



The World Bank

SEYCHELLES SECOND FISCAL SUSTAINABILITY AND CLIMATE RESILIENCE DEVELOPMENT POLICY FINANCING
(P178209)

Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 30-Nov-2022 | Report No: PIDA35030



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BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Seychelles	P178209	SEYCHELLES SECOND FISCAL SUSTAINABILITY AND CLIMATE RESILIENCE DEVELOPMENT POLICY LOAN (P178209)	P176420
Region EASTERN AND SOUTHERN AFRICA	Estimated Board Date 20-Dec-2022	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) The Republic of Seychelles	Implementing Agency MINISTRY OF FINANCE, NATIONAL PLANNING, AND TRADE		

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) strengthen policies for inclusive and sustainable growth

Financing (in US\$, Millions)

SUMMARY

Total Financing	25.00
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DETAILS

Total World Bank Group Financing	25.00
World Bank Lending	25.00

Decision

The review did authorize the team to appraise and negotiate



B. Introduction and Context

Country Context

Seychelles had achieved significant economic progress leading up to the COVID-19 pandemic. Gross domestic product (GDP) growth averaged 4.3 percent between 2009 and 2019, and in 2015 Seychelles became a high-income economy, with GDP per capita of US\$16,975 in 2019, up from US\$11,130 in 2008. After years of an International Monetary Fund (IMF) program the Government had maintained its target of 2.5 percent primary balance and was on target to reduce the debt to GDP ratio to 50 percent by 2021 or 2022. However, while the country achieved positive economic growth and stability outcomes, there has been limited structural economic change and innovation, and Seychelles remains an economy in transition. Tourism and fisheries are still the two key sectors of the economy. Tourism centers on large hotels that offer comprehensive packages, with a high degree of vertical integration that limits the participation of local operators in offering complementary services. The fishing industry remains unchanged, with limited local value added. However, Seychelles is host to one of the largest tuna canneries in the world and the annual contribution to GDP varies from 8 to 20 percent and employs 17 percent of the total population.

In 2021 Seychelles' economy began to rebound from the impact of the COVID-19 pandemic as the number of COVID-19 cases dropped sharply to single digits. The economy contracted by 7.7 percent 2020, driven by a 60 percent decline in tourism arrivals. As the pandemic subsided, tourism picked up and grew by 39.8 percent in 2021, largely due to tourist arrivals from Russia (which accounted for 20 percent of tourist arrivals in 2021). Inflation initially accelerated in 2021 peaking at 9.8 percent in 2021 before declining. The 12-month average inflation rate stood at 4.8 percent in August 2022, while the year-on-year rate was 2.8 percent and is projected to be 3.1 percent in 2022. A 34 percent appreciation in 2021 (after a significant depreciation in 2020) helped keep inflation on a declining trend. This was supported by fiscal consolidation efforts which led to an overall decline in the fiscal deficit from 18.4 percent of GDP in 2020 to 5.6 percent of GDP in 2021. In addition, the Government of Seychelles successfully implemented a Liability Management Operation (LMO) in 2021. The success of the LMO combined with strong economic growth, fiscal consolidation, and a sharp appreciation of the currency in 2021 has substantially reduced debt vulnerabilities. The debt-to-GDP ratio declined to around 76.2 percent of GDP in 2021 from 88.7 percent in 2020.

The proposed Second Fiscal Sustainability and Climate Resilience Development Policy Financing (DPF) aims to support the ongoing recovery and government's efforts to diversify the economy and contain the fiscal deficit. It is the second of three single-tranche DPFs in a programmatic series. The first operation (DPF1) was approved by the Board on November 16, 2021. The GoS changed in October 2020 following a general election that resulted in the opposition being elected to form the new government for the first time since the coup d'état in 1977. The new Government is committed to returning to a sustainable debt path and improving the prospects for sustainable and inclusive medium-term growth.

The macroeconomic framework is deemed adequate despite risks to the outlook. Government is appropriately balancing its commitment to return to fiscal sustainability with its efforts to achieve inclusive growth. The COVID-19 outbreak has severely impacted Seychelles' economy. To bridge the financing gaps created by the crisis, the GoS requested support from the IMF (approved July 2021); the AfDB; and the World Bank. Economic stability is expected in the medium-term as the tourism sector recovers and the government continues fiscal consolidation. However, the outlook is subject to uncertainty and notable downside risks. Risks to the medium-term growth outlook include a prolonged COVID-19 outbreak as variants of the virus materialize and the ongoing War in Ukraine which would result in a reversal of the improvement in foreign direct investment, and a reduction in tourist arrivals. The rise in global interest rates would place additional depreciation pressures on the rupee, while increasing the cost of debt. An appreciation of



the US dollar would exacerbate these trends, overall leading to higher inflationary, and undermining Seychelles' competitiveness. Domestic risks are centered around potential fiscal slippages as the Government may face challenges implementing permanent saving measures as the pandemic continues. Risks to the macroeconomic framework are mitigated by the government's strong commitment to fiscal consolidation and debt sustainability which is being supported by this DPF series as well as the IMF EFF program. The government is targeting spending in social protection through the PforR for Social Protection and a hiring freeze in the public sector. The GOS is also adopting measures to diversify economy and facilitate a recovery in economic growth.

