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Report No: PGD49

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR A

PROPOSED DEVELOPMENT POLICY GRANT

IN THE AMOUNT OF SDR 3.7 MILLION
(US$5.0 MILLION EQUIVALENT)

TO THE

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

FOR THE

THIRD STRENGTHENING GROWTH AND FISCAL POLICY
DEVELOPMENT POLICY FINANCING

November 19, 2019

Macroeconomics, Trade and Investment Global Practice
Africa Region

Democratic Republic of São Tomé and Príncipe

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of October 31, 2019)

Currency Unit =	São Tomé and Príncipe Nova Dobra (STN)
STN 22.06 =	US$1
SDR 0.72495813=	US$1

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
AGER	*Autoridade Geral de Regulação de São Tomé e Príncipe* (General Regulatory Authority of São Tomé and Príncipe)
AML/CFT	Anti-Money Laundering/ Combating the Financing of Terrorism
AQR	Asset Quality Review
BCSTP	*Banco Central de São Tomé e Príncipe* (Central Bank of São Tomé and Príncipe)
CEM	Country Economic Memorandum
CIT	Corporate Income Tax
COSSIL	*Gabinete de Coordenação e Seguimento de Licitações* (Office for Coordination and Suppo of Procurement)
CPS	Country Partnership Strategy
CRC	*Central de Registro de Crédito* (Public Credit Registry)
DGA	Directorate General of Customs
DGE	General Directorate of Environment
DI	Directorate of Taxation
DPF	Development Policy Financing
DPO	Development Policy Operation
DSA	Debt Sustainability Analysis
DSM	Demand Side Management
ECF	Extended Credit Facility
EMAE	*Empresa de Água e Electricidade* (Water and Electricity Company)
ENCO	*Empresa Nacional de Combustíveis* (National Fuel Company)
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GoSTP	Government of São Tomé and Príncipe
GRS	Grievance Redress System
HDI	Human Development Indicator
HFO	Heavy Fuel Oil
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development

ICBP	World Bank Institutional Capacity Building Project
IDA	International Development Association
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
IPP	Independent Power Producer
KPIs	Key Performance Indicators
LCPDP	Least Cost Power Development Plan
LCU	Local Currency Unit
LDP	Letter of Development Policy
LED	Light Emitting Diode
MFD	Maximizing Finance for Development
MIP	Management Improvement Plan
MIRNA	Ministry of Infrastructure, Natural Resources, and Environment
MIS	Management Information System
MTEF	Medium-Term Expenditure Framework
MTSFFP	Ministry of Employment, Solidarity, Family, and Vocational Training
NAP	*Norma de Aplicação Permanente* (Permanent Rule)
NDP	National Development Plan
NIPD	*Carteira Nacional de Projectos* (National Investment Portfolio Database)
NIR	Net International Reserves
NPLs	Non-performing Loans
PEFA	Public Expenditure and Financial Accountability
PENPS	*Política e Estratégia Nacional de Proteção Social* (National Policy and Strategy for Social Protection)
PER	Public Expenditure Review
PFM	Public Financial Management
PIM	Public investment management
PIT	Personal Income Tax
PLR	Performance and Learning Review
PRSP	Power Sector Recovery Project
PV	Present Value
SDR	Special Drawing Rights
SME	Small and Medium Enterprise
SNIP	*Sistema Nacional de Investimento Público* (National Public Investment System)
SNP	National Planning System Law
SOE	State-Owned Enterprise
SP	Social Protection
SSA	Sub-Saharan Africa
STN	São Tomé and Príncipe Nova Dobra
STP	São Tomé and Príncipe
TA	Technical Assistance
VAT	Value-Added tax
WB	World Bank
WBG	World Bank Group

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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

THIRD STRENGTHENING GROWTH AND FISCAL POLICY DEVELOPMENT POLICY FINANCING

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic	If programmatic, position in series
P164321	Yes	3rd in a series of 3

Proposed Development Objective(s)

The objective of this operation is to help the government introduce growth-enabling reforms in the financial sector, business environment, and infrastructure; generate fiscal resources and savings; and improve quality of expenditures.

Organizations

Borrower: MINISTRY OF PLANNING, FINANCE, AND BLUE ECONOMY

Implementing Agency: MINISTRY OF PLANNING, FINANCE, AND BLUE ECONOMY

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**5.00**

DETAILS

International Development Association (IDA)	5.00
IDA Grant	5.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

High

Results

Indicator Name	Baseline (2015)	Target (2020)
Result Indicator 1: Number of banks below the Central Bank's minimum Capital Adequacy Ratio (12 percent).	3	0
Result Indicator 2: Share of the population with access to formal financial services (e.g. bank accounts).	39 percent	45 percent
Result Indicator 3: Share of real estate properties and mortgages registered and digitized in the Public Notary Registry.	0 percent	70 percent
Result Indicator 4*:* EMAE's operational profit/loss (in million LCU).	-224.9	-194.7
Result Indicator 5: Number of complaints received by EMAE.	6,542	3,000
Result Indicator 6: Tax revenues, except custom duties on oil (in million LCU).	831.1	1050.0
Result Indicator 7: Number of SOEs' performance monitoring systems in place.	0	2
Result Indicator 8: Share of ongoing and finalized projects with basic information included in the National Investment Portfolio Database.	0 percent	95 percent
Result Indicator 9: Number of beneficiaries enrolled in the three core social protection programs and receiving regular payments as set in law.	0	4,000 (of which 50 percent has received payments through the formal financial system).

IDA PROGRAM DOCUMENT FOR A PROPOSED GRANT TO THE DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Third Strengthening Growth and Fiscal Policy Development Policy Financing (DPF) aims to support São Tomé and Príncipe (STP) in its efforts to promote private-sector-led growth and macroeconomic stability for growth and poverty reduction.** This proposed operation, in the amount of SDR 3.7 million (equivalent to US$5 million), is the third in a programmatic series of three development policy operations (DPOs). The objective of the operation is to help the government introduce growth-enabling reforms in the financial sector, business environment, and infrastructure; generate fiscal resources and savings; and improve the quality of expenditures. The reforms of the proposed operation are aligned with the International Monetary Fund's (IMF) new Extended Credit Facility (ECF), which was approved by the IMF Executive Board in October 2, 2019.

2. **STP is a low middle-income and small-island country that faces challenges typical of small states.** It consists of two main islands in the Gulf of Guinea, has a surface area of 1,001 sq. km, and is administratively divided into six districts, in addition to the Autonomous Region of Príncipe *(Região Autonóma do Príncipe*, RAP). STP is a multiparty democracy and a unitary state, and its total population is approximately 200,000 people, with 42.6 percent of the population at or below the age of fourteen. In 2018, the country's per capita gross national income was estimated at US$3,430 in purchasing power parity (PPP), and its per capita gross domestic product (GDP) was US$1,890. As a small island country, STP is characterized by: (i) a small population; (ii) a small land area; (iii) remoteness; and (iv) a high fixed cost of public goods—all factors that affect the country's public sector capacity, trade, fiscal accounts, and human development.

3. **Poverty reduction appears to have been rather stagnant in STP since 2010.** Poverty numbers from the latest survey in 2017 are not yet available. But estimates based on growth and distribution assumptions indicate that around one-third of the country's population lives on less than US$1.90 (2011 PPP) per day in 2019, a decline of roughly 2 percentage points relative to 2010. The change in poverty has been mainly attributed to economic growth (increases in the mean value of household income) rather than the redistribution of income across the population, and inequality in STP remains high for international standards (Gini index of 56.3 in 2017). Additional welfare indicators such as the Human Development Index (HDI), at 0.59 for STP lags the average for peers (at 0.62). Moreover, STP's total fertility rate is 4.5 births per woman, and its adolescent fertility rate is 96.3 per 1,000 women aged 15-19. The unemployment rate in STP is 8.9 percent in 2017, with females having an unemployment rate 3 times higher than that among males (14.5 performance among females compared to 5 performance among males).

4. **The October 2018 elections and the subsequent change in administration reset the policy dialogue on critical reforms to the DPO.** STP held parliamentary and local elections in October 2018, which yielded a coalition government that took office in the end of November. Coalition governments are historically unstable in STP and have difficulty in advancing reforms. The change of governments also led to a reshuffle in most government positions. In addition, some expenditure and borrowing made in the end of 2018 delayed a thorough assessment of the macroeconomic picture. The new administration needed time to familiarize itself with the macroeconomic condition it had inherited as well as with the

ongoing policy reforms. These developments, together with the lapse of the previous IMF program, delayed the preparation of the third operation relative to the originally proposed schedule, as the World Bank team had to reassess the adequacy of the macroeconomic policies and the suitability of the reform program, and to engage with the new administration to ensure that the program remains aligned with the new government program. The new administration has gradually gained understanding of the difficult macroeconomic situation and gained ownership of the program, supporting and acting on strong measures such as value-added tax (VAT) introduction and fuel price hikes.

5. Economic growth, which has been overly reliant on public expenditure, has been declining due to reduced government funding (external loans, grants, and own-source revenues), and more recently due to the energy crisis. The country's GDP growth rate slowed from an average of 4.9 percent in 2010-15 to 2.7 percent in 2018. In the same period, public investments dropped from an average of 22.1 percent of GDP to 9.0 percent, while grants declined from an average of 15.2 percent of GDP to 8.2 percent in 2018. Tax revenues also declined by about three percentage points of GDP between 2010-15 and 2018. As a result, public debt increased significantly, reaching 118 percent of GDP as of June 2019. The rise in public debt was further propelled by a build-up of government and state-owned enterprises' (SOEs) arrears, which increased domestic debt. While the agriculture and tourism sectors—where most private -sector-led growth originates—grew in the last 10 years, they have not been able to replace the government as the economy's main growth driver. The combination of a weak private sector and strained public sector has reduced economic growth, and has brought about energy outages, a liquidity crunch, and high exposure of banks to the public sector.

6. The new administration of STP has reiterated its commitment to make the private sector the country's leading driver of economic growth. The new administration has acknowledged that STP's macroeconomic situation is fragile, that the public sector bureaucracy is too large and inefficient, and that future growth will have to be led by the private sector. This operation aims to address these challenges by supporting reforms that will enable higher levels of private-sector growth and restore macroeconomic stability. For example, the supported financial sector reforms aim to reduce risks from a banking crisis while providing companies and consumers with tools to have more access to credit. The supported energy reforms aim to increase the supply of low-cost and reliable energy, relieving private companies from the burden of relying on power generators. Finally, the proposed fiscal measures aim to increase tax revenue and improve public investment spending and the efficiency of SOEs, which will help policymakers achieve balanced budgets and provide the public services needed to increase private-sector growth.

7. The macroeconomic situation remains challenging, but recent government measures and the new IMF program have been addressing some of the imbalances. The government has acknowledged the severity of the country's current macroeconomic situation. The approved 2019 budget promotes fiscal consolidation of more than 1 percentage point of GDP. The recently approved IMF program for a total of US$19 million focuses on fiscal consolidation, SOE reform, and monetary tightening to support the country's currency peg. Although the macroeconomic imbalances have deteriorated since the approval of the second operation, the government has taken measures to address these imbalances; the proposed DPO program, complementary World Bank engagements, and the ECF will ensure that critical reforms such as the VAT implementation and SOE reform remain on track.

8. The risk of the proposed operation is high due to (i) political and governance; (ii) macroeconomic; (iii) fiduciary; and (iv) institutional capacity for implementation and sustainability risks. These risks emanate from the short tenure of the current government, its coalition nature, the need for support from Parliament to implement some reforms, vulnerability to domestic and external shocks

and their potential impact on program objectives, and the complex design of the operation.

9. The operation is aligned with the World Bank Group (WBG) Maximizing Finance for Development (MFD) framework and the recently adopted Africa Regional Strategy. The operation supports MFD-enabling reforms, including achieving macro-financial stability; improving the business climate; implementing SOE reforms; and regulating the energy sector. It is also aligned with the Africa Regional Strategy, as it aims to create sustainable and inclusive growth (through increased domestic resource mobilization, improved public investment management, and higher financial inclusion) and strengthen human capital (by expanding social protection (SP) coverage).

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

10. A decline in government expenditure and foreign direct investment (FDI), a slowdown in agriculture and tourism, and energy shortages, have slowed GDP growth. The country's GDP growth rate averaged 5 percent from 2001 to 2014 – STP's golden growth era - before starting to gradually decline, reaching an estimated 2.7 percent in 2018. The economy's main growth drivers, public spending—mainly public investment financed by grants and loans—FDI, tourism, and agriculture, have declined or slowed growth in recent years.[1] Public investments have declined due to a reduction in loan and grant disbursements. Grants dropped from an average of 15.2 percent of GDP in 2010-2015 to 12 percent in 2016-2018. While FDI peaked in 2010 and 2011 during the initial oil licensing round, it declined when no oil reserves were discovered. In recent years, the tourism sector, which generated US$61 million in 2018, has grown at a slower pace, and both the volume and value of agricultural products have fallen slightly. For example, the value of the country's cocoa exports dropped by 5 percent between 2016 and 2018, and the total value of its agricultural production declined by 11.7 percent between 2014 and 2016, according to the latest data available. Disruptions in weather patterns and agricultural pests were the main reasons for the decline in production.

11. The economy was also adversely affected by the elections, political uncertainty, and the energy crisis in the second half of 2018 with waning effects in 2019. The 2018 elections and the long transitioning period led to an overspending and overborrowing in the domestic market, which affected the private sector by draining their liquidity – through delayed government payments to suppliers – and crowding out bank financing. Meanwhile, STP experienced a severe energy crisis in late 2018. STP's energy production capacity dropped from 20 MW to as low as 7 MW as diesel generators systematically failed, a result of inadequate infrastructure maintenance. The water and energy company, *Empresa de Água e Electricidade* (Water and Electricity Company EMAE), responded by cutting the electricity supply, leaving parts of the country with energy access for only a few hours a day and other areas without energy for several days. The ensuing protests and widespread popular discontent led to roadblocks that constrained fuel distribution in the country. Both the electoral period and the energy crisis caused a significant slowdown in economic activity that led to lower tax collection, a scarcity of goods, higher inflation, and lower foreign exchange inflows. The government still has not been able to settle the payment arrears to suppliers or the bank loans taken to pay salaries. On the energy side, STP was able to bring energy production back to 16 MW, reducing and rationalizing the blackouts. A 9 MW-diesel fired generator for São Tomé and a 0.7

[1] STP does not produce national accounts from the demand side.

MW diesel fired generator for Príncipe were donated by British Petroleum, which will allow energy supply to be reestablished to the full demand level and conduct proper maintenance of the other generators. On the other hand, *Empresa Nacional de Combustíveis* (National Fuel Company, ENCO), the fuel supplier has reduced the quantity of fuel imported and raised fuel prices to EMAE due to the growing arrears from EMAE to ENCO.

12. Public revenues—especially tax revenues—have been declining and reached a new low in 2018 due to the elections and the energy crisis. One of the main causes of STP's fiscal fragility is its low capacity to mobilize domestic revenues. Despite some raises in tax rates, especially on alcoholic beverages, tax revenues have been falling since 2015 due to the following reasons: (i) an excessive dependency on import taxes—particularly on fuel;[2] (ii) arrears from large taxpayers – including from the fuel importer (ENCO); (iii) an inadequate tax policy; and (iv) a very low tax administration capacity. Tax collection efforts were also negatively affected by the sluggish economy. As a result, tax revenue as a share of GDP dropped from 14.6 percent of GDP in 2015 to 12.5 percent of GDP in 2018.

13. Current expenditures are not excessively high and have generally been under control, leaving low tax revenue as the main source of budget imbalances. STP's current expenditures are not high for a small island country and have been managed relatively well, except for some slippages that were recorded in 2017 and 2018 in relation to IMF program targets. Current expenditures averaged 18.1 percent of GDP from 2010 to 2015, before declining to an average of 16.5 percent of GDP in 2016-2018. The domestic primary deficit increased from 1.6 percent of GDP from 2010 to 2015 to 3.3 percent of GDP from 2016 to 2018, despite that primary expenditures declined by 1.5 percentage points of GDP from 2015 to 2018, signaling that the persistence of the budget deficit is mostly credited to underperforming tax revenues. Overall budget deficits have been reduced since 2010, but this is mostly credited to reduced public investments financed by grants and not to fiscal policy decisions per se.

14. Public debt has been increasing since STP had its debt forgiven in 2008 due to external borrowing, budget deficits, loss-making SOEs, energy subsidies, and government arrears. The total debt-to-GDP ratio increased significantly from 58.5 percent in 2008 (when it completed the Heavily Indebted Poor Countries (HIPC) program and the Multilateral Debt Relief Initiative) to 113.4 percent in 2015. A large part of the public investment that boosted growth from 2001 to 2014 was paid for by external loans, leading to an increase in public debt. The debt also increased during part of this period due to lower fuel prices in STP than abroad, creating a fuel subsidy that was assumed by the government in the form of debt with the fuel supplier. This subsidy has been reverted since 2016 as domestic prices are now higher than international prices and the difference is being used to reduce this debt. From 2015 to 2018, debt growth tapered off due to lower external loan disbursements, the forgiveness of pre-HIPC debt from China, and higher domestic fuel prices that allowed the country to amortize debt related to past fuel subsidies. However, domestic debt increased. The previous administration expanded the electricity grid, providing access to energy to more people in both islands. Greater access, however, came with higher public debt since EMAE is a loss-making SOE, whose debt is guaranteed by the government and with tariffs set on average at half of its costs. The decline in budget revenues has led the government to fail to pay its suppliers on time, accumulating arrears with EMAE, the telecom company (CST) and other suppliers, and most recently with domestic banks, which have financed investments from SOEs, autonomous and sovereign agencies, but also financed the government payroll.

[2] Revenues from custom taxes on fuel increased on 2017 and 2018 mainly because of the settlement of arrears from ENCO. They declined by 60 percent until June of 2019.

15. STP's public external debt is of low risk, but the government arrears pose heightened risks to the economy. STP's total debt, which includes pre-HIPC debt, a contested debt with Nigeria, government arrears, and SOE debt, was US$500.4 million, or 118.1 percent of GDP, in June 2019. If debt contracted before the HIPC program, as well as the disputed debt, is excluded on the assumption of debt forgiveness following the LIC-DSF guidance, the country's debt-to-GDP ratio drops to 94.2 percent in 2019. STP's overall debt profile is of low risk since the average time to maturity of the external debt is 11.6 years and the average debt cost is 1.2 percent. The risk, however, is greater for the domestic debt, which has shorter maturity and especially for the government arrears to suppliers, whose terms of payments have not been agreed, which could lead to immediate supply cuts in fuel and telecommunication services and demand for outright payment in full.

16. Inflation is anchored by a fixed exchange rate peg and external account sustainability is determined by financing availability. STP enjoys a fixed exchange rate peg at the rate of STN 24.5 per euro, which decreased its inflation rate substantially from 10.4 percent in 2012 to 4 percent in 2015.[3] The peg is supported by a credit line up to an amount of 25 million euros (US$27.5 million) from the World Bank of Portugal, which can be used only when net external assets are below three months of imports. The high inflation differential and large current account deficit might be a threat to the peg, however, the literature and empirical evidence suggest that the benefits of fixed exchange rate outweigh the costs for small countries[4] and that the sustainability of the peg is ensured by the availability of financing.[5] Given the country's fixed exchange-rate regime and its underdeveloped interbank market, the ability of the *Banco Central de São Tomé e Príncipe* (Central Bank of São Tomé and Príncipe, BCSTP) to conduct independent monetary policy is limited.

17. Inflation has moderated in 2019, after fuel prices, weather, and supply shocks caused inflation to peak in 2018. Inflation peaked at 10.2 percent in October 2018, ending the year at 9.0 percent—1.3 percentage points higher than in 2017. Inflation increased due to higher fuel prices, heavier-than-usual rainfall, the energy crisis, and scarcity among some common consumer goods. The government increased fuel prices in June 2018 in response to higher international prices, resulting in higher transportation costs. This, in turn, increased the price of consumer goods, as most goods in the country are transported by trucks. In the second half of 2018, STP recorded heavier-than-usual rainfall, preventing fishermen to venture out to sea, which raised the price of fish. Excessive rainfall also reduced cereal and pepper production, leading to higher prices. Moreover, the energy crisis led many households and businesses to lose their perishable products, causing the supply to drop and prices to increase. Finally, STP experienced a rice shortage in 2018, doubling the price of rice, which also affected substitute goods such as taro and yam. Inflation moderated in 2019, reaching 7 percent as of August. Inflationary pressures are concentrated on domestically produced goods, resulting from weather shocks (lemon and pepper) and

[3] Despite the currency peg, the inflation rate has not converged fully to the euro area. The reason for the non-convergence are threefold: (i) large structural differences between the economies such as STP's remoteness and the development of the non-tradable sector that reflect different composition of CPI baskets; (ii) policy differences in the labor market (i.e., existence of wage indexation), differences in tax policy (i.e., different tax rates), barriers to trade (including tariff and non-tariff barriers), and transportation costs or price indexation; and (iii) differences in the external environment, such as oil price fluctuations and its transmission process to the local economy.

