laying the foundation for the development of the digital economy and the blue economy. The digital economy offers a unique opportunity for Seychelles to accelerate economic growth, promote competition and enhance public service delivery. To realize the potential for transformative economic growth, there is a need to strategically and proactively invest in the elements of the digital economy to ensure that businesses and people can keep pace and thrive in an increasingly digital world. With the outbreak of COVID-19, there is an added urgency to transition to digital financial services and benefit from its gains in efficiency, tailored products, and new services. Similarly, the blue economy seeks to advance productivity and growth using Seychelles' natural endowments while proactively preserving them.

E. Implementation

Institutional and Implementation Arrangements

8. **The MoFEPT is responsible for supervision and monitoring of the reform program supported by this operation.** The monitoring will be closely coordinated by the principal secretary. The participating ministries, departments and agencies will furnish relevant information and documentation on the status of their respective programs to MoFEPT which will monitor progress against the operation's objectives and results framework. For those that are not, MoFEPT will liaise with focal points in the other ministries involved as needed to provide such information at a frequency and in a format satisfactory to the World Bank. The World Bank may provide implementation support and periodic monitoring and dialogue with the relevant line ministries and other stakeholders to ensure timely implementation and adequate monitoring of indicators and outcomes of the program.

9. **“Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB’s Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB’s independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank’s attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank’s corporate Grievance Redress Service (GRS), please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.”

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

Poverty and Social Impacts



10. **The COVID-19 pandemic is estimated to have reversed the strides made in poverty reduction in preceding years by deepening poverty and creating a new group of poor.** Prior to the outbreak of Covid-19, Seychelles had made notable progress in reducing poverty, having declined by 13 percentage points from 38.3 percent in 2013 to 25.4 percent in 2018. The country had also become more equal as indicated by the decline in Gini coefficient from 0.35 in 2013 to 0.30 in 2018. Average income per adult increased from SCR 6,375 to SCR 7,025 per month (USD 389 - 428) and the share of income held by the bottom 40 percent of the population increased from 19.6 percent in 2013 to 21.1 percent in 2018. Although the country avoided a major outbreak of COVID-19, the measures adopted to contain the virus disrupted economic activity leading to a contraction of the economy in 2020, particularly in tourism. Simulations suggest that the economic crisis from COVID-19 may have led poverty in 2020 to increase to 37.1 percent from the observed 25.3 percent in 2018, thereby wiping out progress achieved since 2013. This was primarily driven by contraction in services sectors which account for the largest share of employment. The measures introduced by the government in response to the pandemic mitigated some of the impacts on welfare. The simulated poverty rate in 2020 dropped from 37.1 percent to 29.1 percent after incorporating mitigation measures, while inequality declined to about the same level as the pre-pandemic level. The COVID-19 response measures benefitted the poorest population. However, they do not adequately protect the new poor that are not in the bottom of the distribution. The reversal of these measures as part of fiscal consolidation by the GOS is expected to adversely affect welfare and while economic recovery is forecasted, the projected economic growth is unlikely to offset a rise in poverty in the short-term. Poverty is simulated to increase from 29.1 percent in 2020 under the mitigation measures to 33.2 percent in 2021 after withdrawal of the mitigation measures.

11. **Overall, the proposed measures in the DPF are expected to have a beneficial impact on the poor, particularly in the medium-term.** All of the prior actions' effect on poverty reduction will likely be indirect as the prior actions are aimed at adoption of laws and regulations to promote better fiscal management, risk-sensitive land use planning and strengthening the policies to create an enabling environment for inclusive and sustainable growth. Once these regulations come into force and are implemented, however, the effects on poor are expected to be positive. First, improved fiscal space and a stable macroeconomic framework that crowds in private investment should help incentivize economic recovery. In addition, given the fundamental importance of the environment in the development of Seychelles, addressing challenges/constraints to the sustainability of these natural resources is expected to contribute to poverty reduction by improving future growth prospects. Similarly, addressing the AML/CFT issue and creating the enabling environment for digital development in particular digital payment systems will lead to more inclusive economic growth and thus poverty reduction in the medium-term.

Environmental, Forests, and Other Natural Resource Aspects

12. **The policies supported by this DPO are not expected to have negative effects on Seychelles' environment, forests, water resources, habitats, or other natural resources.** Some of the reforms and policy actions supported by the proposed operation will have a positive impact on the country's environment, forests, and other natural resources in the medium-term. All the actions supported by the operation are policy-oriented and do not directly finance environmentally impactful investments. Prior actions designed to strengthen fiscal management and to develop digital economy are environmentally neutral. Any eventual environmental and social adverse impacts associated with activities supported by the current DPF will rely on the existing national legal and regulatory framework. It will subsequently be monitored and addressed through the national procedures in place in Seychelles.

G. Risks and Mitigation

13. **The overall risk level associated with this operation is "Moderate".** This reflects a range of risks including macroeconomic, institutional capacity and uncertainty surrounding COVID-19. Macroeconomic risk in Seychelles is



elevated due to the negative external shock experienced in 2020 from COVID-19 that still persist. Mitigating factors are the strong political resolve of the GoS, on-going communication efforts, and growing realization within Seychelles that there are few good alternatives at this point to pursuing the major reforms highlighted in this operation.

14. **The macroeconomic risk for the operation is rated as substantial.** Although Seychelles has maintained macroeconomic prudence and achieved economic stability over the last 10 years, as with most other countries, the pandemic has affected the economy of Seychelles through both domestic and external channels. The significant decline in economic activity resulted in lower domestic revenue and drastically higher government spending in response to the economic and social effects of the crisis. This has resulted in a high financing gap for which the Government sought external financing as well as domestic financing. The financing of the deficit has affected fiscal and debt sustainability. This operation contributes to the mitigation of fiscal instability by providing concessional financing which would lower debt service costs as compared to financing through capital markets or the domestic market. A prolonged COVID-19 outbreak through variants of the virus would continue to affect tourism and FDI inflows, causing a deeper recession and prompting further intervention by the Government. The GoS's good track record on macroeconomic and public finance management, including through the successful completion of the ECF program (2017-2019), as well as the recently signed 3 year extended fund facility (EFF) with the IMF.

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APPROVAL

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