Relationship to CPF

The structural reform agenda supported by the DPF 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 DPF is 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)

The Program Development Objectives are to support the government's effort to: (i) strengthen medium-term fiscal sustainability; (ii) build resilience and (iii) strengthen policies for inclusive and sustainable growth. The financing of US\$25 million provided by this operation will address Seychelles' immediate funding needs. The proposed approach is a programmatic series of three operations focused on strengthening the government's medium to long-term reforms. The DPF program was modified at the time of the preparation of the second DPF due to some adjustments to timing of the Government's reform agenda as well as underlying capacity constraints at the Attorney General's office. Overall, the policy reforms under the second DPF remain grounded in recent analytical work and extensive policy dialogue.

Key Results

The key result for this operation is achieving fiscal sustainability and supporting critical structural reforms that will lay the foundation for resilient economic growth. Prior actions under Pillar 1 are expected to have an important impact on business tax revenue collected by the Seychelles Revenue Commission through (i) the prevention of the erosion of the corporate tax base through international profit shifting and (ii) the strengthening of the operations of the tax commission. Prior Actions under Pillar 2 are expected to improve the physical resilience concerning hazard and climate risk by addressing land use and zoning decisions as well as development permits. Also under Pillar 2, the beneficial ownership databases are expected to improve the level of transparency around the owners of the International Business Concerns (IBCs) in Seychelles. Pillar 3 supports policy reform that is expected to expand financial inclusion and boost uptake of digital financial services by enabling the expansion of the financial sector. Moreover, under Pillar 3, development of the aquaculture sector in Seychelles will help bring about greater additions to the supply volumes and diversifications in seafood products available to the value chains.

D. Project Description



The proposed operation supports reforms that are critical for a strong and inclusive recovery. As in all small state countries, the crisis has demonstrated the fragilities of Seychelles' current growth model and has opened a window of opportunity to advance reforms where consensus has strengthened and have become more critical for Seychelles' resilience. In sum, the operation supports reforms that would help the country to build back better, through measures that will help unleash the potential of other industries outside the tourism sector, such as the digital and Blue economy. 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. The proposed programmatic DPF series aims to help the authority to implement crucial structural reforms:

Pillar A aims to strengthen medium-term fiscal sustainability by reducing fiscal risks from SOEs and restoring the public debt path on a downward trajectory. The effect of COVID-19 on the economy and the resulting increase in borrowing 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, while cementing the public debt ratio on a declining path.

Pillar B aims to strengthen physical and financial resilience. Seychelles remains vulnerable to the adverse effects of natural hazards and climate change. In addition, the impact of the pandemic on the economy (growth and employment) poses significant risks to the financial sector. The GoS has shown strong leadership to better understand the sources of vulnerabilities and to build greater resilience against natural hazards, climate change impacts and financial sector risk.

Pillar C aims to strengthen policies to create an enabling environment for inclusive and sustainable growth by strengthening the legal and regulatory framework for the digital and blue economies. 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

The program has benefited from the World Bank's consultation and coordination with various stakeholders in Seychelles through various projects and engagements. Given the continued effect of COVID-19 on travelling, stakeholder consultations have focused on relevant government agencies as well as regular exchanges with development partners. The design of prior actions draws from ongoing analytical work as well as a wide stakeholder consultation process, including all relevant private sector players. PA3 supports reforms on tax avoidance and profit shifting which is informed by the Tax and Offshore ASA that was prepared in close collaboration with the Seychelles Revenue Commission. Through previous work on Disaster Risk Management the team has consulted extensively on climate change risk and adaptation issues, including with District Administrators, Regional Council members, Non-governmental Organizations, development partners and private sector representatives.

The WBG has been working in close collaboration with Seychelles' main development partners in supporting the design



and implementation of reforms. The IMF has provided critical support to Seychelles' fiscal consolidation effort and the Bank continues to collaborate closely with IMF counterparts on reforms promoting macroeconomic stability. To leverage complementarities and avoid duplicative efforts, the WBG also collaborates with the AfDB. The World Bank is also working with development partners on targeted investments in disaster risk and public financial management.