[4] *Open and Nimble: Finding Stable Growth in Small Economies* (World Bank) summarizes the discussion on the choice of exchange-rate regimes for small economies (pages 61-64). It explains the theoretical and empirical arguments that favor fixed exchange rate regimes in small countries.

[5] The counter-intuitive response of the trade balance to the real appreciation of the STN suggests that the current account deficit is not being driven by declining international trade competitiveness, but rather by STP's fiscal deficits, which are in turn enabled by foreign aid flows. This causality is common among EMDEs (Chinn & Prasad, 2003; Duarte & Schnabl, 2015).

from the energy shortages that increased the price of substitute goods (wood and charcoal) and the price of fish, since boats are propelled by diesel. Expansion of monetary aggregates, which was an enabling factor to inflation in 2018 has been reversed. The M2 and M3 money supply, which grew by an annual rate of 19.4 percent and 15.2 percent respectively in 2018, are now at 16.6 and 9 percent as of July 2019.

18. The trade balance and the current account have improved in recent years. The trade deficit narrowed from 34 percent of GDP in 2015 to 28 percent in 2018. As exports, excluding re-exports, only slightly declined from 2.9 percent to 2.2 percent of GDP in the same period, the improvement in the trade balance was primarily attributed to a reduction in imports, which fell from 37.4 percent to 31.7 percent of GDP. The reduction in imports was registered across all categories, except for capital goods, which were already at a low level in 2015. The surplus in the services balance fell due to lower growth in the tourism sector and lower service imports. As a result, STP's current-account deficit, excluding official transfers, narrowed from 24.8 percent of GDP in 2015 to 18.9 percent in 2018.

19. Despite reduced external financing needs in 2018, international reserves dropped due to lower capital inflows, being only partially reestablished in 2019. While the country's lower current-account deficit has translated into lower external financing needs, existing financing needs have not been met since capital inflows have declined significantly. This led to a loss of 38.6 percent in net international reserves (NIR) in 2018. At its lowest point in March 2019, NIR totaled US$27.4 million, which was equivalent to a mere 1.7 months of imports. STP's low level of international reserves has created difficulties for both companies and people to access foreign exchange. The BCSTP currently reports a backlog of nearly US$10 million in unfulfilled foreign exchange requests due to low international reserves. Some grant disbursements from China and European Union (EU) allowed STP to partially rebuild its reserves, which now stands at US$39.2 million or 2.5 months of imports.

20. The banking sector continues to face stability challenges, although authorities have taken important steps to better assess risks and strengthen the resolution framework. While the average reported capital adequacy ratio was 31.5 percent in June 2019, and all banks met the regulatory minimum ratio of 12 percent, non-performing loans (NPLs) remained high at 27 percent. NPLs could further rise and capital positions could erode as banks reclassify loans and create additional provisions in line with the recommendations of the recently concluded asset quality review (AQR) of the entire banking system. STP's banking system is liquid, reflecting a lack of lending opportunities in an environment of persistently high NPLs. The country's banks have increased their holding of Treasury bills (which totaled 8 percent of assets in September 2018) and lending to SOEs, directly exposing themselves to government arrears. After the failure of Bank Equador in 2016, the BCSTP revoked the license of *Banco Privado* in June 2018, following the bank's protracted breach of prudential norms. Both banks are currently being liquidated. To deal with emerging risks, the BCSTP continues to strengthen the supervisory and resolution framework, focusing on the development of a resolution manual and the introduction of risk-based supervision.

21. Financial depth and intermediation have been declining, reflecting banks' increased risk aversion and the closure of some banks. The size of STP's financial sector (by assets) declined from 79 percent of GDP in 2012 to an estimated 50 percent of GDP as of September 2018,[6] making it one of the smallest financial systems in the world. As of September 2018, credit to the private sector was estimated at 21 percent of GDP, down from a peak of 39 percent in 2011. In the same period, loans accounted for only 34 percent of total banks' assets, and the credit-to-deposit ratio declined to 58 percent, from 63

[6] As of September 2018, total assets were estimated at US$220 million.

percent in September 2017. This means that banks are channeling much less credit to STP's private sector. Indeed, the Financial Inclusion Survey completed in 2017[7] showed that 39 percent of adult population had access to financial services and only 3 percent of the country's micro, small, and medium-sized enterprises had access to credit. Overall, low levels of access to finance underscore the urgency of implementing secured transactions reforms to mitigate small and medium-sized enterprises' (SMEs) lack of immovable collateral, as well as upgrading the credit registry to improve the availability of information on borrowers and allow banks to better access risks.

22. The government has recognized the country's difficulties and is taking measures to address macroeconomic imbalances. It has communicated to the population that the macroeconomic situation of the country is acute and has asked international financial institutions to be as candid as possible in their assessments. It increased debt transparency by conducting a thorough analysis of government arrears, which were included in the debt stock for the first time. Authorities have also demonstrated a willingness to take hard, but needed, measures starting with the new IMF program, the introduction of VAT with a tax rate of 15 percent, and the increase in fuel prices to generate resources to pay down the debt with ENCO. Moreover, the government has agreed to increase taxes, suspend civil servants' benefits, and contain the growth of the wage bill. The government has made clear that it will not contract new external loans that cannot be sustainably repaid by the country and that the country's development will have to come from the private sector. Other long-term and more structural measures such as bank supervision improvements and modernization of the property and land registry are progressing as well.

[7] BCSTP, 2018. *Inquérito à Inclusão Financeira* (draft).

Table 1. Selected Economic Indicators (2015-2022)

	2015	2016	2017	2018	2019	2020	2021	2022
					Projected			
Real Economy		***Percentage of GDP***						
GDP at constant prices	3.8	4.2	3.9	2.7	2.5	3.0	3.5	4.0
GDP deflator	5.1	5.1	2.0	4.7	4.7	5.0	4.1	2.8
Consumer prices								
End of period	4.0	5.1	7.7	9.0	6.6	8.7	5.3	4.3
Period average	5.3	5.4	5.7	7.9	7.8	8.4	6.9	4.7
Fiscal Accounts								
Total revenue	**28.9**	**29.3**	**28.0**	**23.7**	**20.3**	**23.3**	**22.8**	**23.5**
Tax revenue	14.6	12.7	12.8	12.5	12.2	13.0	13.6	14.0
Non-tax revenue (excl. oil)	1.4	1.4	1.1	0.6	0.9	0.9	0.9	0.9
Grants	12.1	14.2	13.5	8.2	6.6	8.7	7.9	8.0
Total expenditure	**37.3**	**35.3**	**33.1**	**26.6**	**22.9**	**23.2**	**22.5**	**22.2**
Of which: Domestic primary expenditures	17.8	16.7	17.2	17.5	15.2	15.6	15.6	15.3
Current expenditure	17.1	16.1	17.1	16.4	15.9	16.1	16.1	15.9
Capital expenditure	18.2	17.9	14.7	9.2	5.5	7.1	6.4	6.4
Of which: financed by the Treasury	1.2	1.1	0.6	1.5	0.3	0.4	0.3	0.3
Financed by external sources	17.0	16.9	14.1	7.7	5.1	6.7	6.1	6.1
HIPC Initiative-related social expenditures	0.6	0.2	0.3	0.1	0.2	0.2	0.2	0.1
Overall balance	(8.4)	(6.1)	(5.1)	(1.8)	(1.0)	0.0	0.3	1.2
Domestic primary balance, excl. oil	(1.7)	(2.6)	(3.3)	(4.1)	(2.1)	(1.6)	(1.1)	(0.4)
Public debt	112.7	108.2	111.4	108.9	113.9	111.6	109.3	107.0
Selected Monetary Accounts		***Annual Percentage Change***						
Base money	37.5	5.0	(9.6)	0.8	(0.5)	2.6	7.1	7.6
Credit to the economy	3.8	8.3	2.5	(1.6)	(6.7)	0.6	6.6	7.1
Central Bank reference interest rate (percent)	10.0	10.0	9.0	9.0	N.A	N.A	N.A	N.A
Average bank lending rate (percent)	23.3	19.6	19.6	19.8	N.A	N.A	N.A	N.A
External sector		***Percentage of GDP***						
Current account balance (incl. official transfer)	(11.8)	(7.1)	(13.4)	(10.9)	(11.9)	(8.0)	(7.2)	(5.5)
Current account balance (excl. official transfer)	(24.8)	(20.5)	(24.4)	(19.4)	(18.5)	(16.7)	(15.1)	(12.7)
Foreign direct investments	8.1	6.0	11.0	6.8	9.1	9.0	8.9	8.9
Net international reserves								
Millions of U.S. dollars	56.3	49.7	46.8	28.6	28.8	30.2	31.8	33.3
Months of imports	5.9	3.1	2.9	1.8	2.1	2.1	2.0	2.0
Exchange rate (new dobras per US$, annual average)	22.1	22.1	21.7	20.7	21.7	21.6	21.4	21.3
Exchange rate (new dobras per US$, end of period)	22.4	23.4	20.5	21.5	21.3	21.1	19.1	21.4
Memorandum item								
Gross Domestic Product								
Millions of new dobra	7.031	7.698	8.154	8.763	9.402	10.167	10.954	11.714
Millions of U.S. dollars	318.3	347.5	375.0	422.6	433.0	470.5	510.7	549.8
Per capita (in U.S. dollars)	1.627	1.739	1.836	2.022	2.033	2.158	2.290	2.410

Sources: São Tomé and Príncipe Authorities and WB and IMF staff estimates and projections: October 2019.

Table 2. Central Government Operations and Financing Needs (2015-2022)

% of GDP	2015	2016	2017	2018	2019	2020	2021	2022
						Projected		
Total revenue	**28.9**	**29.3**	**28.0**	**23.7**	**20.3**	**23.3**	**22.8**	**23.5**
Tax revenue	14.6	12.7	12.8	12.5	12.2	13.0	13.6	14.0
Income tax	2.1	3.6	3.1	2.8	2.8	3.0	3.4	3.6
Import tax	8.1	5.1	4.8	5.5	5.3	5.1	4.9	4.7
Other	4.4	4.1	4.9	4.2	4.1	4.9	5.3	5.7
Non-tax revenue (excl. oil)	1.4	1.4	1.1	0.6	0.9	0.9	0.9	0.9
Grants	12.1	14.2	13.5	8.2	6.6	8.7	7.9	8.0
Total expenditure	**37.3**	**35.3**	**33.1**	**26.6**	**22.9**	**23.2**	**22.5**	**22.2**
Current expenditure	17.1	16.1	17.1	16.4	15.9	16.1	16.1	15.9
Payroll	8.9	8.8	9.1	9.1	9.2	9.2	9.1	8.9
Interest Payments	0.6	0.4	0.5	0.4	0.7	0.8	0.8	0.8
Goods & Services	2.6	2.2	2.7	3.0	2.6	2.5	2.4	2.3
Subsidies & Transfers	5.0	4.7	4.7	3.9	3.4	3.7	3.9	3.9
Capital expenditure	18.2	17.9	14.7	9.2	5.5	7.1	6.4	6.4
Overall fiscal balance (commitment basis)	-8.4	-6.1	-5.1	-1.8	-1.0	0.0	0.3	1.2
Net change in domestic arrears	-1.2	0.0	0.1	0.9	0.0	-0.6	-0.7	-0.6
Float and statistical discrepancies	0.1	0.0	-0.7	-0.3	0.0	0.0	0.0	0.0
Overall fiscal balance (cash basis)	**-9.4**	**-6.1**	**-5.7**	**-1.3**	**-1.0**	**-0.6**	**-0.4**	**0.6**
Financing	**9.4**	**6.1**	**5.7**	**1.3**	**1.0**	**0.6**	**0.4**	**-0.6**
Net External	10.1	6.5	4.3	0.9	0.1	-0.7	-0.2	-0.4
of which program financing (loans) and disbursemen	12.8	8.0	5.5	1.6	1.7	0.8	1.2	1.0
of which scheduled amortization	-2.7	-1.5	-1.2	-0.7	-1.5	-1.5	-1.4	-1.4
Net domestic	-0.7	-0.4	1.4	0.4	0.8	1.3	0.7	-0.2
Net bank credit to the government	-0.7	-0.4	1.4	0.4	0.8	1.3	0.7	-0.2
of which banking system credit (excluding National	-0.6	-0.1	1.3	2.4	0.6	1.2	0.5	-0.2
of which National Oil Account	-0.1	-0.4	0.1	-2.0	0.2	0.2	0.2	0.1
Nonbank financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Sources: São Tomé and Príncipe Authorities and WB and IMF staff estimates and projections: October 2019.

Table 3. Balance of Payment Financing Requirements and Sources (2015-2022)

US$ Million	2015	2016	2017	2018	2019	2020	2021	2022
						Projected		
Gross financing requirements	**-96.6**	**-66.3**	**-91.7**	**-70.1**	**-88.2**	**-92.1**	**-90.9**	**-83.0**
Current account, excluding official transfers	-78.9	-71.4	-91.5	-82.0	-80.1	-78.7	-76.9	-69.8
Financial account	-8.4	-4.6	-4.3	-3.5	-6.6	-7.4	-7.5	-7.5
Scheduled amortization	-7.5	-3.7	-4.3	-3.1	-6.2	-7.1	-7.2	-7.2
IMF/MDRI repayments	-0.9	-0.9	0.0	-0.4	-0.4	-0.3	-0.3	-0.3
Change in external reserves (-ve=increase)	-9.2	9.7	4.1	15.4	-1.5	-6.0	-6.5	-5.7
Available funding	**96.6**	**66.3**	**91.7**	**70.1**	**88.2**	**92.1**	**90.9**	**83.0**
National Oil Fund (net)	2.1	1.9	2.7	1.8	3.6	3.7	3.5	3.2
Oil signature bonuses	2.5	3.2	2.3	10.2	2.8	2.8	2.5	2.8
Saving (-ve=accumulation of oil reserve fund)	-0.4	-1.3	0.4	-8.4	0.8	0.9	1.0	0.4
Expected disbursements	72.2	55.7	58.1	40.1	35.2	47.7	47.8	52.5
Multilateral HIPC interim assistance	6.0	2.9	3.1	1.6	3.4	3.3	3.3	3.3
Grants	32.6	46.4	47.6	32.9	25.2	37.8	37.0	40.7
Concessional loans	33.6	6.4	7.4	5.6	6.6	6.6	7.5	8.5
Private sector (net)	22.3	8.7	30.9	28.2	49.4	40.7	39.6	27.3
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: São Tomé and Príncipe Authorities and WB and IMF staff estimates and projections: October 2019.

Box 1: The Energy Sector and Reforms at the EMAE

STP has the third highest cost of energy in SSA. This partly reflects the challenges faced by energy systems in small island countries such as small-scale operation and the lack of interconnectivity between systems, but it also reflects problems in the outdated transmission and distribution system, an energy generation mix highly dependent on costly fuel, and the poor management of the utility company EMAE.

EMAE has been registering large losses and accumulating arrears with suppliers. After an expansion of the electricity network, EMAE's annual losses surged to about 4 percent of GDP during 2016-2018, compared to an average of 1.5 percent of GDP in SSA. The losses mainly reflect high technical and commercial losses (totaling 33 percent of the energy produced). Meanwhile, the collection rate (91 percent in 2018), including from public institutions, is suboptimal. The losses have been predominantly financed by accumulating arrears to the fuel supplier – the oil company ENCO, which reached about 23 percent of GDP by mid-2019 (Figure 1).

The World Bank's Power Sector Recovery Project (P166805) supports a long-term structural improvement of the EMAE and STP's energy sector. The project, co-financed by the European Investment Bank, has four main activities that are also supported through the DPO: (i) improving the physical infrastructure, including the rehabilitation and expansion of the main hydropower plant, rehabilitation of the electricity grid, and installation of meters; (ii) developing sectorial planning, particularly development of a Least Cost Power Development Plan (LCPDP) (**DPF 3 Prior Action #6**); (iii) improving the regulatory framework and strengthening the capacity of the regulator AGER (**DPF 3 Prior Action #7**); and (iv) implementing a Management Improvement Plan (MIP) of EMAE (**DPF 3 Prior Action #6**). The goal is to achieve cost recovery over the medium term by reducing production costs and distribution losses, as well as by protecting revenue through improving billing and collection and reducing commercial losses. Addressing operational inefficiencies (mainly transmission and distribution losses and bill collection) could reduce losses to below 1 percent of GDP.

Without a drastic change in the cost of production or compensating measure, the EMAE's financials will continue to worsen in the short-to-medium term. Short-term measures are required to reduce the fiscal burden from the energy sector, including:

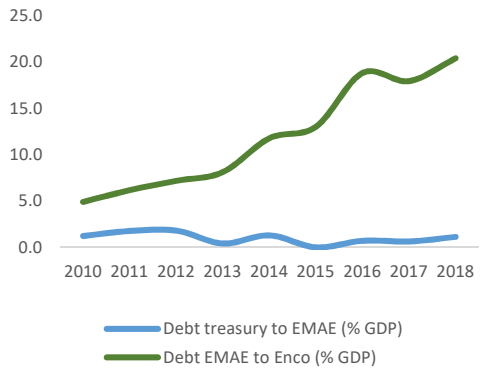
- **Switch from an expensive energy mix dominated by diesel generation to a more affordable mix, consisting**

of heavy fuel oil (HFO), hydropower, and solar energy, as recommended by the LCPDP. The elimination of diesel would also end the challenge of rampant diesel theft. The government should seek to attract reputable private-sector developers that are interested in developing an IPP for an HFO plant on the island through a competitive process. The development of generation options is well outlined in the LCPDP.

- **Accelerate the implementation of the MIP** to reduce non-technical losses and improve billing and collection, which is key to promoting the sustainable development of the power in the medium term. The first strategic step was the development of the MIP for EMAE, together with the definition of a clear concession contract, with indicators for operational efficiency and accountability, which will entail the launch of a sustainable plan for tariffs and finding a financial equilibrium in its current operation.
- **Implement demand-side management (DSM) measures to suppress peak electricity demand and overall electricity consumption.** An electricity demand study showed that 68 percent of the evening peak demand is related to residential consumption, and lighting accounts for about 70 percent. As of today, lighting requirements are mainly met by inefficient incandescent lighting (74 percent of households), or moderately efficient compact fluorescent lamp bulbs (29 percent of households). A government-led DSM program that exchanges inefficient lighting with more efficient light emitting diode (LED) bulbs for residential consumers could significantly reduce peak demand as well as overall electricity demand. Ideally, the DSM program should be combined with a prohibition on incandescent bulbs. Furthermore, all government agencies should implement the LED program and ensure efficient energy use.
- **Enforce payment discipline.** Measures include (i) installing pre-paid meters for all non-essential public consumption, disconnecting electricity services due to non-payment; and pre-paying for the consumption of essential services from the central budget; (ii) agreeing on arrears clearance plans with large private consumers, SMEs, and residential consumers, or disconnecting services due to non-payments; and (iii) conducting a communication campaign to explain that collective action is needed to improve electricity services and penalize, through the judicial system, customers found to be illegally accessing electricity services.

In addition to supporting long-term structural improvement of EMAE and the energy sector, this DPO also supports short-term measures to improve the financial standing of EMAE and reduce the fiscal burden from the energy sector. Reforms in the third operation include energy saving measures – a light bulb exchange program **(DPF 3 Prior Action #5)**.

Figure 1: Cumulative Payment Arrears, EMAE to ENCO and Treasury to EMAE, 2010-2018 (% of GDP)



Source: EMAE, Ministry of Finance, and Word Bank estimates, October 2019

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

23. GDP growth rates are expected to gradually recover as the energy supply is fully restored, weather shocks are absorbed, grant inflows increase, and the tourism sector resumes its growth momentum. The country's energy supply has been partially reestablished, but the acquisition of new generators will allow STP to reestablish power generation to the level of the demand early in 2020. Therefore, GDP growth rates should not be constrained by energy shortages anymore. The effects of weather-related shocks on the agriculture sector and the fishing industry have abated, and the tourism sector growth is picking up, benefiting from an increase in the number of seats available on airplanes due to large airplanes operating in the flights from Accra and Lisbon and the re-establishment of the air connection with Cabo Verde. Grant inflows are also expected to increase following the approval of the IMF program and the continuation of the government.

24. Strong fiscal consolidation is expected in 2019 and beyond as the government implements the new IMF program. The IMF program includes a robust and front-loaded fiscal consolidation that are expected to reduce STP's domestic primary balance from 3.2 percent of GDP in 2018 to 1.7 percent of GDP in 2019 and bring it below 1 percent in the long-run. Also, the absence of the factors that depressed tax collection in 2018—the elections and the energy crisis—will likely result in a rebound in corporate tax revenue, which would aid the government's fiscal consolidation efforts. Moreover, the DPO series is supporting the implementation of the government's strategic policies related to fiscal consolidation through measures to implement a VAT (DPF 3 Prior Action #8), reform SOEs (DPF 2 Prior Action #9), and improve the efficiency of public expenditures (DPF 2 Prior Action #10).

25. Inflation is expected to fall as shocks dissipate and growth in monetary aggregates is contained. Inflation in 2018 was propelled by shocks such as excessive rain, energy black-outs, and higher external oil prices that are not expected to be seen again in 2019. However, inflation in 2019 will experience some negative effect from the fuel price increase. The implementation of a new monetary policy tool to shore up excess liquidity will constrain inflation and reduce the impact of any pass-through from potential shocks. The main risks to inflation are: (i) weather-related shocks that have become more frequent due to climate change; and (ii) increases in fuel prices or tax rates that will eventually be needed to balance the budget. The introduction of the VAT in 2020 will trigger a one-off increase in prices. In the worst-case scenario, inflation would reach 12 percent in 2020, subsiding to 6 percent in 2022.

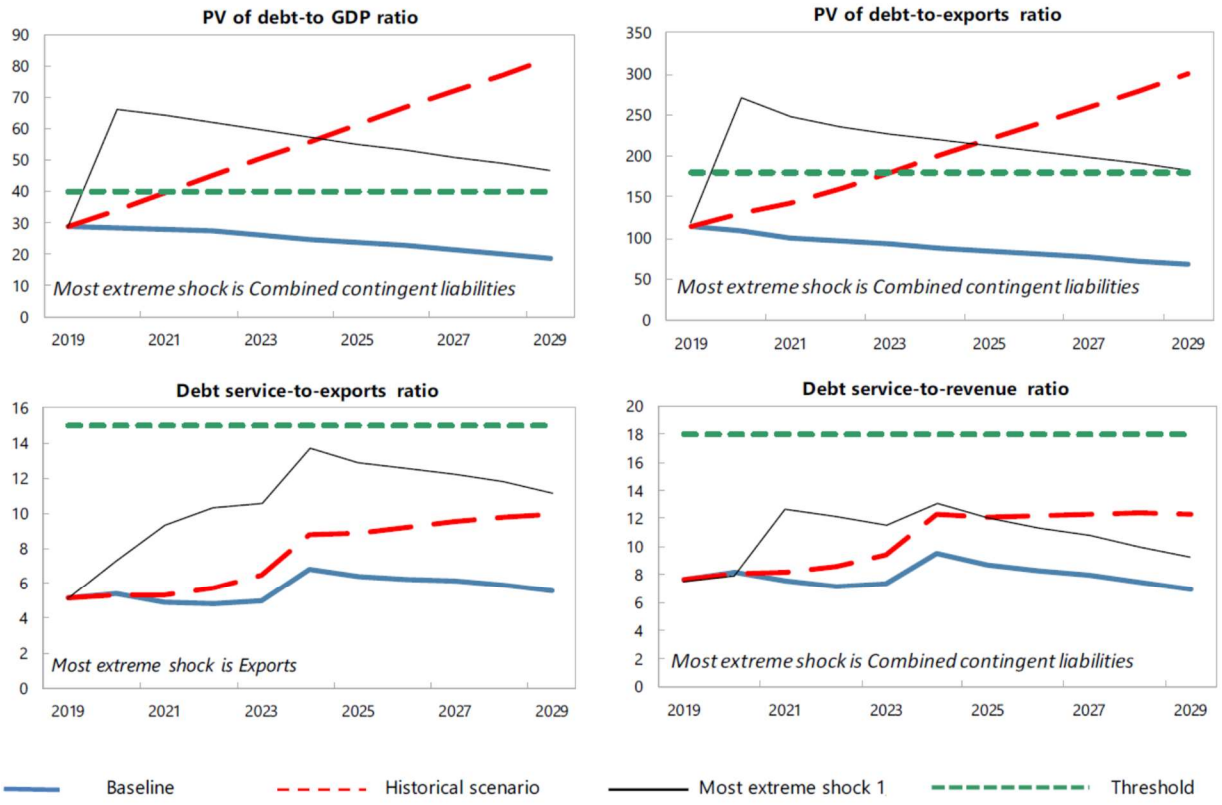
26. STP's external account will continue to improve as oil prices stabilize, energy efficiency improves, and grants and tourism receipts increase. The current-account deficit is expected to be financed through grants and concessional loans as well as tourism receipts. Increased financial assistance in the form of grants and concessional lending is expected from official donors in 2020 onwards, as some donors halted disbursements due to the elections and the lapse of the IMF program. The government is seeking to establish new donor relationships and strengthen the currents ones. The government is also making a significant effort to attract private investments, which should yield benefits in the medium term.

27. STP remains in debt distress due to prolonged unsettled external arrears, but debt can be deemed sustainable under programmed policies. STP is in debt distress because of the regularization of STP's post-HIPC sovereign arrears (to Angola, Brazil, and Equatorial Guinea, totaling around 2.6 percent of GDP) is still ongoing. The Governments of STP and EQG reached an initial agreement to clear the loan in arrears and the renegotiation of the loan with Brazil is pending parliamentary approval by the lender country. The government is also working to curb the increase in domestic debt by regularizing payments to suppliers and utilities as well as aggreging on a settlement plan for past arrears. Under the baseline

scenario, the present value (PV) of the total PPG debt-to-GDP ratio breaches the benchmark, mainly because of the inclusion of EMAE's arrears to ENCO and newly identified government arrears to private suppliers. Hence, staff assesses that total PPG debt is sustainable provided EMAE's planned reforms are implemented and the country continues to borrow externally only at concessional terms at a measured pace. All the three total PPG debt ratios (PV of debt-to-GDP, PV of debt-to-revenue, and debt service-to-revenue) are most sensitive to a primary balance shock.

28. While the macroeconomic situation is difficult, the government is actively taking measures in the right direction to address the problems, which deems the macroeconomic framework adequate for this operation. The current macroeconomic framework is consistent with domestic and external balance, since the exchange-rate peg serves as an anchor to inflation and the government is showing commitment to restore fiscal and external balances. Some of the factors that affected the economy in 2018 have already been addressed, such as electoral uncertainty and the energy crisis. The government is making important efforts and taking tough decisions, such as increases in fuel prices and the introduction of the VAT, to make things right. The macroeconomic program, supported by the IMF ECF, sets performance criteria (floor) for the domestic primary balance and NIR and establish a ceiling for government borrowing and guarantees (both domestic and external). Moreover, the IMF program contain structural benchmarks for the VAT, bank supervision, and energy sector reforms. STP's macroeconomic risks include the government's inability to sustain fiscal consolidation, a deterioration in the banking sector, higher international prices of fuel and food, and a sudden reversal in external financing flows that would weaken support to the peg. Given the context, the government is making important efforts and taking tough decisions to make things right. Even if several things are expected to align appropriately, and the short-term outcomes may not be brilliant, that set of policies make a sustainable and credible medium-term framework.

Figure 2: Debt Sustainability Analysis



Customization of Default Settings	Size	Interactions
Tailored Tests		
Combined CLs	Yes	
Natural Disasters	No	No
Commodity Prices 2/	n.a.	n.a.
Market Financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.8%	1.8%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	23	23
Avg. grace period	9	9

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

2.3. IMF RELATIONS

29. STP has a new IMF program, which supports fiscal consolidation and the stability of the exchange-rate peg. The new program was approved by the IMF Board of Directors on October 2, 2019. The three-year program is extended under the ECF modality for a total of US$19 million. It focuses on fiscal consolidation and monetary tightening to support the exchange rate peg. The IMF program is aligned with the overall work program of the World Bank and has several structural benchmarks that are rooted in World Bank projects, reflecting World Bank-IMF coordination on VAT implementation and financial sector development.

3. GOVERNMENT PROGRAM

30. The Government of São Tomé and Príncipe (GoSTP) program is composed of its medium-term National Development Plan (NDP) 2017-2021 and the XVII government program. There are sectorial strategies for the country's financial and energy sectors, human capital, and SP. The XVII Government program is the most relevant since it was done by the current government. The NDP 2017-2021, which was developed by the previous government, will be revised as required by law and aligned with the current administration's objectives. Nonetheless, no big changes are expected since neither the NDP nor the XVII Government program have major disagreements. The NDP 2017-2021 sets out three main development objectives for STP: (i) accelerate economic growth; (ii) poverty reduction; and (iii) environmental protection. Meanwhile, the XVII government program defines two main objectives for the country: (i) create the basic conditions to reach an average growth rate above 7 percent, sustained by private investment, electric power generation, and infrastructure development; and (ii) strengthen social cohesion by improving the effectiveness of the public sector. The XVII program is composed of four strategic axes and twenty-two strategic policies. The four axes are: (i) strengthen democracy and rule of law; (ii) achieve robust economic growth and increase job creation; (iii) improve the quality of health and SP; and (iv) implement a development-oriented foreign policy. The program's strategic policies include measures to build solid institutions; a service-led growth model that is sustained by investment in human capital; a sound macroeconomic policy (e.g., fiscal consolidation, improvement in the business environment, and an increase in bank credit and microfinance); development of infrastructure (i.e., urbanization, energy, and water), and social assistance programs and a conditional cash transfer program (*Rendimento Mínimo de Inserção Social*). The XVII government program represents an improvement from previous plans, as it has a simpler structure and excludes highly ambitious infrastructure projects. Nonetheless, some ambitious aspirations remain, such as turning STP into a provider of financial and health services. The program, however, lacks bottom-up costing and a clear financing plan.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

31. The proposed operation aligns with the government´s objectives by supporting the second and third axis of the XVII government program. Specifically, the operation will support the government's strategic policy objective of developing the financial sector by strengthening the BCSTP's supervision and intervention capacity (Prior Action #1). It also includes measures to develop the national payment system, the microfinance sector, and the property registry system (Prior Actions #2, #3, and #4, respectively), which will support bank credit expansion and increase access to finance. Reforms of public water and

energy utilities (Prior Actions #5, #6, and #7) also aim to leverage the development of infrastructure and improvement in the business environment. Moreover, DPO reforms will support the implementation of the government's strategic policies related to fiscal consolidation through measures to implement the VAT (Prior Action #8). Finally, the proposed operation will support the government´s objectives to reduce poverty through the tracking of payments under SP programs (Prior Action #9).

32. The objective of the proposed DPO is to support the implementation of growth-enabling reforms in the financial sector, business environment, and infrastructure; generate fiscal resources and savings, and improve the quality of expenditures. These reforms will address the main obstacles to economic development in STP and are expected to promote financial development and inclusion, attract investors, develop more efficient and accessible infrastructure, and foster fiscal sustainability and private-sector-led growth in the medium term. The operation is organized around two pillars, each including several policy actions:

Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure. Policies under this pillar aim to support the BCSTP to effectively address vulnerabilities in the financial sector by improving bank supervision and financial soundness. They also aim to develop a national payment system and the microfinance sector, as well as improve the registry of properties, which will increase the availability of credit, accelerate financial inclusion, and improve the tourism sector. Additionally, Pillar A will support policies aimed at expanding infrastructures and improving public service delivery.

Pillar B: Generate fiscal resources and savings and improve the quality of expenditures. This pillar includes policies aimed at strengthening fiscal sustainability and protecting poor and vulnerable households.

Lessons Learned

33. The design of the proposed operation incorporates lessons learned from previous DPOs in STP. The three main lesson learned from the last DPO series were: (i) close and constant follow up with public authorities and development partners is crucial to obtaining accurate and timely information concerning government actions that affect macroeconomic stability; (ii) implementing agencies need the capacity to move forward and follow up on status indicators; and (iii) resource effectiveness needs to be improved. Based on these lessons learned and the increase in the World Bank's budget allocation to STP, this DPO benefits from a potentially larger World Bank team focusing on STP and exploring synergies with other operations. The large resource envelope allowed the World Bank to conduct analyses and provide technical assistance (TA) that underpin and strengthen the DPO. Finally, this DPO will mainly work with agencies that were involved in the previous operation—such as the BCSTP, the Ministry of Finance, and the Minister of Employment and Social Action—and have a long experience working with the World Bank.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

34. The policy matrix supported by this programmatic series has been modified to sharpen the focus on growth-enhancing reforms and strengthen the links between this proposed DPO and the World Bank's support to the energy sector. This operation is also closely aligned with the recently concluded Country Economic Memorandum (CEM, 2019) that identified six key challenges for STP's development, out of which four are addressed by this DPO: (i) the twin budget and current account deficits; (ii) credit constraints; (iii) uncertainty surrounding property rights and land tenure; and (iv) poor quality infrastructure.

Table 4. Summary of Changes in Prior Actions from DPF 2 to DPF 3

Trigger	Prior Action	Explanation for Change
In order to obtain more reliable information on banks' financial soundness, the Recipient, through its Central Bank, has carried out a review of the quality of banking sector assets (Asset Quality Review-AQR) and mandated banks to adjust Non-Performing Loans classification and provision accordingly.	The Recipient, through BCSTP, has approved the Report for the STP Banking System Asset Quality Review, as part of its efforts to improve financial soundness of commercial banks.	The team decided to drop the second part of the prior action on the implementation of recommendation of the AQR (on loan reclassifications, bank provisions) due to the time needed for the BCSTP to carry out this task in a satisfactory manner. The implementation of the recommendations of the AQR is further a structural benchmark under the IMF program for end-2019.
In order to expand the range of assets that can be pledged by borrowers and strengthen the quality of collaterals, thereby improving access to credit, the Recipient has submitted to the parliament a new law on guarantees that: (i) introduces the concept of a functional approach to secured transactions; (ii) widens the range of assets that can be used as collateral; and (ii) allows for the establishment of a movable collateral registry.		Dropped. This prior action was dropped since more time is required to coordinate this ambitious legal change between the Ministry of Justice, central bank, and the agents involved.
In order to increase the information available to lenders for assessing borrower's creditworthiness, which would improve access to credit, the Recipient, through its Central Bank, has improved the Public Credit Registry (*Central de Registro de Crédito,* CRC) by: (i) instituting back-up procedures; (ii) instituting real-time update procedures; and (iii) expanding the scope of information.		Dropped. This prior action was dropped due to time required in procuring the upgrades of the CRC.
In order to implement the key provisions of the microfinance law, the Recipient, through its Central Bank, has passed the regulations, which establish the supervisory and reporting procedures for microfinance institutions.	The Recipient, through BCSTP, has passed key regulations which establish the minimum entry, operation requirements, risk management minimum requirements, and supervisory and reporting procedures for microfinance institutions.	No changes.
	The Recipient, through: (i) its	The new prior action guarantees the

	National Assembly, has passed the legal framework for payment services providers and payment system operators, which outlines the oversight framework, and duties and powers of BCSTP; and (ii) BCSTP, has passed the key implementing regulations under the National Payments System Law, which provide for the legal protection of the electronic transfer of funds and the licensing and supervision of payment institutions and payment system operators	implementation of the new Payment Services Law (SNP) that was supported under DPO2 and entered into force in November 2018.
	The Recipient, through its Council of Ministers, has approved the institutional structure for enabling interoperability between the land property register (*Registo de Propriedade*) and the cadaster (*Registo Cadastral*)	The new prior action complements the implementation of the new property registration code and public notary code that was supported under DPO2. These new codes laid the foundation for improvements and upgrades in the land registration system such as digital registries, interoperability, and joint titling.
In order to allow for a more efficient and accurate billing and reduce potential for underreporting of consumption, the Recipient, through EMAE, has introduced a new remote metering system connected to the management system that will allow for automated metering and billing.		Dropped. The prior action was dropped due to delays in public tender for the metering system with remote metering. The metering system will be financed by the EIB.
In order to reduce arrears from the government to EMAE, the Recipient has taken the following actions: (i) condition the budget transfer to autonomous institutes on the timely payment of energy bills; (ii) agree on payment plans for overdue energy bills for each autonomous agency; and (iii) give priority to energy bill payments just after payroll and debt service.	The Recipient, through the President of the Republic, has instituted an energy demand management program, which includes the exchange of low efficient bulbs with higher efficient ones.	The prior action was changed to support measures that reduce demand for energy and therefore more immediately impact EMAE's performance. Reduction and clearance of arrears are being supported through the implementation of EMAE's MIP, the increase of domestic revenue mobilization and the increase in domestic fuel prices.
In order to structurally reduce the cost of energy and promote long-term private investment, the Recipient, through its Council of Ministers, has approved the Least-Cost Power Development Plan.	The Recipient, through its Council of Ministers, has approved: (a) a Least-Cost Power Sector Development Plan, which provides the basis for a competitive process for all power generation	The team added the approval of the MIP for EMAE in the prior action to ensure high-level support for its implementation. The MIP will help reduce non-technical losses and improve billing and collection, which

	activities; and (b) a Management Improvement Plan for EMAE, which aims to improve EMAE's operational performance.	is key to setting the power sector on a more sustainable path in the medium term.
In order to improve the quality of service, the Recipient, through AGER, has signed a concession contract with EMAE including all the company's obligations including rules on tariffs and sanctions.	The Recipient, through AGER, has signed a concession contract with EMAE, which stipulates the obligations of the Recipient and the licensee, including rules on tariffs and sanctions.	No changes.
In order to broaden the tax base and generate more own-source revenues, the Recipient has submitted to parliament a draft law to implement a VAT.	The Recipient, through the National Assembly, has passed the Value Added Tax Code, which sets forth provisions aimed at broadening the tax base and generating more own-source revenues.	The prior action was strengthened to reflect the criticality of having the law approved rather than only submitted to parliament.
In order to improve accountability of the SOE management, the Recipient, through its Council of Ministers, has established a performance monitoring system with financial and non-financial targets for all SOEs, with clear incentives for compliance.		Dropped. The World Bank Institutional Capacity Building Project (ICBP) provides support for the implementation of the SOE reform plan, the first step being the hiring of an advisor to support the implementation of the plan, including the establishment of a performance monitoring system. SOE sector reform is critical, and the government's commitment for the continuation of the reform is outlined in the letter of development policy.
In order to increase transparency and ensure accuracy of SOE's financial position, the Recipient has published accounts audited by an external and independent auditing company for its main public owned SOEs (EMAE, ENASA and ENAPORT).		Dropped. This prior action was dropped in an effort to streamline the matrix; this reform is also supported by the ICBP and the World Bank team has received pre-audits (audit reports done by external auditors, but without an opinion from the accountant) for all SOEs.
In order to improve selection of public investment projects, the Recipient, through its Council of Ministers, has established a National Investment Portfolio Database, (*Carteira Nacional de Projectos,* NIPD) to serve as the single source for public investment projects, from which all public investment projects will have to be		Dropped. Work on public investment management (PIM) is supported by World Bank TA through the Korean Trust Fund and the Institutional Capacity Building Project. Through the TA, the authorities and DPO team realized that there is a need to pass a law before implementing the NIPD: a law on the National Public Investment System (*Sistema*

sourced to be executed through the Public Investment Program (*Programa de Investimentos Públicos*).		*Nacional de Investimento Público,* SNIP). This prior action has been dropped since the submission/ passing of the law will require more time. The government's commitment to SOE reform is outlined in the letter of development policy.
In order to allow for tracking and reconciliation of funds allocated to SP payments, the Recipient has instituted a predominantly financial system-based formal payment mechanism for SP programs.	The Recipient, through the Ministry of Finance, has instituted a financial system-based (non-cash) payment mechanism to allow for the tracking and reconciliation of funds allocated to SP payments.	No changes.

Table 5. Summary of Changes in Results Framework from DPF 2 to DPF 3

Previous results indicator	Current results indicator	Explanation for Change
Result Indicator 1: Number of banks below the Central Bank's minimum Capital Adequacy Ratio (12 percent) Baseline (2015): 3 Target (2020): 0	Result Indicator 1: Number of banks below the Central Bank's minimum Capital Adequacy Ratio. (12 percent) Baseline (2015): 3 Target (2020): 0	No changes.
Result Indicator 2: Score on Doing Business indicator "Getting Credit". Baseline (2015): 0 out of 20 Target (2020): 10 out of 20		Dropped. This results indicator was dropped since the corresponding prior action (law on secured transactions) was also dropped. The team and the client agreed that stakeholders needed more time to understand the implications of the law.
Result Indicator 3: Share of the population with access to formal financial services (e.g. bank accounts). Baseline (2015): 53 percent Target (2020): 65 percent	Result Indicator 2: Share of the population with access to formal financial services (e.g. bank accounts). Baseline (2015): 39 percent Target (2020): 45 percent	The baseline and the target were changed to reflect the findings of recently conducted financial inclusion survey. The previous results indicators were based on administrative data, that were found to have overestimated financial inclusion. The new target is ambitious yet feasible and takes into account the recent trends in access and the long gestation for reforms to be implemented.