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

Poverty and Social Impacts

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 25.3 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 (US\$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. 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 (the Financial Assistance for Job Retention program (FA4JR, the Unemployment Relief Scheme and the social welfare assistance) 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. As tourism started to return in 2021, social protection programs were ended as they became a burden to the national budget. While the end of social protection programs reduced government fiscal pressures, there are reasons to believe that poverty may have been negatively affected.

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 policies to create an enabling environment for inclusive and sustainable growth. Once these regulations come into force and are implemented, however, the effects on the 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 to promoting sustainability of these natural resources is expected to contribute to poverty reduction by improving future growth prospects. Similarly, creating the enabling environment for digital development and payment systems will lead to more inclusive economic growth and thus poverty reduction in the medium-term.

Environmental, Forests, and Other Natural Resource Aspects

The policies supported by this DPF 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 adverse environmental and social 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.

The GoS environmental laws, regulations and policies are in place and generally acceptable. Biodiversity conservation and ecosystem protection are regulated under different legislation, notably the National Parks and Nature Conservancy Act (1969, as amended), the Fisheries Act (1987), the Wild Animals and Birds Protection Act (1961). To mitigate the identified weaknesses, the DPF has recommended a participatory policymaking process, and that the subsequent actions from the DPF do not lead to any weakening or disregard of the environmental and social due diligence process. As per Operational Policy 8.60, the World Bank has assessed whether the country policies supported by this DPF are likely to have an impact on the environment, forests, and natural resources. This assessment shows that the Prior Actions 1, 3 and 6 are likely to have a positive impact on the country's environment, forests, and natural resources. Prior Action 1 (expanding SOEs' financial reporting, to strengthen transparency and accountability for improved service-delivery) will have a positive impact on the country's natural and human environment if key performance indicators capture environmental outcomes. Managing and reporting on environmental performance can significantly benefit both SOE/businesses and the environment. Prior Action 3 on adopting a new Physical Planning Bill puts in place measures to adapt, build resilience and minimize vulnerability to the impacts of Climate Change. Prior Actions 6, adoption of the Mahe Fisheries regulations addresses the challenge of resource utilization and supports policies that address pressures exerted by the fisheries sectors on the coastal and marine natural resources to ensure their long-term sustainability.

G. Risks and Mitigation

The overall risk to this DPF is moderate. Risks associated with the macroeconomic context and institutional capacity to implement, as well as other risks related to the uncertainty surrounding COVID-19 are rated substantial. All other risks are rated moderate. Macroeconomic risks in Seychelles are elevated due to the continued adverse effects from COVID-19. Also, the discovery of new COVID-19 strains continues to pose a risk to the economic recovery. 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. Implementation risk is elevated due to the weak capacity to coordinate across the various sectors engaged in the proposed reforms for this operation. Implementation capacity risk is further heightened by the uncertainty around new COVID-19 strains that could rapidly increase infections and deepen existing shocks to the health system. The World Bank and other international organizations are currently working with Seychelles to mitigate these risks through budget support operations and TA provided to the Ministry of Finance and the Central Bank of Seychelles. Policies supported by this DPF will help mitigate the adverse effects of environmental and climate related shocks.

The macroeconomic risk for the operation is rated substantial. Although Seychelles has maintained macroeconomic prudence and achieved economic stability over the last ten years, as with most other countries, the pandemic has affected the economy of Seychelles through both domestic and external channels. Risks associated with the institutional capacity for implementation and sustainability risk are rated substantial. The implementation of the reforms supported by this DPF requires strong collaboration among a number of implementing agencies and strong coordination by MoFEPT as executing agency. While Seychelles has made significant progress in institutional capacity building since 2009, implementation capacity is lagging. The DPF mitigates this risk by strong dialogue with Government, as well as implementation support, in close coordination with international development partners. Other risks are Substantial. The spread and duration of the COVID-19 crisis both at the national and global levels remain uncertain due to the discovery of additional strains of the COVID-19 virus. Also, while Seychelles was able to contain the virus and has vaccinated more than 80 percent of its adult population, the possibility of new COVID-19 variants poses a constant threat to the already low capacity of the health system. The burden on the healthcare systems from COVID-19 could impede treatment of



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other diseases and the provision of other routine care (preventive, promotional and adaptative) which can hamper Human Capital accumulation in the long term. This risk is partially mitigated by the ongoing vaccination campaigns.

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APPROVAL

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Approved By

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