Result Indicator 4: Share of real estate properties and mortgages registered and digitized in the Public Notary Registry. Baseline (2015): 0 Target (2020): 90 percent.	Result Indicator 3: Share of real estate properties and mortgages registered and digitized in the Public Notary Registry. Baseline (2015): 0 percent Target (2020): 70 percent.	The target was slightly reduced to take into account the actual pace of digitalization at the Public Notary Registry.
Results Indicator 5: EMAE's non-technical losses. Baseline (2015): 26.4 percent Target (2020): 23.8 percent Intermediate (2017): 23 percent	Result Indicator 4: EMAE's operational profit/ loss (in millions LCU). Baseline (2015): - 224.9 million LCU Target (2020): -194.7 million LCU	The new results indicator will capture the impact of short-term measures to improve the financial standing of EMAE (contain losses, avoid new arrears, introduce energy saving measures), including the demand side measures (PA#5) and the approval of the MIP (PA#6). It is a very challenging target based on experience from utility reforms implemented in the past in SSA and other regions.
Results Indicator 6: Amount of Public Sector Arrears to EMAE. Baseline (2015): 36.4 billion Target (2020): 12 billion		
Results Indicator 7: Energy cost of production Baseline (2015): 8,545.22 STD/Kwh Target (2020): 8,300.00 STD/Kwh		Dropped. The World Bank Power Sector Recovery Project supports a long-term structural improvement of the energy sector, including a reduction in the energy production costs. The reduction in overall generation cost is, however, not feasible before 2020.
Result Indicator 8: Number of complaints received by EMAE Baseline (2015): 6,542 Target (2020): 3,000	Result Indicator 5: Number of complaints received by EMAE. Baseline (2015): 6,542 Target (2020): 3,000	No changes.
Result Indicator 9: Tax revenues (as a share of GDP) Baseline (2015): 14.6 percent Target (2020): 15.8 percent	Result Indicator 6: Tax revenues except custom duties on oil (in millions LCU). Baseline (2015): 831.1 million LCU Target (2020): 1050.0 million LCU	Revenues from custom duties on oil were excluded due to their volatility and the fact that the DPO-supported revenue measures do not impact custom duties on oil. Also, the indicator is in nominal LCU to isolate from GDP swings.
Result Indicator 10: Percentage of performance targets achieved – average for SOEs. Baseline (2015): N.A. Target (2020): 50 percent	Result Indicator 7: Number of SOEs' performance monitoring systems in place. Baseline (2015): 0 Target (2020): 2	The results indicator was changed to accommodate the delay in implementing the SOE reform plan, as a result of the change in government and represents a coverage of 50 percent of the SOE sector.
Result Indicator 11: Share of ongoing and finalized projects with basic information included in the National Investment Portfolio Database.	Result Indicator 8: Share of ongoing and finalized projects with basic information included in the National Investment Portfolio Database.	Small change in target to accommodate for eventual technical difficulties to reach 100 percent.

Baseline (2015): 0 Target (2020): 100 percent	Baseline (2015): 0 percent Target (2020): 95 percent	
Result Indicator 12: Number of beneficiaries enrolled in the three core SP programs and receiving regular payments as set in law. Baseline (2015): 0 Target (2020): 4,000 (out of which 50 percent has received payments through the formal financial system).	Result Indicator 9: Number of beneficiaries enrolled in the three core SP programs and receiving regular payments as set in law. Baseline (2015): 0 Target (2020): 4,000 (of which 50 percent has received payments through the formal financial system).	No changes.

35. While the results are expected to be achieved only in 2020, some results indicators have shown considerable progress. In 2019, the BCSTP reported that all banks were above the minimum capital adequacy ratio. Following an effort to install meters in residencies, the number of complaints to EMAE dropped to less than 4,000 in 2018. Finally, the government has registered almost 90 percent of the target population for the core SP programs.

Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure

Objective A.1. Introduce growth-enabling reforms in the financial sector and business environment

36. STP's financial sector has persistently faced multiple vulnerabilities, including high levels of NPLs, a concentration of loan portfolios, foreign exchange shortages, and a deficient credit infrastructure. NPLs totaled 24.6 percent of all bank loans in December 2018, despite declining from a peak of 29.8 percent in 2015. A high level of NPLs and a lack of business opportunities[8] have lowered banks' profitability and constrained their ability to generate internal capital. For example, only one in five banks were profitable as of June 2018. Due to the small size of the economy, a few clients represent a large portion of loan portfolios, exposing banks to liquidity and solvency risks in case of default. The banking sector is concentrated but it is a structural feature of the financial systems in small economies, and the concentration is not in itself a binding constraint. Moreover, shortages of foreign exchange continue to constrain the ability of banks to engage in international trade and foreign exchange trading, which are usually significant sources of income and profitability. Finally, a costly and uncertain enforcement of loan agreements and collateral due to an inefficient court system and the absence of alternative dispute resolution mechanisms continue to be a burden on banks, which partly explains their reluctance to lend and inability to resolve NPLs. The financial sector reform in STP initiated with a financial sector development strategy, financed by a TA from the FIRST Initiative, which continued to support financial sector reform in STP in the three areas supported by this DPO series: financial sector supervision, payments systems, and microfinance.

[8] Regional banks entered the STP market between 2000 and 2013 amid expectations of potential of offshore oil revenue and expanding business opportunities that did not materialize.

PA#1: Financial sector supervision

Rationale

37. Improving the regulation, supervision, and resolution of banks is key to reduce financial sector vulnerabilities and for enabling the banking sector to support economic growth. Only well-supervised and capitalized banks can efficiently mobilize and allocate savings to productive investments, while providing other critical financial services such as payments. A high level of NPLs has been a drag on lending, as it has reduced bank incentives to assume more risk. Reducing vulnerabilities and increasing the soundness of banks will require not only efficient regulations and supervision to ensure that banks operate prudently but also a strong resolution framework to facilitate the orderly exit of failed banks.

38. The government has implemented various measures to enhance the stability of the financial sector and enable it to contribute to economic growth. Policymakers in STP passed a new banking resolution law in 2017, which gave the BCSTP ample powers and tools to resolve distressed financial institutions in timely and orderly manner. They also adopted complementary regulations to be applied in the resolution of failing financial institutions and in preparation and adoption of recovery plans by banks. In addition, the BCSTP has finalized a resolution manual to facilitate the implementation of the new legal and regulatory framework for the financial sector. Moreover, the authorities are revising the BCSTP law and the financial institutions law, among other laws, to ensure their alignment with the resolution law. They also plan to upgrade the credit registry, with support from the ICBP to improve the quality and scope of information to facilitate banks' risk management. With support from the IMF, the BCSTP is also strengthening its supervisory framework through the introduction of risk-based supervision mechanisms, and it is encouraging banks to step up their loan recovery efforts.

39. Previous reforms in STP have provided the BCSTP with the tools needed to conduct effective bank supervision and resolution. In 2015, authorities initiated an ambitious reform program to strengthen financial stability, with TA from the IMF and World Bank. This DPO series supported the passage of the country's banking resolution law, which gave the BCSTP the power and authority to deal effectively with distressed financial institutions by facilitating early intervention and providing additional policy instruments to address vulnerabilities (***Prior Action #1 for DPF1).*** Following the passage of the resolution law, authorities issued regulations on two key provisions of the law: (i) bank resolution measures (i.e., bank sale, recapitalization, and unilateral merger); and (ii) the minimum content of the bank recovery and reorganization plan (***Prior Action #1 for DPF2).*** The BCSTP used the new framework to initiate the resolution of two banks, mitigating immediate risks to financial stability.

DPF 1 Prior Action #1: The Recipient, through its National Assembly, has approved a banking resolution law (*Medidas Especiais de Saneamento, Resolução e Liquidação de Instituções Bancárias*) that provides the Central Bank with the power and authority necessary to deal effectively with distressed financial institutions by facilitating early intervention and providing additional policy instruments to address vulnerabilities.

DPF 2 Prior Action #1: In order to strengthen the bank resolution framework, the Recipient, through its BCSTP, has adopted regulations implementing the Recipient's financial institutions resolution law, which set out: (i) the measures to be applied by the BCSTP in the resolution of distressed financial institutions; and (ii) the requirements for the elaboration and adoption of recovery and resolution plans.

***DPF 3 Prior Action #1*: The Recipient, through BCSTP, has approved the Report for the São Tomé and**

Príncipe Banking System Asset Quality Review, as part of its efforts to improve financial soundness of commercial banks.

Results Indicator #1: Number of banks below the Central Bank's minimum Capital Adequacy Ratio (12 percent). Baseline (2015): 3. Target (2020): 0

Substance and criticality

40. The AQR is critical to financial sector stability because it exposes gaps in loan classification and provision, determines the need for bank recapitalization, and identifies supervisory gaps. This operation supports the completion of an AQR to help the BCSTP obtain more reliable information on banks' financial soundness (***Prior Action #1 for DPF 3***). Funded by the ICBP, the AQR took stock of banks' asset classification and provisioning practices, identified deviations from BCSTP's guidelines and international norms, and recommended necessary adjustments to ensure compliance. The AQR also determined shortfalls in loan losses provisioning and capital levels. Where applicable, the BCSTP will require banks to reclassify loans, make additional provisions, and develop recapitalization plans to ensure compliance with minimum requirements. Recapitalizations will be key to ensuring that the AQR effectively contributes to the soundness and stability of STP's financial sector. Moreover, the findings of the AQR will inform the development of plans to close supervisory gaps, such as limited enforcement of prudential norms and weaknesses in banks' risk management practices and internal controls. While the BCSTP has yet to finalize an action plan to guide the implementation of the recommendations of the AQR, banks have already reclassified some loans and increased provisions, following BSTP's instructions based on the AQR findings. The BCSTP is also discussing the adoption of the AQR methodology to value collateral of loans – mainly real estate – in a phased manner. The World Bank and IMF are supporting the BCSTP with TA on the implementation of all the findings and recommendations of the AQR, which is a structural benchmark under the IMF program for end-2019.

41. The expected result from these reforms is to have all banks comply with the minimum capital adequacy ratio. The reforms supported by this operation aim to enhance the stability of the banking sector. In particular, the AQR will propose adjustments to banks' provisioning levels and capital positions, and in case of capital shortfalls, the BCSTP will require banks to recapitalize to be in compliance with the minimum capital requirements. In tandem, the resolution framework already allows the BCSTP to resolve problem banks and protect depositors. The DPO's reforms will be evaluated by the number of banks below the minimum capital adequacy ratio of 12 percent (*Results Indicator #1*).

PA#2: Payment systems

Rationale

42. The deficient payment infrastructure in STP constrains economic development, especially in the tourism industry. The country's limited payment infrastructure and access channels limit the access to payment services— in particular, in rural areas and on the island of Príncipe, including the payment and collection of taxes, the payment of utility bills and wages, and disbursement of welfare benefits. The current payment infrastructure is not reliable – employees spend most of their time fixing manually problems created by system errors – and therefore bank cards and electronic transactions are used less and less in STP. The African Development Bank (AfDB)is financing an upgrade of the payment system, but the project is severely delayed, and thus the payment system remains a major constraint. The absence of an adequate national payment infrastructure (comprising all the relevant clearing, switching, and settlement systems), the lack of connectivity of the local payment system with international card

networks (e.g., VISA, Mastercard, etc.)[9], and the high costs of international transactions significantly impair economic activity. This is especially relevant for the development of the tourism sector since tourists cannot use their international credit cards in STP, restricting the revenues generated by the tourism activity in the country.

43. Mobile payment services in STP are extremely underdeveloped, underscoring the need for the recently concluded update of the legal and regulatory framework, increasing capacity, and upgrading the payment infrastructure. Current electronic retail payment instruments rely on banks and bank accounts. Mobile phone coverage is available in all seven districts, access to mobile cellular phones increased from 58 phones per 100 people in 2010 to 91 phones in 2017, and the number of internet users as a percentage of the total population increased from 19 percent to about 28 percent in the same period.[10] However,[11] there are currently no mobile payment products available to unbanked clients in STP. Payment system reforms aim to support the development of payment solutions and attract private investments for mobile service providers and new products and services.

44. The approval of the new payment service law, the creation of the new directorate, and reforms supported under previous DPOs marked the initial steps in establishing an efficient, safe, reliable, and modern national payment system. As a first step in the reform process, the BCSTP has created, operationalized, and staffed a new directorate (*Direção de Sistemas de Pagamento*) to better align the mandate and responsibilities of the payment systems oversight team at the BCSTP with international standards and best practices, in particular the CPMI-IOSCO Principles for Financial Markets Infrastructures (***Prior Action #2 for DPF1***). The role of the restructured department is to oversee the development and supervision of new non-bank payment services providers (payment institutions), as well as new retail payments products and services. The government submitted to the parliament a new Payment Services Law (RJSNP) that was approved by Parliament on November 2018. The RJSNP **(*Prior Action #3 for DPF 2*)** provided a comprehensive framework for payment services, including clear rules for the provision of payment services, operation of payment systems, and market entry. The RJSNP also grants BCSTP adequate powers and tools for effective oversight and supervision of the financial sector; it also promotes competition by allowing the entry of new payment service providers in the market, such as payment institutions and the use of agent networks.

DPF 1 Prior Action #2: The Recipient, through its Central Bank, has created, operationalized and staffed a new directorate (*Direcção de Sistemas de Pagamentos*) to consolidate in the same unit all responsibilities related to oversight, policy formulation and development of the national payment system.

DPF 2 Prior Action #3: In order to expand the outreach of the banking system and support financial inclusion through the usage of mobile financial services, the Recipient, through its Council of Ministers, has approved and submitted to the Parliament the proposed National Payment Systems Law, which sets forth the statutory level principles for regulation on modern payment methods, such as agent banking, mobile money, and electronic payments.

[9] The World Bank and the AfDB are supporting the technical work and financing the purchase of equipment needed to modernize the national payment system and its connection with the international credit card network.
[10] IEG Project Performance Assessment Report Cameroon, Chad, Central African Republic, São Tomé e Príncipe: Internet and Mobile Connectivity. Central African Backbone Program (APL 1A and APL 2), June 4, 2018.
[11] IEG Project Performance Assessment Report Cameroon, Chad, Central African Republic, São Tomé e Príncipe: Internet and Mobile Connectivity. Central African Backbone Program (APL 1A and APL 2), June 4, 2018.

***DPF 3 Prior Action #2*: The Recipient through: (i) its National Assembly, has passed the legal framework for payment services providers and payment system operators, which outlines the oversight framework, and duties and powers of BCSTP; and (ii) BCSTP, has passed the key implementing regulations under the National Payments System Law, which provide for the legal protection of the electronic transfer of funds and the licensing and supervision of payment institutions and payment system operators.**

Results Indicator #2: Share of the population with access to formal financial services (e.g. bank accounts). Baseline (2017): 39 percent. Target (2020): 45 percent.

Substance and criticality

45. A safe and efficient national payment system, combined with a sound legal and regulatory framework, is critical for economic development, as it allows for greater competition, cost reduction, and a wider choice for end users by offering a broader scope of payment instruments and channels. The World Bank, under the FIRST Project, has worked closely with the BCSTP to develop all supporting regulatory framework for the RJSNP, namely the Decree-Law on the Legal Framework on Payment Services Providers and System Operators and regulations (*Norma de Aplicação Permanente,* NAP) on Electronic Fund Transfers **(*Prior Action #3 for DPF3*)** and on authorization of payment institutions (such as mobile payments providers) and operators, as well as the activation of the National Payments Council.[12] Improving the existing national card switch and associated infrastructure is a priority to preserve and enhance public trust in the use of electronic payment instruments. This will facilitate future introduction of other solutions in mobile financial services with potential for financial inclusion of the unbanked in both rural and urban areas.

46. A modern national payment system will yield several benefits including on financial inclusion, social safety nets, digital economy, and tax collection. Beyond supporting financial inclusion, a safe and efficient national payment system is the backbone of the financial sector and is critical to financial stability and economic growth. It is also a pre-requisite for the digital economy, facilitates tax collection and the application of Anti-Money Laundering/ Combating the Financing of Terrorism (AML/CFT) and anti-corruption laws. Furthermore, SP programs of the GoSTP would benefit from an efficient national payment system and increased use of electronic payment instruments as they enable better identification of beneficiaries, faster and more efficient payment execution, and easier and safer access to benefits. Expected results of this reform will be measured jointly with the Prior Action #2 on the microfinance law, please see below (*Results Indicator #2*). The team will also try to isolate and report on the effect of improved payment system infrastructure on tourism exports from the Balance of Payments data.

PA#3: Financial inclusion

Rationale

47. There is a small unregulated microfinance sector in STP that, if well regulated, could contribute to expanding access to finance. Few informal lenders currently provide short-term, high-interest loans, but these are not under the supervision of the BCSTP. While these institutions could provide valuable

[12] National Payment Councils are an internationally recognized best practice and have been implemented in many countries. The NPC would bring together a broad range of relevant actors from public and private sides, including representatives of payment services users and providers (banks but also future non-banks providing payment services), various BCSTP Departments, Telecom Regulator, SPAUT- current Switch Operator, and other relevant authorities. This would ensure effective mobilization and commitment around common goals, and effective consultation of all relevant parties.

services to people who do not normally have access to bank credit or savings, they could also harm consumers by not following good business practices and adopting abusive sales and debt collection strategies that take advantage of clients. Therefore, the BCSTP is seeking to regulate this emerging industry and formalize microfinance providers. Establishing a legal, regulatory, and supervisory framework for microfinance, together with reforms already underway for modernizing the national payment system and strengthening the banking sector, could improve the overall stability, integrity, and development of STP's financial sector and protect the rights of consumers. The government approved in 2018 the first law on microfinance **(*Prior Action #2 for DPF2*)**.

DPF 1 Prior Action #2: The Recipient, through its Central Bank, has created, operationalized and staffed a new directorate (*Direcção de Sistemas de Pagamentos*) to consolidate in the same unit all responsibilities related to oversight, policy formulation and development of the national payment system.

DPF 2 Prior Action #2: In order to develop the microfinance sector and promote the offer of microfinance services, the Recipient, through its Council of Ministers, has approved and submitted to Recipient's Parliament a draft law on microfinance.

***DPF 3 Prior Action #3*: The Recipient, through BCSTP, has passed key regulations, which establish the minimum entry, operation requirements, risk management minimum requirements, and supervisory and reporting procedures for microfinance institutions.**

Results Indicator #2: Share of the population with access to formal financial services (e.g. bank accounts). Baseline (2017): 39 percent. Target (2020): 45 percent

Substance and criticality

48. The upgrade of the payment infrastructure is not sufficient to increase access to finance - proper regulation of the microfinance sector is also critical for access to finance. Due to the underdeveloped payments system infrastructure, policy initiatives in support of financial inclusion depend on reforms to improve and modernize the current infrastructure, strengthen and improve the legal and regulatory framework with the objective to promote the entry of new payment service providers, use of alternative channels, promote digital retail payments, and improve consumer protection and financial literacy. Proper regulation including on consumer protection is needed to support the development of the microfinance sector and increase access to finance. This operation now supports the implementing regulation - supervision and reporting requirements for microfinance institutions **(*Prior Action #3 for DPF3*)**. As for the payments area, the World Bank FIRST project has provided extensive TA for review of legal framework for payments.

49. Support for the implementation of a new national payment system and microfinance law, which has been recently approved, will yield several benefits including on financial inclusion, social safety nets, digital economy, and tax collection. The expected results are an increase in the quality and quantity of payment services provided by banks and the entry in the market of new payment service providers, increasing competition and offer of new digital financial services. The new landscape will meet the needs of the banked and unbanked population, particularly in terms of affordability and accessibility. This will promote financial inclusion, allow for the growth in tourism and tourism revenues, and support economic transactions and the digital economy. This set of reforms will be evaluated by the share of the adult population with access to formal financial services (e.g. transaction accounts) *(Results Indicator #2)*.

PA#4: Business environment and property registry

Rationale

50. The absence of a functioning land information system in STP constitutes a major constraint on the government to perform sustainable land governance operations. The possibility to record, store, and manage data related to land is essential for land governance efforts.[13] The government needs access to accurate and updated land information to assign and protect land rights, value and tax property, manage the use of resources, and implement dispute resolution mechanisms, all of which are essential objectives of sustainable land governance. A lack of access to land information also hinders the emergence of functioning land markets, which hampers private investment in land-related sectors.

51. The country's property registries and cadasters are deficient and outdated, and there is no unique identification number for land parcels, which prevents the existence of an interoperable information system. Property registries in STP are paper-based and require manual bookkeeping, increasing errors and generating risks in terms of security, transparency, and legal certainty. Land transactions, including cadaster and property registration functions, are distributed among various government agencies, reducing the efficiency in data production processes and affecting the quality of information. Finally, the country's land information systems lack a unique identification number, preventing their interoperability with other systems like the tax registry, rendering all land management efforts inefficient. The lack of interoperability of the country's information systems results in data fragmentation and increased transaction costs, prevents economies of scale, and affects the quality of information to inform policy formulation.

52. The GoSTP has made efforts to reduce the cost of registering properties and mortgages and improve the effectiveness of land information systems to improve the business environment. Under this DPO series, the bank has supported the government in reducing the cost of registering mortgages **(*DPF 1 Prior Action #3)*** and reviewing and approving a new property registration code and public notary code **(*DPF 2 Prior Action #4*)**. These new codes laid the foundation for upgrading land registration systems, such as digital registries, improving the interoperability of databases, and allowing joint titling.

DPF 1 Prior Action #3: The Recipient, through its Council of Ministers (*Conselho de Ministros*), has reduced legal fees (i.e. taxes and registry fees) associated with the registry of mortgages.

DPF 2 Prior Action #4: In order to reduce costs and simplify procedures to register property, therefore improving its ability to serve as loan collateral and foster access to finance, the Recipient, through the Council of Ministers, has approved and submitted to the recipient's Parliament (i) the proposed Property Registration Code; and (ii) the proposed Public Notary Code.

***DPF 3 Prior Action #4*: The Recipient, through its Council of Ministers, has approved the institutional structure for enabling interoperability between the land property register *(Registo de Propriedade)* and the cadaster *(Registo Cadastral)*.**

Results Indicator #3: Share of real estate properties and mortgages registered and digitized in the Public

[13] See: Food and Agriculture Organization of The United Nations (FAO) (2012). Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security. Rome and; Deininger, Klaus; Harris Selod, and Anthony Burns (2012). The Land Governance Assessment Framework Identifying and Monitoring Good Practice in the Land Sector. World Bank, Washington DC.

Notary Registry. Baseline (2015): 0. Target (2020): 70 percent.

Substance and criticality

53. The third operation supports the first steps toward the interoperability of the country's land information systems[14] (*DPF 3 Prior Action #4*). This will be ensured by the creation of a cadaster and registry technical committee, comprised of the General Directorate for National Registry and the Direction of Geographical and Cadastral Services, to foster collaboration around land transactions and property demarcation and registration, as well as facilitate periodic meetings to resolve operational bottlenecks.

54. **Expected results include an improvement in the effectiveness of property registration.** Results will be measured by the share of real estate properties and mortgages registered and digitized in the new public notary registry *(Results Indicator #3)*.

Objective A.2. Introduce growth-enabling reforms in the infrastructure sector

55. STP's energy supply does not meet its demand[15] and is unreliable[16] and costly. As a result, the electricity grid suffers from frequent outages, especially during periods of peak demand. The fragility of the energy sector became evident in 2018, when a combination of an expanded power grid and generator capacity based on inadequate planning and maintenance led to an energy crisis that cut supply by as much as 75 percent. STP has the third-highest energy supply costs in SSA.[17] This is partly due to challenges faced by energy systems in small island countries, including small-scale operations and a lack of interconnectivity between systems due to insularity. However, STP's energy sector also suffers from an outdated transmission and distribution system, an energy generation mix highly dependent on costly fuel and difficulties in managing the EMAE. Moreover, most of the country's energy comes from low-efficiency thermal generators, leading to high fuel consumption and aggravating the structurally high cost of energy.

56. EMAE is financially unsustainable, has historically underinvested in maintenance, and has large payment arrears with fuel supplier. Despite high energy tariffs, the EMAE is not able to recover its costs; the average cost of service (0.27 US$/KWh) is above the average tariff (0.23 US$/KWh).[18] As a result, the EMAE's own capital is negative at €63 million in 2018 and its costs exceeded revenues by €11 million in 2018—equivalent to 3.1 percent of GDP. Faced with insufficient tariff revenue, the EMAE has been unable to honor payment agreements and has accumulated arrears with suppliers, especially the fuel supplier, ENCO, in the amount of €91 million—approximately 23 percent of GDP. In addition, a lack of financial resources has prevented the EMAE from properly maintaining its assets, resulting in a degradation and

[14] Currently, there are two main cadasters: the property registry at the Ministry of Justice and the land registry at the Ministry of Infrastructure, with no correspondence between them.
[15] The total nominal installed capacity in the country is 30 MW, but only 15 MW is guaranteed. The energy mix consist of diesel-fueled generators (95 percent), with the remaining energy coming from a hydropower plant (around 1.9 MW).
[16] There are no available statistics on standard industry measures for energy interruptions, but the index on reliability of supply and transparency of tariff from the Doing Business survey is zero in STP.
[17] STP has third highest cost of electricity service in 2014 U.S. dollars per kWh billed after Comoros and Sierra Leone. Operating costs of power utilities in SSA are twenty times higher in island countries than in non-island countries, and that operating costs for small systems (less than 150 MW) are six times higher than for larger systems (>1000 MW). Source: Trimble, Chris et al. "Financial Viability of Electricity Sectors in Sub-Saharan Africa: Quasi-Fiscal Deficits and Hidden Costs" World Bank Policy Research Working Paper 7788, The World Bank Group, Washington D.C: 2016.
[18] Based on EMAE 2017 figures.

loss of assets, low-quality services, and high customer dissatisfaction. The major commercial challenges faced by the EMAE include inadequate metering and billing and overdue bills from public and private clients. Client arrears reached €12.6 million in 2018—equivalent to 92 percent of the EMAE's annual revenue in the same year.[19]

PA#5: EMAE's commercial losses

Rationale

57. The EMAE could significantly improve its finances through reducing commercial (non-technical) losses. Commercial losses are significant in the EMAE. Total transmission and distribution losses (T&D losses), which are comprised of technical and commercial losses, amount to 34 percent (vis-à-vis 15 percent from comparators[20]), of which 23 are commercial. Commercial losses in the EMAE are caused by underpricing, inefficient billing and collection (bill collection rate at 89 percent, vis-à-vis 93 percent from comparators[21]) and large payment arrears from clients, over-staffing, electricity and diesel theft.

58. This DPO series supports EMAE's efforts to improve energy billing and collection, to reduce commercial losses, and to generate more revenue. The first measure to improve its billing and collection was the introduction of a revised system of prepaid energy services that allows for accurate metering and invoicing **(*DPF 1 Prior Action #4*)**, followed by a campaign to raise public awareness of the importance of paying energy bills on time to avoid service disconnection **(*DPF 2 Prior Action #5*)**. The electricity utility is also addressing arrears accumulated by the government, its largest client. Public clients pay the highest energy tariff, they make up 36 percent of the EMAE's revenues and 50.3 percent of bills in arrears. A metering campaign will be rolled out in January 2020, with the aim to better monitor actual consumption of public customers and the possibility to implement cutting off policy for nonpayment. The GoSTP has concluded an inventory of its energy and water bills and is working on a new arrear settlement plan with the EMAE.

DPF 1 Prior Action #4: The Recipient, through EMAE, has introduced a revised system of pre-paid energy services that will allow for accurate consumption metering and invoicing, as well as eliminating the risk of non-payment**.**

DPF 2 Prior Action #5: In order to promote transparency and incentivize timely payments, the Recipient, through EMAE, has published its policy to improve billing collection and launched a public awareness campaign through public TV and radio.

***DPF 3 Prior Action #5*: The Recipient, through the Presidency of the Republic, has instituted an energy demand management program, which includes the exchange of low efficient bulbs with higher efficient ones.**

Result Indicator #4: EMAE's operational profit/ loss (in million LCU). Baseline (2015): - 224.9 million LCU. Target (2020): -194.7 million LCU.

[19] Please refer to Box 1 on the energy sector and reforms at EMAE in the macroeconomic policy framework section for more financial and operational information on the EMAE.
[20] Weighted average value across 39 SSA countries.
[21] Median value across 39 SSA countries.

Substance and criticality

59. The third operation supports energy efficiency measures to reduce overall electricity consumption and therefore reduce EMAE's losses. Electricity DSM – measures that seek to manage or decrease overall electricity consumption – can have significant economic, reliability and environmental benefits, while reducing the overall electricity system expenditures. Since EMAE is a loss-making SOE, less energy demand means reduced losses in the EMAE. An electricity demand study for STP showed that 68 percent of the evening peak demand is related to residential consumption, of which lighting accounts for about 70 percent. As of today, lighting requirements are mainly met by inefficient incandescent lighting (used by 74 percent of households), or moderately efficient compact fluorescent lamp bulbs (29 percent of households).

60. The energy demand program will promote the adoption of more efficient lighting and gradually ban the import of less efficient ones. The government will implement a DSM program that exchanges inefficient lighting with more efficient LED bulbs for residential consumers at no additional cost (***DPF 3, Prior Action #5***). Under this program each household will be giving LED lamps in exchange for the return of low-efficient incandescent light, which will be discarded according to good environmental practices. The program will also gradually ban the importation and use of low energy-efficient incandescent lamps in order to ensure sustainability of the gains over time, which is a structural benchmark in the IMF program. This is expected to significantly reduce peak demand as well as overall electricity demand. Considering a reduction in peak demand only, the annual electricity demand could be reduced by about 10 percent, which is close to the annual demand growth (7 percent). The DSM program would also reduce energy consumption and bills of residential customers, and thus mitigate the risk of new arrears accumulation. The light bulb exchange will take nine months, will be completed in 2020 and be financed by grants. It will also be designed in way to ensure that poor households benefit equitably from it and will include a sensitization strategy to promote energy efficiency and use of low consumption LED lights.

61. Expected results include an improvement in EMAE's operational results. The DSM program is expected to reduce the electricity system expenditures for the EMAE. This should in turn reduce commercial losses and improve the EMAEs operational result (*Results Indicator #4*).

PA#6: Energy planning

Rationale

62. The high cost and unreliable supply of energy are the direct result of insufficient planning in the expansion of the system by EMAE. Historically, the EMAE has based investment decisions on the availability of financing and equipment for quick deployment, rather than on long-term environmental and cost considerations. This has resulted in an inefficient and fragmented energy system with high production costs. Moreover, the energy sector suffers from various management problems at the EMAE, including inefficient billing and collection systems, the absence of an integrated management system, a lack of consistent accounting practices, and non-existent internal control mechanisms.[22] The second operation addressed this lack of planning by binding any power generation decision to the LCPDP (DPF2 Prior Action#6).

[22] For instance, the pre-audit report commissioned in 2018 showed that some accounts in EMAE's balance sheet could not be reconciled. Also, some wages and benefit payments were not recorded through the payroll system, thus circumventing internal control mechanism.

DPF 2 Prior Action #6: In order to structurally reduce the cost of energy, increase the share of renewable sources, and promote long-term private investment, the Recipient, through its Council of Ministers, has ruled that any capacity expansion of the power sector will have to follow the prescriptions of the integrated Least-Cost Power Development Plan, and that any exception would need to obtain the approval of the Recipient's Minister of Infrastructure, who shall have to provide the rationale for such exemption and publish said decision.

***DPF 3 Prior Action #6*: The Recipient, through its Council of Ministers, has approved: (a) a Least-Cost Power Sector Development Plan, which provides the basis for a competitive process for all power generation activities; and (b) a Management Improvement Plan for EMAE, which aims to improve EMAE's operational performance.**

Results Indicator #4: EMAE's operational profit/ loss (in million LCU). Baseline (2015): - 224.9 million LCU. Target (2020): -194.7 million LCU.

Substance and criticality

63. Better energy sector planning and management at the EMAE are critical to reduce energy costs, improve the reliability of the country's energy supply in the long term, and reduce commercial losses. This DPO series, together with the Power Sector Recovery Project (PRSP), has been supporting better sector planning and management at the EMAE. The LCPDP is a planning mechanism that selects the optimal combination of power generation and transmission at the lowest cost, while complying with reliability standards and other policy commitments, such as environmental standards and the target to generate at least half of the energy supply from renewable sources. Since its approval, the LCDP has been the basis for discussions with various donors and private players on options for long term generation capacity addition in STP.

64. Inefficiencies at the EMAE will be addressed by the Management Improvement Plan (MIP). The MIP, which was supported through the World Bank's PRSP, assessed the EMAE's business processes with the objective to improve efficiency, transparency and accountability in operations in all business areas. The MIP provides detailed action plans for the reduction of commercial losses, including for the establishment of a loss reduction unit to address payment arrears; and the modernization of billing and installation of pre-paid and smart meters. The MIP suggests specific key performance indicators (KPIs)to monitor and evaluate the implementation of the plan. One main activity from the MIP, which already being implemented is the recruitment of an HR firm to competitively recruit all directors working under the EMAE CEO, based on clear job description and with contracts including KPIs, linked to the objectives of the MIP. This operation foresees the formal endorsement by the Council of Ministers of (i) the LCPDP, which promotes a competitive process for all power generation activities; and (ii) an MIP for the EMAE, **(*DPF 3 Prior Action #6*)**, which will empower government agencies to implement these plans**.**

65. Expected results include an improvement in EMAE's operational results. The adoption of the LCPDP and MIP are expected to reduce commercial losses and improve the EMAE's operational result (*Results Indicator #4*). The ongoing PSRP will also monitor the implementation of both plans.

PA#7: Energy regulation

Rationale

66. An adequate regulatory framework is needed to improve the quality of service and foster private investment in the energy sector. In order to improve service quality, the EMAE's service standards need to be defined and agreed upon between the EMAE and the GoSTP in the form of a concession contract, overseen by the sector regulator, *Autoridade Geral de Regulação de São Tomé e Príncipe* (AGER[23]). Additionally, standards must be overseen by an independent regulator that has the authority and ability to impose credible sanctions on the EMAE. An independent regulator with the relevant sectoral expertise would also ensure that electricity prices are set and adjusted according to the principle of cost recovery and based on a sound and transparent methodology. This in turn could increase price predictability and attract private sector interest in operating and investing in STP's electricity sector.

67. This DPO series supports reforms in energy regulation to improve the quality of service. The first DPO established a customer complaint redress system at the EMAE for the mediation of conflicts between citizens and the EMAE, overseen by the AGER (***DPF 1 Prior Action #5***). The second DPO supported the publication of minimum quality criteria for energy services through the AGER (***DPF 2 Prior Action #7***).

DPF 1 Prior Action #5: The Recipient, through AGER, has mandated EMAE to: (i) establish a comprehensive customer complaint redress system, for the mediation of conflicts between citizens and EMAE, as well as representing the interests of the public, receiving feedback, complaints, information requests and suggestions for improvement of service; and (ii) send to AGER monthly reports of complaints received from customers.

DPF 2 Prior Action #7: In order to improve the reliability of energy supply, the Recipient, through AGER, has published the minimum quality criteria for the provision of services in the electricity sector.

***DPF 3 Prior Action #7*: The Recipient, through AGER, has signed a concession contract with EMAE, which stipulates the obligations of the Recipient and the licensee, including rules on tariffs and sanctions.**

Result Indicator #5: Number of complaints received by EMAE. Baseline (2015): 6,542. Target (2020): 3,000.

Substance and criticality

68. A concession contract between the government and the EMAE, overseen by the AGER, constitutes a cornerstone of regulation and is critical for improving service quality. While the contract is included in the energy law as an obligation, it has never been implemented. The third operation supports the establishment of a concession contract between the GoSTP and the EMAE **(*DPF 3 Prior Action #7*)**. The contract aims to formalize the framework and conditions applicable to service delivery by the concessionaire (rights and obligations, economic and service quality regulations, regime for monitoring performance, electricity tariff setting procedures and enforcing compliance, etc.) will last for 20 years. The contract foresees also the establishment of performance indicators, infrastructure

[23] AGER is a multi-sector regulator in STP, responsible for the regulation and supervision of the telecommunications, postal services, water and electricity sectors.

investment commitments, and minimum supply levels. The contract has been made public in the official gazette.

69. Expected results include an improvement in the quality of energy services. This improvement will be reflected in a more reliable energy supply and better customer service, which will be measured by the number of complaints received by the EMAE (*Results Indicator #5*).

Pillar B: Generate fiscal resources and savings and improve the quality of expenditures

Objective B.1: Generate fiscal resources and savings

PA#8: Revenue mobilization

70. STP's level of tax revenue is low and insufficient to meet the country's growth and development needs. Tax revenue reached 12.6 percent of GDP in 2018—among the lowest in the world. There is compelling evidence that a tax revenue ratio of 15 percent of GDP is the minimum threshold for a state to function effectively. Therefore, strengthening domestic revenue mobilization became an IDA18 policy commitment. The World Bank's latest Public Expenditure Review (PER) for STP revealed that the GoSTP can increase domestic revenue by 3 to 5 percentage points of GDP by reforming its tax policy and improving the country's tax administration.

Rationale

71. The country's revenue underperformance is the result of an outdated tax policy and inefficient tax administration. Tax revenue relies heavily on indirect taxes, mainly customs duties. Instead of a general and broad-based consumption tax on goods and services, STP has a series of specific consumption taxes. STP is one of only eight African countries (out of a total of fifty-five) that do not have a VAT. It does have a stamp tax, which is levied on many transactions. Revenue from direct taxation comes mainly from the personal income tax (PIT), while corporate income tax (CIT) revenue has been declining over the past years. Moreover, current tax administration practices are inefficient: customs duties and taxes are managed by different offices—the Directorate of Taxation (DI) and the Directorate General of Customs (DGA)—which makes coordination difficult and results in additional administrative costs. Tax audits are also inaccurate, labor intensive, and lack a risk-based approach. The DI and DGA have no specific strategic planning units, which weakens their capacity to monitor activities and performance assessments, and lack accountability. The DI's information technology (IT) capacity is also low, and there is an urgent need to replace the current system. Finally, the collection of tax arrears is poorly monitored, and collection enforcement is a lengthy and costly process due to STP's inefficient judicial system.

72. The GoSTP aims to broaden the tax base by reforming the country's tax policies. Policymakers have approved several changes in the tax legislation in recent years. In the first DPO, the tax structure for the PIT and CIT was adjusted and simplified. The amount of the minimum tax paid (presumptive taxation) was also increased for the first time since 1995, and a cumbersome structure with six taxation thresholds was simplified to one threshold (***DPF 1 Prior Action #6***). A key element to broadening the tax base in STP and increase long-term revenue is to adopt a VAT. The GoSTP has taken steps to implement a VAT with support from the World Bank, the IMF, and the AfDB. Also, the previous administration submitted a VAT law to Parliament in May 2018. However, the law had to be resubmitted to Parliament in 2019 due to end of the legislative session. A precondition for the successful introduction of the VAT is the adoption of necessary regulations for fiscal invoicing and supporting accounting and tax information from taxpayers (***DPF 2 Prior Action #8***).

DPF 1 Prior Action #6: The Recipient, through its Council of Ministries, has simplified the tax structure and updated the threshold values of tax brackets for presumptive income taxation.

DPF 2 Prior Action #8: In order to generate the tax and accounting information needed to implement the VAT, the Recipient, through its Council of Ministers, has adopted the legal framework for fiscal invoices and similar documentation, whereby it legally mandated companies to issue fiscal invoices, set out said invoice's minimum content and time requirements for storing them.

***DPF 3 Prior Action #8*: The Recipient, through the National Assembly, has passed the Value Added Tax Code, which sets forth provisions aimed at broadening the tax base and generating more own-source revenues.**

Result Indicator #6: Tax revenues excluding except custom duties on oil (in million LCU). Baseline (2015): 831.1 million LCU. Target (2020): 1050.0 million LCU.

Substance and criticality

73. The implementation of the VAT requires a combination of policy, legal, and administration reforms, including (i) improving IT systems; (ii) recruiting new staff; and (iii) training new and existing staff. The DI has provided a list of activities leading to the implementation of the VAT. These activities will be supported by the World Bank (through the ICBP), the AfDB, and the IMF. Project components include the enhancement of physical infrastructure and logistics; the development of a new IT system; capacity building of tax administration staff; education of taxpayers; and a communication campaign on the VAT.

74. To formalize the legal framework for the VAT, the GoSTP has approved the VAT law, which is based on TA from the World Bank and IMF (*DPF 3 Prior Action #8*). The adoption of the VAT law is a structural benchmark under the new IMF ECF. The VAT law will allow the GoSTP to transition to a VAT regime in 2020. With TA from the World Bank and IMF, the government will also adjust related regulations—including the harmonization of the VAT with other consumption taxes—and strengthen the operational capacity of the taxpayer administration to ensure the successful roll-out of the VAT.

75. Expected results include the implementation of reforms to broaden the tax base and generate a stable source of public revenue. These will be evaluated by revenue performance outcomes and measured by the tax revenue amount, excluding custom revenues on oil (*Result Indicator #6*). The introduction of the VAT is expected to drive the modernization of the tax administration by improving operations—including a new IT system—and other tax administration areas such as direct taxation. Potential adverse effects of the implementation of the VAT, including price increases and less income for poor households, are mitigated by exempting agricultural goods from the VAT and introducing a targeted cash-transfer program.

SOE management

76. STP's SOEs, which operate in the critically important infrastructure sector, are hindered by inefficient management practices. The GoSTP controls four fully-fledged SOEs in the electricity, water and sanitation (EMAE), airport (ENASA), ports (ENAPORT), and postal services (Correios) sectors. These companies are vital for the economy and the country's ability to attract tourists and export cocoa and other goods. The efficient operation of these SOEs is therefore of strategic importance to STP.

Rationale

77. SOEs face several challenges related to efficiency, financial viability, and transparency. The four majority-owned SOEs have incurred significant losses in recent years. They are thinly capitalized, unable to finance themselves, and heavily reliant on the state or international donors for their investments. Moreover, the quality of SOE services ranges from uneven to poor. Due largely to their deteriorating financial performance and inability to run their operations autonomously, SOEs have been facing serious operational problems, hampering their ability to provide quality services. Their loss-making positions and liquidity problems have prevented the government from deriving any significant revenues from these enterprises in the form of taxes or dividends. Instead, SOEs have accumulated significant arrears with suppliers and creditors.

78. Corporate governance of SOEs is weak. While the legal and regulatory framework for SOEs is mostly adequate, state ownership arrangements are unclear, which results in a significant administrative burden and limited operational autonomy. Accountability mechanisms are also unclear: despite being obligated to follow general principles of efficiency and effectiveness, SOEs are not bound by fiscal or financial outcomes. There is no established mechanism for monitoring the performance of SOEs or its managers, and the financial reporting of SOEs is inadequate.

79. Reforms targeting SOEs have so far progressed very slowly, despite a consensus that poorly managed SOEs are a burden on the country's economy and public finances. The previous government acknowledged that SOEs were nearly bankrupt. In January 2017, the Council of Ministers requested an MIP for the country's main SOEs and decided to freeze personnel expenses until SOEs were financially sound. However, those initiatives were never implemented. The World Bank is supporting SOE reforms through several instruments. Its PSRP supports management reforms at the EMAE—the largest SOE—and the recent PER carried out a diagnostic of the management and control of SOEs, which formed the basis for the government's SOE reform plan. The reform plan was approved in the second DPO (***DPF 2 Prior Action #9***) and aims to strengthen SOE governance and performance and reduce SOE-related fiscal risks. The PRCI also supports the implementation of the government's SOE reform plan. Furthermore, the GoSTP has conducted, with World Bank guidance, external pre-audits[24] of its three main SOEs.

80. The new administration is committed to SOE reform, as outlined in the letter of development policy. The ongoing ICBP (P162129) provides support for the implementation of the SOE reform plan. The first step is the hiring of an advisor to support the implementation of the plan, including the establishment of a performance monitoring system. At the same time, the government is hiring with World Bank support an external accounting audit of all SOEs.

81. Expected results from the reforms include improvements in SOE management, oversight, and performance. The approval of the SOE reform plan, and its operationalization through the establishment of a proper monitoring system, will strengthen SOE monitoring and accountability. This in turn would drive both financial and non-financial improvements of SOEs (*Result Indicator #7*) and improve their quality of services. The monitoring system is also expected to improve the SOEs' internal controls and enhance the quality of their financial reporting. Furthermore, aggregate SOE reports, annual financial statements, and audit reports should increase the transparency of the SOE sector.

[24] Pre-audits report on (i) misstatements in financial statements that will be subject to review and (ii) significant weaknesses in accounting policies, practices, and procedures and internal control during the preparation of financial statements.

DPF 2 Prior Action #9: In order to improve SOE's financial and non-financial performance, the Recipient, through its Council of Ministers, has approved an SOE reform plan that established a performance monitoring system with financial and non-financial targets for all SOEs and incentives to ensure compliance.

Result Indicator #7 Number of SOEs' performance monitoring systems in place. Baseline (2015): 0. Target (2020): 2.

Objective B.2: Improve the Quality of Expenditures

Public investment management

82. STP needs to improve the efficiency of public investments to compensate for the rapidly declining public investment ratio. The country's public investment as a share of GDP almost halved over the last six years due to a decline in grants—the main source of investment financing. As a share of GDP, STP has a high public capital stock compared to its structural peers. However, this is not reflected in the quality of infrastructure, as STP suffers from a large infrastructure gap in energy, transport, and water and sanitation. With grants expected to play a smaller role in financing future investments, improving the efficiency of public investments—including those of SOEs—to better use existing resources and support national priorities is crucial for the future development of STP.

Rationale

83. The country's PIM practices are weak. STP lacks credible strategic guidance for public investment to ensure they are focused on the country's development goals. While the Vision 2030, the NDP, and the XVII government program provide strategic guidance, these documents are very broad and fail to provide effective guidance.[25] There are also no formal project appraisal mechanisms in place to assess the technical feasibility and the potential impact of projects, and criteria for project selection are unclear.[26] Moreover, project implementation suffers from low planning capacity—cost and time overruns are common—and procurement practices are inefficient. Also, there are no completion and evaluation reviews available that assess the quality of completed projects. A large portion of donor-funded public investments is managed separately from domestically funded Public Investment Projects (PIPs). As a result, the preferences and financing of donors and lenders are important to implement specific interventions in the country.

84. The GoSTP has taken the first step to improve PIM by approving the National Planning System Law (SNP) in 2018. The SNP, which establishes the broad framework for national plans and capital expenditure, was approved in the second DPO (***DPO 2 Prior Action #10***). The law focuses on transparency, public consultation, monitoring and evaluation, the harmonization between different planning instruments, and the connection between planning and budget instruments through a medium-term

[25] The country's strategy for reaching its development goals needs to be re-considered, in particular regarding the large infrastructure projects with dubious viability. While important infrastructure gaps remain, the government continues to pursue projects with little prospects of commercial viability, which if carried out would drain resources from much needed investments in more viable enterprises. An example is the government's aspiration to turn the country into an air transport hub by expanding the current airport's runway. These projects have little technical backing and risk the investment's financial sustainability.

[26] The Directorate of Planning is not involved in the selection, and the Directorate of Budget does not have any formal role in selecting projects.

expenditure framework. The World Bank supports PIM activities through trust funds and the ICBP. Project components include (i) creating a comprehensive public investment portfolio database; (ii) developing a project prioritization and investment programing tool; (iii) creating a project management cycle framework; (iv) performing TA to improve the legal framework; and (v) setting up software applications.

85. The new administration is committed to PIM reform, as outlined in the letter of development policy. With TA from the World Bank, the GoSTP will create the legal framework for establishing a national investment portfolio database (NIPD). Once the Council of Ministers pass the SNIP, the project database will be set up with guidance from the World Bank. The Directorate of Planning will update the database regularly and create a comprehensive project database, which will include data on project finances, outcomes, and outputs, as well as other indicators. The database will include projects in the pre-investment phase, both domestically funded and donor-financed programs, concluded projects, and other information needed for government agencies to monitor investment spending.

86. Expected results. This set of prior actions and triggers will be evaluated by the number of investment projects that are included in the public investment database (*Result Indicator #8*).

DPF 2 Prior Action #10: In order to improve the efficiency and Value for Money of public investment, the Recipient's Parliament has enacted a National Planning System Law (SNP) that harmonizes planning and budget tools and lays the foundation for the appraisal and selection of public investment projects.

Result Indicator #8: Share of ongoing and finalized projects with basic information included in the National Investment Portfolio Database. Baseline (2015): 0. Target (2020): 95 percent.

PA#9: Social protection

87. STP's SP programs are ineffective due to fragmentation, low coverage, underfunding, and lack of staff, leaving poor and vulnerable households with little protection. Specifically, SP programs are fragmented, have low coverage, offer low benefits, and fail to deliver timely and regular transfers to the extreme poor. In 2016, the GoSTP spent less than 0.7 percent of GDP on SP and assistance—well below the African regional average of 1.2 percent of GDP and among the lowest in the region. There are currently eleven SP programs,[27] including three core social safety net programs.[28] Program coverage is either unknown or below 30 percent of the target population, and benefits are low. There is also uncertainty regarding the programs' financial resources, which reduces the efficiency of the SP framework. Moreover, several programs are partly financed by external aid, including the school feeding program, which increases uncertainty related to funding and continuity. Finally, the SP system suffers from operational constraints due to underfunding and understaffing, which undermines program implementation and supervision. The constraints mentioned above resulted in an inefficient, low transparency and low accountability of the SP programs in their different steps along the delivery chain from the intake, registration, and enrollment of the beneficiaries to the delivery of cash to the beneficiaries. These constraints also contributed to the irregular payments of the cash transfers to the beneficiaries.

[27] Excluding higher education scholarships.

[28] The first program is a conditional cash-transfer program for families in extreme poverty (vulnerable families' program). The second is a non-contributory pension program for the poor elderly, handicapped, and chronically ill (social pension program). Finally, the third program is a labor-intensive public works and community service program. There are also higher education scholarships, which are not counted as social protection programs.

88. Nonetheless, STP has made significant progress in SP in recent years. In 2014, the GoSTP approved the National Policy and Strategy for Social Protection (*Política e Estratégia Nacional de Proteção Social*, PENPS). The strategy is implemented through the Ministry of Employment, Solidarity, Family, and Vocational Training (MTSFFP) and aims to establish a SP system that protects the Santomean population, especially poor households and children, against natural and idiosyncratic shocks, and in turn, contribute to poverty reduction. The strategy has five objectives: (i) eliminating extreme poverty through conditional cash transfers and activities promoting human capital development; (ii) developing a robust mandatory contributory SP system; (iii) promoting employability of vulnerable groups like the youth, women, and the disabled; (iv) developing adequate delivery systems for the implementation of SP programs; and (v) defining adequate coordination mechanisms for the SP sector. Additionally, the PENPS supports three core social safety net programs, including conditional cash transfers for families in extreme poverty (vulnerable families' program, VFP)**.**

89. The World Bank has provided TA to the GoSTP over the last five years to establish the building blocks of a coherent and efficient SP system.[29] Through the actions carried out in the previous DPO, it has been possible to strengthen the efficiency, transparency and accountability of the SP programs. With support from the World Bank, the GoSTP has registered all SP beneficiaries in a single registry, which was a prior action for the second DPF operation (***DPF 2 Prior Action #11***).[30] World Bank support to SP also included the establishment of a social registry and the development of an operational manual with a targeting methodology and eligibility criteria for the VFP.

DPF 2 Prior Action #11: In order to coordinate and harmonize social protection and poverty reduction policies, the Recipient has registered in the Recipient's social registry all the beneficiaries of the three core social protection programs defined by the Recipient's Social Protection Policy and Strategy.

***DPF 3 Prior Action #9*: The Recipient, through the Ministry of Finance, has instituted a financial system-based (non-cash) payment mechanism to allow for the tracking and reconciliation of funds allocated to social protection payments.**

Result Indicator #9: Number of beneficiaries enrolled in the three core social protection programs and receiving regular payments as set in law. Baseline (2015): 0. Target (2020): 4,000 (of which 50 percent has received payments through the formal financial system).

Substance and criticality

90. The approved World Bank Social Protection and Skills Development Project (P163088) will support the operationalization of STP's core SP delivery systems and strengthen the government's capacity to ensure the effective management of safety net programs. The project includes activities to support the GoSTP in its efforts to scale up conditional cash transfers, behavioral change activities, and entrepreneurial skills training. It will also provide conditional cash transfers to 2,570 households in 2019, equivalent to 91 percent of all households living in extreme poverty.[31]

[29] Rapid Social Response Trust Fund: Project P149534 in 2014 "Building Blocks for the Social Protection System in São Tomé e Principe" and Project 163445 in 2017 "Development of Effective Delivery Systems for Social Protection."
[30] This has generated fiscal savings since 10 percent of beneficiaries did not exist. In future, the government will have to exclude beneficiaries identified as non-poor and registry-eligible beneficiaries based on the new household survey.
[31] The cost of the conditional cash-transfer program amounts to US$1 million, or 0.2 percent of GDP, annually, which the GoSTP will fund going forward.

91. The current payment delivery system for existing safety net programs is, however, inefficient and not transparent. The MTSFFP currently uses a manual cash payment system to deliver subsidies to program beneficiaries through its district offices. In practice, this means that cash is withdrawn from the government account and transported and delivered physically to beneficiaries. This inefficient method has led to delays in payments to beneficiaries and limited financial reconciliation, as there are no fiduciary mechanisms for transferring funds from the central to the district level. The GoSTP recognizes the need for institutional reforms to ensure that social safety net payments are made in a reliable, efficient, and transparent way.

92. This DPO supports the establishment of a predominantly financial system-based formal payment mechanism for SP programs through a third party (*DPF 3 Prior Action #9*). This will allow the payments delivered through the banking system will allow to reduce the cash transfer costs and deliver the cash in a more transparent and accountable way that will also allow a "real time" reconciliation of the payments to the beneficiaries. The GoSTP will contract a financial institution that will be responsible for transfers to beneficiaries.[32] To support the implementation of the new payment mechanism, the MTSFFP will adjust its management information system (MIS) and conduct a communication campaign for beneficiaries.

93. The expected results include increased transparency and control as well as more timeliness and predictability in the disbursement of benefits. The establishment of a formal payment mechanism is expected to improve the timeliness and predictability of social safety net payments to program beneficiaries. Increased transparency of payment delivery mechanisms and an improved MIS for the monitoring and reconciliation of funds should increase the effectiveness of the SP system. This should also increase the number of beneficiaries enrolled and receiving regular payments in the three core SP programs (*Result Indicator #9*). Finally, the use of electronic payment instruments and basic transaction accounts for beneficiaries to receive payments also includes a component focused on improving financial inclusion.

Table 6. DPO Prior Actions and Analytical Underpinnings

Prior actions	Analytical Underpinnings
Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure	

[32] Although the Government is actively working to create a new legal framework that will allow for the modernization of STP's financial system (see Prior Action #1 DPF 3), there are currently no alternative payment service providers to banks (i.e., post office, mobile network operators, or microfinance institutions).

Prior Action #1: The Recipient, through BCSTP, has approved the Report for the São Tomé and Príncipe Banking System Asset Quality Review, as part of its efforts to improve financial soundness of commercial banks.	The GoSTP. "Financial Sector Development Implementation Plan: 2016–2020", Washington D.C: self-published, 2016. The WBG, "Upgrading the Credit Registry Platform in the Republic of São Tomé and Principe" (unpublished manuscript, June 2017), Microsoft word file. The WBG. "STP – Secured transactions law and practice: legal and institutional diagnosis study" (unpublished manuscript, July 2017), Microsoft word file. Beck, Thorsten. "Microfinance- A critical literature survey" IEG Working Paper 2015/4, The WBG, Washington D.C: 2015. Deloitte Consultores S.A. "Relatório Preliminar da Qualidade dos Ativos" (unpublished manuscript, March 2019). Basel Committee's Guidance on the Application of the Basel Core Principles for Effective Banking Supervision to the Regulation and Supervision of Institutions Relevant to Financial Inclusion, CGAP Guide to Regulation and Supervision of The Joint WBG and the Committee on Payments and Market Infrastructures (CPMI) Payments Aspects for Financial Inclusion Task Force Report the Committee on Payments and Market Infrastructures (CPMI) – International Organization of Securities Commissions (IOSCO) Principles for Financial Market Infrastructures. The main recommendation of the Financial Sector Development Strategy is to update or introduce new regulatory frameworks to strengthen financial sector supervision, increase financial inclusion, and improve financial infrastructure.
Prior Action #2: The Recipient, through: (i) its National Assembly has passed the legal framework for payment services providers and payment system operators, which outlines the oversight framework, and duties and powers of BCSTP; and (ii) BCSTP, has passed the key implementing regulations under the National Payments System Law, which provide for the legal protection of the electronic transfer of funds and the licensing and supervision of payment institutions and payment system operators	
Prior Action #3: The Recipient, through BCSTP, has passed key regulations, which establish the minimum entry, operation requirements, risk management minimum requirements, and supervisory and reporting procedures for microfinance institutions.	
Prior Action #4: The Recipient, through its Council of Ministers, has approved the institutional structure for enabling interoperability between the land property register *(Registo de Propriedade)* and the cadaster *(Registo Cadastral)*.	Direcção Geral dos Registos e Notariado. *Plano Estratégico dos Registros e Notariado 2017-2019*. São Tomé: October 2016. Lamb, Tony; Endo, Victor; Stanley, Victoria. 2016. *Systematic property registration: risks and remedies (English)*. Washington, D.C.: WBG. The absence of a proper land information system and a weak land governance framework are identified as the major constraints to development.

Prior Action #5: The Recipient, through the Presidency of the Republic, has instituted an energy demand management program, which includes the exchange of low efficient bulbs with higher efficient ones.	The WBG. "Power Sector Recovery Project" Washington D.C: self-pub, 2016. The WBG. "Beyond Connections: Energy Access Redefined" Washington D.C: self-pub, 2015. Trimble, Chris et al.," Financial Viability of Electricity Sectors in SSA: Quasi-Fiscal Deficits and Hidden Costs" World Bank Policy Research Working Paper 7788, The WBG, Washington D.C: 2016. Mundi Consulting. "Memorando do Sistema de Controlo Interno e Aspetos Contabilísticos EMAE 2015 e 2016", São Tomé e Príncipe: 2018. Ricardo Energy and Environment. "Least Cost Development Plan Report for STP (Final Draft)" São Tomé e Príncipe: 2018. The PSRP project describes several problems of the energy sector in STP including the following: (i) chronic underinvestment, (ii) constrained supply, (iii) old and poorly maintained transmission and distribution network, (iv) inadequate metering equipment, (v) large technical and non-technical losses, and (vi) scarce regulatory and planning capacity.
Prior Action #6: The Recipient, through its Council of Ministers, has approved: (a) a Least-Cost Power Sector Development Plan, which provides the basis for a competitive process for all power generation activities; and (b) a Management Improvement Plan for EMAE, which aims to improve EMAE's operational performance.	
Prior Action #7: The Recipient, through AGER, has signed a concession contract with EMAE, which stipulates the obligations of the Recipient and the licensee, including rules on tariffs and sanctions.	
Pillar B: Generate fiscal resources and savings and improve the quality of expenditures	
Prior Action #8: The Recipient, through the National Assembly, has passed the Value Added Tax Code, which sets forth provisions aimed at broadening the tax base and generating more own-source revenues	The WBG. "STP: Public Expenditure Review", Washington D.C: self-pub, 2018. IMF. "STP: Towards a Slim VAT – simple, local and modern", IMF/ FAD Technical Assistance Report, Washington D.C: self-pub, 2016 The PER laid out low domestic revenue mobilization as the main reasons behind the chronic fiscal deficits and pointed to VAT as a more modern and efficient way of taxation that was lacking in STP.
Prior Action #9: The Recipient, through the Ministry of Finance, has instituted a financial system-based (non-cash) payment mechanism to allow for the tracking and reconciliation of funds allocated to social protection payments.	The WBG. "Building Blocks to the social protection system (P149534)" This report concluded that the coverage and transfers of assistance program are very low, payments irregular, and have limited impact on the well-being of the beneficiaries. The selection criteria of the beneficiaries are not clearly defined and there is no targeting mechanism for the different programs. Basic subsystems as a registry of beneficiaries, a targeting system, or a MIS do not exist, and low and declining resources are being allocated to social assistance programs in recent years.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

94. This operation reflects the priorities and objectives of the WBG Country Partnership Strategy

(CPS) FY2014-2018 (Report No. 83144), which has been extended to FY2020. The CPS supported STP's Second Poverty Reduction Strategy Paper (2012-2016), which focused on ways to boost growth and job creation to achieve poverty reduction. The CPS was extended for two years to incorporate the results of the Performance and Learning Review (PLR) and the NDP 2017-2021. The previous two focus areas have been streamlined and aligned with the new government's priorities and now focus on: (i) supporting macroeconomic stability and inclusive growth; and (ii) strengthening human capacity and reducing vulnerability. Objectives under the first focus area include: (i) increased fiscal revenue and improved quality of public expenditures; (ii) strengthened governance of SOEs and extractive industries and improved transparency; (iii) improved performance of the infrastructure sector (i.e., ICT, energy, and transport); and (iv) an improved business environment, focusing on the tourism sector and SMEs. Objectives under the second focus area include: (i) enhanced education quality and skills; (ii) improved poverty targeting and access to social safety nets; and (iii) increased adaptive capacity of coastal communities. Gender, partnerships, and capacity building are elements that cut across all the proposed engagements.

95. The DPO series will contribute to both focus areas of the CPS. For instance, the operation's prior action on banking supervision will strengthen the stability of the financial sector, which is aligned with the first CPF focus area to support macroeconomic stability. Reforms of the property registry and prior actions on payment systems and financial inclusion will help improve the business environment and support inclusive growth. Also, the prior action on VAT will increase fiscal revenue and help achieve a more sustained budget balance position, while prior actions focusing on the SOE sector and PIM will improve the quality of public expenditures and strengthen SOE governance and transparency. Moreover, energy-related reforms will support the long-term structural improvement of the EMAE and the energy sector. They will also foster macroeconomic stability by containing the SOEs' losses and associated fiscal risks in the short term. Finally, the prior action on SP is closely related to the objective of increasing access to social safety nets under the CPS' second focus area by streamlining SP programs, expanding coverage, and improving the targeting of the SP policy framework.

96. The DPO will also directly and indirectly contribute to the WBG twin goals. The revision of the SP policy framework and the expansion of fiscal space (through measures to increase revenue mobilization) would allow for an improvement in the targeting and coverage of SP programs. Policies supported by the operation are likely to boost shared prosperity. Also, the revised SP policy will focus not only on the extreme poor but also on other poor and vulnerable groups. Moreover, policy changes to improve the credit market are expected to increase access to credit and market opportunities for households in the bottom part of the income distribution. Finally, affordable and increased access to energy are also associated with reduced poverty and greater shared prosperity.

97. This DPF series follows a two-pronged approach in which the DPO supports the policy reforms, while the IPFs and other World Bank interventions provides the TA needed for reform implementation and sustainability. In the energy sector, the World Bank is supporting an investment financing project (P157096) that will increase the reliability of the power supply, help reduce the cost of energy, improve the management of the utility company, and strengthen the regulatory framework. The DPF operation will support policymakers to improve regulations in the energy sector and the management and oversight of SOEs. Furthermore, the World Bank Social Protection and Skills Development project (P163008) will support the operationalization of the GoSTP's core SP delivery systems and strengthen its capacity to ensure the effective management of safety net programs. Several DPO reforms are also supported by the World Bank's Institutional Capacity (P162129) and FIRST (P159937) projects, including reforms focusing

on the financial sector, the property registry, the VAT, and SOEs. Also, the DPF series is supported by ongoing and recently completed advisory services and analytics in SP (P149534) and the financial sector (P150418). Other World Bank reports that inform the DPO series include the latest PER (P161140), which focuses on STP's tax policy and administration, SOEs, and PIM, and the ongoing country economic memorandum (P164180).

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

98. Government programs and supported policy reforms have undergone public consultations. Policymakers consulted with the public during the formulation of the NDP, which is aligned with reforms supported by this operation. Consultations with stakeholders in the financial sector were also conducted throughout the formulation of the financial sector's development strategy. Similarly, there were various rounds of public consultations during the formulation of the PENPS (e.g., the PENPS established a formal council on SP). Moreover, reforms of the public notary and property registration codes were created by a committee with members from the country's courts, the public prosecutor's office, and university law schools. The drafting of the new national planning law was also preceded by consultations with key stakeholders. Both the diagnostic of the SOE sector and the SOE reform plan were shared with the management of all SOEs and high- and mid-level government officials before they were completed and approved. Also, public consultations were carried out during the development of the LCPDP.

99. This DPF series is coordinated with STP's main developing partners. The policies supported by the proposed operation complement and leverage the support provided by development partners. For example, the IMF is providing TA focused on the country's revenue administration and tax policy, including the implementation of the VAT and banking resolution. The AfDB is supporting an investment lending project in the energy sector and financing the infrastructure for the payment system upgrade. Moreover, the EU is financing a public expenditure and financial accountability (PEFA) assessment that will guide its TA in public financial management (PFM) in the coming years. The European Investment Bank is supporting the modernization of STP's energy sector through investment lending. Finally, Portugal has been providing TA to STP's justice sector, which will facilitate the implementation of a property registry reform and reforms in the financial and banking sector.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

100. Overall, the proposed DPO supports policy and institutional changes that are expected to have poverty-reducing effects in the medium - to long-term; however, there will be distributional effects in the short-run that should be addressed. The main poverty-reducing effects from this DPO come from the support to introduce cash transfer to poor and vulnerable families, the energy demand program that will distribute for free more efficient light bulbs for all households, and the reforms on the payment system and microfinance. The short-term negative effect on poverty comes from the introduction of VAT.[33] However, the introduction of the VAT will help improve the fiscal position of the government and to improve macro-stability and economic growth in the medium to long term. In turn, this could help prevent

[33] This DPO does not support energy tariff revision or increases of any sort.

economic crisis-induced increases in poverty.

101. While the introduction of the VAT will not affect income concentration, it is expected to increase the poverty headcount between 1.5 and 3.0 percentage points. The simulation of the impact of the VAT was done by taking into account direct and indirect effects using consumption data from the 2017 household survey. It reveals the VAT will not affect income concentration, as measured by the Gini coefficient, in a significative way, even when different sets of exemptions are introduced. However, the implementation of the VAT is expected to increase the poverty headcount by between 1.5 and 3.0 percentage points. Moreover, the poverty impacts of the VAT appear to be mitigated by exempting food, small producers, and health and education expenditures (exempting health and education spending will be more significant in urban areas). Taking into consideration the early stage of the social safety net system in the country, there are limited prospects at this stage, for using cash transfers to mitigate the negative impacts of VAT on the poor or any other sub-population group with precision.[34] Nonetheless, the deployment of cash transfers program as supported in prior action 9 will mitigate some of the effects of VAT, even though that is not the primary purpose of the program. Fortunately, as it is confirmed by the simulations of the impacts of a VAT exempting food, small producers, and health and education expenditures, the approved VAT law reducing the tax burden on food staple items by 50 percent, seems to be contributing significantly at mitigating the negative impacts of the VAT. It is also reassuring that the analysis reveals that 51 percent of the VAT collection will be paid by the richest decile of the population.

102. Improved financial inclusion and a more resilient financial system will benefit the poor. Modern development theory sees lack of access to finance as a cause of persistent income inequality and slower growth. Small enterprises and poor households face greater obstacles with access to finance, especially in developing countries. The 2017 household survey and the 2017 survey on financial inclusion show that poor people are excluded from banking, financial transactions, and credit. Poverty rates are higher (70 percent) among the group who declare not having a bank account compared to those who do (43.8 percent). Only 38.7 percent of the population has banks accounts, with a significant gender and rural gap; 58.7 percent of women and 60 percent of rural population do not have a bank account. The expansion of the payment system network and the use of other delivery channels such as mobile banking could have a relevant impact on poverty since near 70 percent of the population receives their income in cash or check. In addition, 75 percent of the population does not have any bank credit and 89 percent of the SMEs had credit requests denied.

103. Poorer households tend to use less electricity, yet electricity spending is more of a financial burden. The 2019 survey on energy access based on the Multi-Tier Framework found that while nearly 50 percent of the households in the first quintile of the income distribution use less than 100 kWh per month, 47.5 percent of these households spend more than 10 percent of their budget on electricity. In addition, the same survey reported that affordability was the main hindrance for households not being connected to grid with 42 percent pointing to the one-time cost of the connection and 15 percent pointing to the monthly fees. Therefore, the energy demand program, which will replace for free the low efficient light bulbs for higher-efficiency ones, will reduce the cost of energy for the population. This will be particularly beneficial to the poorer households, which spend a larger share of their income on electricity.

[34] For example, the recent Poverty Assessment for Sao Tome & Principe (2019) confirms that, holding all else equal, female-headed households have the same likelihood of being poor as male-headed households.

5.2. ENVIRONMENTAL ASPECTS

104. Specific policies supported by the DPO series are not expected to have a significant negative effect on STP's forests, water resources, habitats, or other natural resources. The country has a legal and institutional framework to manage and respond to environmental challenges. The General Directorate of Environment (DGE), under the Ministry of Infrastructure, Natural Resources and Environment (MIRNA), is the central institution responsible for environmental management. It oversees all projects expected to have a potential positive or negative impact on the environment. Even though an institutional and legal framework is in place, the inconsistent monitoring, compliance, and enforcement of environmental laws and regulations are of concern, and some prior actions to be implemented under this DPF are likely to have environmental effects and therefore need to be scrutinized and closely supervised.

105. The exchange of low efficient incandescent bulbs to higher efficient LED can bring environmental benefits (Prior Action #5). Positive environmental impacts on deployment of LED bulbs are related to its lifecycle environmental impacts, which are significantly less in comparison to the traditional incandescent bulbs. Moreover, the use of LED bulbs can contribute to significant energy savings, lower local pollution, and reduce greenhouse gas (GHG) emissions.

106. A reduction in the cost of energy and an increase in the share of renewable energy can bring environmental benefits (Prior Action #6). The Least-Cost Development Plan, which has identified hydropower as a priority source of energy to attain National Development Contribution targets, will guide stakeholders in how to develop sub-sector plans that meet the country's energy and development needs at the least cost to the economy and environment. All activities related to capacity expansion of the power sector will have to follow the prescriptions integrated in the LCPDP, which includes compliance with environmental standards. In addition, environmental clauses will be included in the bidding documents and contractual arrangements. Current and upcoming operations in the energy sector will dedicate resources to improve coverage and effectiveness of the current ESIA systems, especially enforcement and compliance monitoring. Participation of civil society in the process of preparing ESIA, and dialogues about environmental policies will incrementally increase accountabilities in environmental and social management activities and ensure proper oversight.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

107. The GoSTP has undertaken some reforms to improve PFM practices, and authorities are committed to continuing these. This commitment is exemplified by the progress in implementing reforms supported by the last DPF series and the creation of an overall PFM action plan that was published in 2016. Previous PFM reforms focused on areas related to the comprehensiveness and transparency of budget documents, medium-term fiscal planning, public financial reporting, and external auditing, including the submission of the 2013 and 2015 public financial statements to the supreme audit institution. While the last PEFA review conducted in 2013 concluded that the GoSTP has made progress on PFM reforms in several areas, there were various challenges that public authorities still needed to address. The review noted that the government had made improvements in the scoring, which demonstrated broad engagement on reforms, and there was a strong public commitment to continue the implementation of reforms. The PEFA also acknowledged advances in PFM performance, including (i) clearer and more comprehensive instructions (budget circulars) for the preparation of budget proposals; (ii) more transparent and comprehensive budget information available to the public and the availability of budget documents through printed forms and the websites of Parliament and the Ministry of Planning, Finance, and the Blue Economy; (iii) some improvements in the preparation of the Medium-Term

Expenditure Framework (MTEF); (iv) more legislative scrutiny of the annual budget law; (v) the establishment of a treasury single account, resulting in greater control over bank accounts and deposits in commercial banks; (vi) the implementation of an integrated financial management information system (IFMIS); and (vii) positive trends in internal controls and tax management. However, the review also revealed that ongoing reform efforts had not yet addressed the key challenges facing PFM in STP, including: (i) low budget credibility; (ii) the absence of the structural and institutional reforms needed to strengthen tax management; (iii) a lack of effectiveness of the IFMIS; and (iv) insufficient follow up on the findings of the audit and monitoring process. These challenges and continuing weaknesses in the PFM environment are a result of constraints in technical capacity, human resources, and available skills, affecting the key institutions responsible for all stages of the PFM cycle, including the General Inspectorate of Finance, which is responsible for internal audit functions, and the supreme audit institution (*Tribunal de Contas*). Nevertheless, the GoSTP's PFM action plan appears adequate to address these challenges over the next few years.

108. STP complies with the World Bank minimum standards on budget transparency for DPOs. STP has published the budget laws both at proposal and approval stage since 2010 and since 2016 the government has been publishing the budget formulation directives as well. The budget proposal is published on the Ministry of Finance's website on the same day it is sent to parliament or with very little delay. The same happens with the approved budget. Despite complying with the World Bank minimum standards on budget transparency for DPOs, the preliminary PEFA report points that transparency could improve by including more information on budget documents such as medium-term budget forecasts, fiscal risks, and include more budgetary information from autonomous government agencies.

109. There has been an improvement in the country's public procurement functions, although challenges remain in the implementation of procurement regulations. A procurement supervisory body and a coordination and assistance procurement cabinet *Gabinete de Coordenação e Seguimento de Licitações* (Office of Coordination and Support of Procurement COSSIL) was created in 2009 to centralize procurement information, assist decentralized procurement units, and ensure uniformity and quality across units. COSSIL may suspend, cancel, or invalidate contractual procedures that are not in accordance with applicable legislation. The main challenges in implementation of procurement regulations include the following: (i) procurement law and regulations are old and do not capture recent innovations in the sector (sustainable procurement, framework contracts); (ii) lack of standard bidding documents leading to use of different instruments by the procuring entities and use of less competitive methods; (iii) large turnover of staff in procuring entities making difficult to maintain a core staff of public procurement practitioners in the public administration and SOEs; (iv) limited information collected on procurement in order to have a clear picture and implement mitigation measures; and (v) no procurement audit of government entities (central and local level) and SOEs (there is an ex-post audit by "Tribunal de Contas" on public accounts but have not a specific procurement component). The World Bank is supporting the improvement of the public procurement system through the revision of legislation, capacity building of COSSIL's staff and procurement units, the preparation of a strategic public procurement plan, and the set-up of a dedicated website to improve transparency. All these actions are included in the ongoing Institutional Capacity Building project (P162129).

110. The BCSTP is responsible for ensuring STP's strong foreign exchange control environment. The IMF's second ECF review and the authorities' request for waivers for nonobservance of performance criterion and modification of performance criteria were made public in December 2016. These documents indicated that the BCSTP still faces capacity constraints, including in the independent oversight of audit

mechanisms, internal controls, and financial reporting. While external audits conducted by a reputable audit firm continue to serve as a critical safeguard, ongoing institutional development will be needed to strengthen capacity and bolster the safeguard framework. The IMF concluded in its review that the BCSTP is committed to strengthening the control environment.

111. Although the fiduciary risk is substantial, STP's PFM environment is adequate to support the proposed operation since ongoing reforms will address some of these risks. In addition, the GoSTP's development strategy and its previous actions to implement reforms demonstrate its commitment to improving the PFM environment. However, the IDA retains the right to request an audit of the dedicated account if it concludes that some risks were not addressed.

112. SDR 3.7 million (equivalent to US$5 million) will be disbursed upon grant effectiveness and following the Recipient's request for withdrawal of grant proceeds. The grant will follow IDA's standard disbursement procedures for DPOs. IDA has informed the GoSTP that there can be no withdrawals unless it is satisfied that the program is being carried out (a) by the Recipient and (b) with the appropriateness of the Recipient's macroeconomic policy framework. Once the operation is approved by the WBG Board of Directors and becomes effective, and following the GoSTP's request for withdrawal of proceeds, IDA will disburse the grant to a dedicated foreign currency account at the BCSTP. The proceeds of the grant will then become part of STP's official reserves. Within 30 days of the receipt of the deposit, the Recipient will provide confirmation to IDA that (a) the grant proceeds were deposited into a public account that is part of the country's foreign exchange reserves (including the date, name, and number of the government's bank account); and (b) an amount equivalent to the grant proceeds has been credited in the Recipient's budget management system within 5 working days of receipt, indicating the exchange rate applied, where applicable. The conversion from foreign to the local currency will be based on the prevailing exchange rate on the date that the funds are credited in the budget management system. The BCSTP will not impose any charges or commissions on the Recipient for these transactions.

113. Based on the level of fiduciary risk associated with this operation, IDA reserves the right to request an audit of the dedicated account on terms acceptable to IDA. If the right were to be exercised, the GoSTP would have the dedicated account audited by an independent auditor acceptable to IDA, with the audit assuring that: (a) the funds have been received and deposited into the account; (b) the funds received in the dedicated account were, within five working days of receipt, converted into local currency and transferred to the consolidated fund account (Treasury Account) of the GoSTP to finance budgetary expenditures; and (c) the amount received has been appropriately accounted for in the government's financial management system. If the proceeds of the grant were to be used for ineligible purposes, as defined in the financing agreement, IDA will require the recipient to promptly, upon notice from IDA, refund an amount equal to the payment to IDA. Funds refunded to IDA, upon such request, shall be cancelled. The administration of this proposed grant will be the responsibility of the MPFBE.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

114. The Ministry of Finance will be the coordinating agency for monitoring and evaluation of the program implementation and progress towards the achievements of the results. The MPFBE has created a dedicated macro and fiscal unit that will coordinate the program implementation and will serve as the main point of contact with international financial organizations. The unit will develop a brief monitoring and evaluation manual with the sources and the methodology for calculating each result indicator. The MPFBE has coordinated several externally financed projects and is the main counterparts of the GoSTP in dealing with international financial organizations, therefore it has experience and adequate institutional

capacity to monitor the DPO program implementation.

115. Data availability and quality are appropriate to monitor progress of the DPO program. The results of the operation will be monitored by standard indicators or based on data already produced by the GoSTP. Standard indicators include the number of banks with capital adequacy ratios below recommended levels or tax revenue ratios. When such indicators are not adequate, the results will be measured by indicators already used by the client. Moreover, monitoring measures will use figures that have been published by the government or data produced by the government that the World Bank has historically used, such as the EMAE's balance sheet.

116. 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 DPO 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.

6. SUMMARY OF RISKS AND MITIGATION

117. The overall risk of the proposed operation is high. The rating is attributed to: (i) political and governance; (ii) macroeconomic; and (iii) fiduciary risks; as well as (iv) risks related to the country's institutional capacity for implementation and sustainability. While the technical design of the program and related fiduciary risks are rated as substantial, all other categories are rated as moderate.

118. While political risk is high due to the change of government, its coalition nature, and the need for Parliament support for some reforms, it is mitigated by a new IMF program and efforts to reach out to the legislature. Political and governance risks are rated high because the operation will be implemented by a new government formed by a coalition of parties, which has historically been unstable in STP. The government will also need the approval from Parliament to implement key measures such as introducing a VAT and supporting fiscal consolidation. Low transparency and accountability at the tax office compound the high-risk rating. Mitigating measures include the IMF program, the government's effort to reach out to Parliament and stakeholders from opposition parties, and the World Bank dialogue with parliamentarians to inform them on the World Bank's supported program in STP.

119. Macroeconomic risk is high due to the country's vulnerability to domestic and external shocks and their potential impact on program objectives, although the new IMF program together with the DPO-supported reforms mitigate this risk. Macroeconomic instability can derail program objectives by reducing the revenue potential of tax measures, the ability to clear arrears in the energy sector, and the impact of measures in the financial sector on stability and access to finance. The country is also vulnerable to domestic shocks such as weather-related shocks that impact inflation and energy supply shocks that affect economic growth and tax collection. STP's vulnerability to external shocks is also high, as high oil prices can lead to higher inflation and SOE losses. Also, less grant proceeds can lead to lower public

investments, which in turn could result in lower economic growth. The new IMF program serves as mitigating measure by including a higher quota volume as well as more widespread and candid communication between relevant stakeholders on the acute macroeconomic situation facing the country.

120. The risk stemming from the program design is substantial due to the multisectoral nature of the operation. The program design is complex because it contains nine prior actions that encompass five different sectors. In addition, the GoSTP has a tradition of working in compartmentalized way, with information not flowing freely from one ministry to the other. The World Bank has reduced the number of prior actions from the second to the third operation as a mitigating measure. It is also engaged in all sectors included in the DPO with analytical work and/ or TA.

121. Institutional capacity risk is high due to low implementing capacity. Technical capacity is low due to a lack of formal intergovernmental cooperation mechanisms, the government's poor track record of following-up on its own decisions, and an insufficiently empowered coordination unit. The operation's mitigating measures include TA and investment operations from both the World Bank and development partners in the energy and financial sectors, tax administration, SOE supervision, and Financial Management Information System.

122. Finally, the fiduciary risk is substantial because of weak internal and external audit functions and major weaknesses in the financial management system, especially in terms of the mismatch between cash flow and budget execution. The World Bank is providing TA through the ICBP to improve the financial management information system, to strengthen IT capacity and the accountancy profession. The EU is financing a new PEFA for STP, which has received comments from the World Bank and will originate a new PFM reform plan.

Table 6: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	High
2. Macroeconomic	High
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	High
6. Fiduciary	Substantial
7. Environment and Social	Moderate
8. Stakeholders	Moderate
9. Other	

Overall	● High

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions			Results
Prior Actions under DPF 1	**Prior Actions under DPF 2**	**Prior Actions for DPF 3**	
Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure			
Objective A.1: Introduce growth-enabling reforms in the financial sector and business environment			
Prior Action 1: The Recipient, through its National Assembly, has approved a banking resolution law (*Medidas Especiais de Saneamento, Resolução e Liquidação de Instituções Bancárias*) that provides the Central Bank with the power and authority necessary to deal effectively with distressed financial institutions by facilitating early intervention and providing additional policy instruments to address vulnerabilities.	**Prior Action 1:** In order to strengthen the bank resolution framework, the Recipient, through its BCSTP, has adopted regulations implementing the Recipient's financial institutions resolution law, which set out: (i) the measures to be applied by the BCSTP in the resolution of distressed financial institutions; and (ii)the requirements for the elaboration and adoption of recovery and resolution plans.	**Prior Action 1:** The Recipient, through BCSTP, has approved the Report for the STP Banking System Asset Quality Review, as part of its efforts to improve financial soundness of commercial banks.	**Result Indicator 1**: Number of banks below the Central Bank's minimum Capital. Adequacy Ratio (12 percent) **Baseline** (2015): 3 **Target** (2020): 0
Prior Action 2: The Recipient, through its Central Bank, has created, operationalized and staffed a new directorate (*Direcção de Sistemas de Pagamentos*) to consolidate in the same unit all responsibilities related to oversight, policy formulation and development of the national payment system.	**Prior Action 2:** In order to expand the outreach of the banking system and support financial inclusion through the usage of mobile financial services, the Recipient, through its Council of Ministers, has approved and submitted to the Parliament the proposed National Payment Systems Law, which sets forth the statutory level principles for regulation on modern payment methods, such as agent banking, mobile money, and electronic payments.	**Prior Action 2**: The Recipient, through: (i) its National Assembly, has passed the legal framework for payment services providers and payment system operators, which outlines the oversight framework, and duties and powers of BCSTP; and (ii) BCSTP, has passed the key implementing regulations under the National Payments System Law, which provide for the legal protection of the electronic transfer of funds and the licensing and supervision of payment institutions and payment system operators.	**Result Indicator 2**: Share of the population with access to formal financial services (e.g. bank accounts). **Baseline** (2017): 39 percent **Target** (2020): 45 percent
	Prior Action 3: In order to develop the microfinance sector and promote the offer of microfinance services, the Recipient, through its Council of	**Prior Action 3:** The Recipient, through BCSTP, has passed key regulations which establish the minimum entry, operation requirements, risk management minimum	

Prior Actions			Results
Prior Actions under DPF 1	**Prior Actions under DPF 2**	**Prior Actions for DPF 3**	
	Ministers, has approved and submitted to Recipient's Parliament a draft law on microfinance.	requirements, and supervisory and reporting procedures for microfinance institutions.	
Prior Action 3: The Recipient, through its Council of Ministers (*Conselho de Ministros*), has reduced legal fees (i.e. taxes and registry fees) associated with the registry of mortgages.	**Prior Action 4:** In order to reduce costs and simplify procedures to register property, therefore improving its ability to serve as loan collateral and foster access to finance, the Recipient, through the Council of Ministers, has approved and submitted to the recipient's Parliament (i) the proposed Property Registration Code; and (ii) the proposed Public Notary Code.	**Prior Action 4:** The Recipient, through its Council of Ministers, has approved the institutional structure for enabling interoperability between the land property register *(Registo de Propriedade)* and the cadaster *(Registo Cadastral).*	**Result Indicator 3**: Share of real estate properties and mortgages registered and digitized in the Public Notary Registry. **Baseline** (2015): 0 percent **Target** (2020): 70 percent.
Objective A.2: Introduce growth-enabling reforms in the infrastructure sector			
Prior Action 4: The Recipient, through EMAE, has introduced a revised system of pre-paid energy services that will allow for accurate consumption metering and invoicing, as well as eliminating the risk of non-payment	**Prior Action 5:** In order to promote transparency and incentivize timely payments, the Recipient, through EMAE, has published its policy to improve billing collection and launched a public awareness campaign through public TV and radio.	**Prior Action 5:** The Recipient, through the Presidency of the Republic, has instituted an energy demand management program, which includes the exchange of low efficient bulbs with higher efficient ones.	**Result Indicator 4***:* EMAE's operational profit/loss (in millions LCU). **Baseline** (2015): - 224.9 million LCU **Target** (2020): -194.7 million LCU
	Prior Action 6: In order to structurally reduce the cost of energy, increase the share of renewable sources, and promote long-term private investment, the Recipient, through its Council of Ministers, has ruled that any capacity expansion of the power sector will have to follow the prescriptions of the integrated Least-Cost Power Development Plan, and that any exception would need to obtain the approval of the Recipient's Minister of Infrastructure, who shall have to provide the rationale for such	**Prior Action 6**: The Recipient, through its Council of Ministers, has approved: (a) a Least-Cost Power Sector Development Plan, which provides the basis for a competitive process for all power generation activities; and (b) a Management Improvement Plan for EMAE, which aims to improve EMAE's operational performance.	

Prior Actions			Results
Prior Actions under DPF 1	**Prior Actions under DPF 2**	**Prior Actions for DPF 3**	
	exemption and publish said decision.		
Prior Action 5: The Recipient, through AGER, has mandated EMAE to: (i) establish a comprehensive customer complaint redress system, for the mediation of conflicts between citizens and EMAE, as well as representing the interests of the public, receiving feedback, complaints, information requests and suggestions for improvement of service; and (ii) send to AGER monthly reports of complaints received from customers.	**Prior Action 7:** In order to improve the reliability of energy supply, the Recipient, through AGER, has published the minimum quality criteria for the provision of services in the electricity sector.	**Prior Action 7:** The Recipient, through AGER, has signed a concession contract with EMAE, which stipulates the obligations of the Recipient and the licensee, including rules on tariffs and sanctions.	**Result Indicator 5:** Number of complaints received by EMAE **Baseline** (2015): 6,542 **Target** (2020): 3,000
Pillar B: Generate fiscal resources and savings and improve the quality of public expenditures			
Objective B.1: Generate fiscal resources and savings			
Prior Action 6: The Recipient, through its Council of Ministries, has simplified the tax structure and updated the threshold values of tax brackets for presumptive income taxation.	**Prior Action 8:** In order to generate the tax and accounting information needed to implement the VAT, the Recipient, through its Council of Ministers, has adopted the legal framework for fiscal invoices and similar documentation, whereby it legally mandated companies to issue fiscal invoices, set out said invoice's minimum content and time requirements for storing them.	**Prior Action 8:** The Recipient, through the National Assembly, has passed the Value Added Tax Code, which sets forth provisions aimed at broadening the tax base and generating more own-source revenues.	**Result Indicator 6**: Tax revenues except custom duties on oil (in millions LCU) **Baseline** (2016): 831.1 million LCU **Target** (2020): 1050.0 million LCU

	Prior Action 9: In order to improve SOE's financial and non-financial performance, the Recipient, through its Council of Ministers, has approved an SOE reform plan that established a performance monitoring system with financial and non-financial targets for all SOEs and incentives to ensure compliance.		**Result Indicator 7**: number of SOEs' performance monitoring systems in place. **Baseline** (2015): 0 **Target** (2020): 2
Objective B.2: Improve the quality of public expenditures			
	Prior Action 10: In order to improve the efficiency and Value for Money of public investment, the Recipient's Parliament has enacted a National Planning System Law that harmonizes planning and budget tools and lays the foundation for the appraisal and selection of public investment projects.		**Result Indicator 8**: Share of ongoing and finalized projects with basic information included in the National Investment Portfolio Database. **Baseline** (2015): 0 percent **Target** (2020): 95 percent
	Prior Action 11: In order to coordinate and harmonize social protection and poverty reduction policies, the Recipient has registered in the Recipient's social registry all the beneficiaries of the three core social protection programs defined by the Recipient's Social Protection Policy and Strategy.	**Prior Action 9:** The Recipient, through the Ministry of Finance, has instituted a financial system-based (non-cash) payment mechanism to allow for the tracking and reconciliation of funds allocated to social protection payments.	**Result Indicator 9**: Number of beneficiaries enrolled in the three core social protection programs and receiving regular payments as set in law. **Baseline** (2015): 0 **Target** (2020): 4,000 (of which 50 percent has received payments through the formal financial system).

ANNEX 2: IMF RELATIONS ANNEX

IMF Executive Board Approves New US$18.2 Million Extended Credit Facility Arrangement for the Democratic Republic of São Tomé and Príncipe

October 2, 2019

- The Extended Credit Facility arrangement aims to support São Tomé and Príncipe's economic and structural reforms.
- Structural reforms should help mobilize revenue, enhance control over public spending, reduce contingent liabilities from SOEs, improve financial stability, and promote sustainable and inclusive growth to reduce poverty, including through empowering women economically.
- The Executive Board decision allows an immediate first disbursement of US$2.6 million to São Tomé and Príncipe.

On October 2, 2019 the Executive Board of the International Monetary Fund (IMF) approved a new 40-month arrangement under the Extended Credit Facility (ECF) for São Tomé and Príncipe in the amount of SDR 13.32 million (about US$18.2 million) in support of the country's economic and structural reforms.*[1]* It will enable an immediate disbursement of about SDR 1.9 million (about US$2.6 million). The remaining amount will be phased over the duration of the arrangement, subject to semi-annual reviews.

The ECF arrangement aims to support the authorities' economic reforms, macroeconomic stability, and private-sector led inclusive growth. It also seeks to alleviate balance of payments pressures and restore fiscal and external sustainability over the medium term.

Following the Executive Board's decision, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, issued the following statement:

"The ECF arrangement supports the authorities' economic reforms to restore macroeconomic stability, reduce debt vulnerability, and alleviate balance of payment pressures to provide the foundation for strong economic growth. It could also help catalyze additional development support.

"The government plans to undertake sustained fiscal consolidation and reforms to reduce debt vulnerability. To this end, the authorities aim to broaden the tax base and ensure equitable tax burden-sharing, including by introducing a value-added tax and strengthening tax administration. Public expenditure will be restrained, made more efficient, and prioritized to protect essential social services. They are also committed to borrowing only at concessional terms and at a measured pace and to enhance debt management capacity.

"Monetary policy will be tightened to encourage savings, ease demand for foreign exchange, and contain inflation. A new payment system allowing credit card transactions is being developed, which will stimulate tourism and raise foreign exchange receipts. Financial sector supervision will be strengthened.

"Comprehensive structural reforms will also be pivotal in promoting private-sector led inclusive growth and safeguarding macroeconomic stability. Key reforms include implementing the Tourism Development Strategy, publishing a codified procedure for the approval of private investments, rehabilitating the energy sector including EMAE, and promoting women's economic empowerment and financial inclusion. The IMF program is complemented by a World Bank social protection program of $10 million to protect the most vulnerable households."

Recent Economic Developments

São Tomé and Príncipe is a fragile, small island-state with limited resources and capacity. The economy has a very narrow production base and depends heavily on imports and foreign aid. Exports of goods amount to only four percent of GDP. While offshore oil exploration continues, no commercial production is expected in the near term. Tourism, agriculture, and fisheries have potential for growth but require better infrastructure and private-led investment. While tourism grew significantly in recent years, local value-added of the sector is very low due to high import content.

São Tomé and Príncipe faces pressing constraints. In 2018, lower external inflows, election-related disruptions, higher fiscal spending, and severe power outages contributed to a fall in real growth to 2.7 percent from 3.9 percent in 2017 and a sharp decline in gross international reserves by $16.3 million (1.5 months of imports). Higher international oil prices and shortages of local produce led to an increase in inflation to 9.0 percent, up from 7.7 percent at end-2017. Preliminary data suggest economic activity remained sluggish in the first half of 2019, and fuel and power shortages weighed on the economy.

The fiscal position deteriorated significantly in 2018. Unbudgeted increases in personnel and capital spending and failure to cut utility consumption as planned contributed to overspending of almost 3.5 percent of GDP. Consequently, the domestic primary deficit reached 4.1 percent of GDP, 2.8 percent of GDP above the target. Furthermore, some government entities were allowed to spend off-budget, effectively loosening the fiscal stance further and raising the public debt by close to 1 percentage point of GDP. Meanwhile, EMAE accumulated arrears to its fuel supplier of close to $16 million (more than 3.5 percent of GDP), and total public debt rose to over 95 percent of GDP at end-2018.

A new coalition government took office in December 2018 following parliamentary elections. The government's reform program seeks to restore macroeconomic stability and unlock growth potential.

Program Summary

The 40-month program seeks to restore macroeconomic stability, bring the debt down to a sustainable path, and unlock growth potential. Fiscal consolidation supported by debt restructuring and monetary tightening will address pressure on foreign reserves and restore fiscal and external sustainability over the medium term. Structural reforms aim to mobilize revenue, enhance control over public spending, reduce contingent liabilities from SOEs, improve financial stability, and promote inclusive growth to reduce poverty, including through empowering women economically. A floor on pro-poor spending, along with a World Bank social protection program, will protect the most vulnerable. The Fund-supported program will also play a catalytic role and provide positive signals to stakeholders.

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[1] The ECF program is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted balance of payments problems.

IMF Communications Department

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ANNEX 3: LETTER OF DEVELOPMENT POLICY

REPÚBLICA DEMOCRÁTICA DE S.TOMÉ E PRÍNCIPE
Ministério do Planeamento, Finanças e Economia Azul
GABINETE DO MINISTRO
(Unidade - Disciplina - Trabalho)

Carta de Políticas de Desenvolvimento

Vossa Excelência
David Malpass
Presidente do Grupo Banco Mundial
1818 H Street, NW
Washington, DC. 20433
EUA

Ref: carta nº **3946**/ GMPFEA/Outubro 2019

Sr. Presidente,

Em nome do Governo da República Democrática de São Tomé e Príncipe, eu tenho o prazer de submeter a vossa elevada consideração o documento da terceira operação do programa em apoio ao fortalecimento do crescimento e política fiscal de São Tomé e Príncipe (STP). Essa operação e seu respectivo donativo dão seguimento ao apoio do Banco Mundial aos esforços do país para realizar reformas conducentes ao crescimento económico, geração de recursos próprios para o financiamento do desenvolvimento, e a melhoria da qualidade do gasto público.

O actual Governo tomou posse em Dezembro de 2018, após eleições parlamentares que levaram ao poder uma coligação de partidos, que se encontravam na oposição ao anterior governo. O Programa do XVII Governo está assente em quatro eixos estratégicos: aprofundamento do Estado de direito democrático; crescimento económico robusto e criação acelerada de empregos; melhoria na qualidade de saúde e na proteção social; e política externa ao serviço do desenvolvimento. Todas as ações do XVII Governo visam atingir dois objetivos: criar as condições para o relançamento do crescimento económico médio superior a 7%, e reforçar a coesão social.

No entanto, o governo tem uma tarefa muito mais urgente a enfrentar dada pela terrível realidade macroeconómica com visíveis impactos sociais, encontrada após a posse. No ano de 2018, São Tomé e Príncipe enfrentou uma crise energética que em seu pior momento reduziu a produção de energia do país em até 75%. A crise energética reduziu drasticamente o nível de actividade do país e a disponibilidade de alimentos com graves consequências sobre a arrecadação de impostos, a inflação, e o bem-estar da população. Além disso, o actual Governo descobriu uma série de despesas que foram feitas pelo Governo anterior sem o necessário lastro financeiro ou com recursos à empréstimos bancários para pagar até a folha de salários e que não foram devidamente registrados na contabilidade governamental. Como resultado, esse Governo despendeu uma considerável quantidade de tempo no

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começo desse ano somente para obter uma fiel fotografia da real situação macroeconómica do país. E, acredite-me, essa fotografia não foi bonita.

O Governo actual vem desde então tentando resolver gradualmente os problemas herdados. A inflação reduziu-se de mais de 10% em seu pico em outubro de 2018 para 7% em julho de 2019. E o crescimento dos agregados monetários, que explicou parcialmente o crescimento da inflação, caiu de taxas de crescimento de 15 a 20% para valores perto de zero ou negativos. As reservas internacionais foram parcialmente recompostas, e as receitas de impostos já apontam um ligeiro crescimento em 2019. O Governo retomou os pagamentos de suas contas de energia e telefonia, e vêm tentando conter a despesa pública. Essa tarefa, porém, vêm se mostrando dificílima dado o baixo nível absoluto das despesas públicas do país, o volume de despesas em atraso, e os aumentos salariais aprovados em lei pelo Governo anterior para vigorar no ano de 2019. A relação entre a dívida pública do país e o PIB subiu não por conta da contratação de novos empréstimos, mas por conta do reconhecimento de dívidas decorrente de pagamento de fornecedores em atraso, crédito bancário, e a dívida da empresa de água e electricidade - EMAE para com a empresa de fornecimento de combustíveis - ENCO, que pela primeira vez foram incorporadas ao estoque da dívida pública, como forma de dar maior transparência a dívida pública.

Esse Governo está comprometido com uma política macroeconómica sólida e não hesitou em tomar medidas duras para atingir o equilíbrio fiscal como aumentar o preço dos combustíveis, elevar impostos existentes e introduzir o imposto sobre valor acrescentado, que é uma das ações apoiadas por essa operação (Ação Prévia #8). A Direcção dos Impostos vem se preparando para a introdução do IVA por meio de missões de expertos internacionais, visitas de estudos e contratação de novos servidores. A partir de agora com a aprovação da lei, a Direcção dos Impostos se empenhará na campanha de comunicação, desenvolvimento de sistemas, e treinamento de funcionários. Como fruto desse trabalho, o Governo não recorreu mais a empréstimos bancários para pagar salários. É compromisso também desse Governo não tomar empréstimos que o país não tenha condições de saldar, mas, sobretudo tornar o sector privado o motor do crescimento económico. Em reconhecimento a esse esforço, o Fundo Monetário Internacional aprovou recentemente um novo programa para STP, que permitirá o desbloqueamento de outras ajudas de parceiros internacionais.

É nesse sentido que o Governo de São Tomé e Príncipe solicita o apoio do Banco Mundial para a terceira operação de política de desenvolvimento. A primeira área de política dessa operação é o sector financeiro. O Banco Central de STP vem desenvolvendo uma parceria frutífera com vistas a melhorar a supervisão bancária e evitar eventuais problemas macro-fiscais decorrente de bancos mal-geridos (Ação Prévia #1), e melhorar a infraestrutura financeira para apoiar o desenvolvimento do sector privado, principalmente do turismo, inclusão financeira e desenvolvimento de programas sociais (Ação Prévia #2). Essa parceria também apoiou o desenvolvimento de todo o quadro legal para o sector de microfinanças (Ação Prévia #3), visando a inclusão financeira e a superação do constrangimento creditício ao desenvolvimento do sector privado.

A avaliação da qualidade dos ativos dos bancos comerciais permitiu ao Banco Central enxergar lacunas nas suas actividades de supervisão e verificar as principais vulnerabilidades do sistema bancário, que já estão sendo tratadas pela área de supervisão. A parceria com o Banco Mundial permitiu estruturar a área de sistema de pagamentos do Banco Central, criar toda a legislação que agora nos permite atuar sobre as falhas do sistema e criar a infraestrutura necessária para a modernização como a conexão com a rede internacional de cartão de créditos e para a inclusão financeira.

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O recém-concluído Memorando Económico do País apontou corretamente a incerteza dos direitos de propriedade da terra como um dos constrangimentos ao desenvolvimento do sector privado, principalmente nas áreas de turismo e agricultura. Ademais, o marco legal de propriedade da terra tem grande implicação sobre a questão do género, ainda mais em um país como STP onde a maior parte das uniões são informais. Nesse sentido, essa operação, em conjunto com os demais apoios do Banco, vem permitir a inter-operabilidade dos principais cadastros de propriedade e fundiário no país, bem como salvaguardar o direito de propriedade da terra das mulheres (Ação Prévia #4). O governo está a digitalizar todos os arquivos, o que é o primeiro passo para a inter-operabilidade, que vai ser alcançada com o novo sistema que está em construção.

A questão energética é crítica em STP. O actual Governo conseguiu gradualmente restaurar a capacidade da produção de energia para 85% da procura. Em 2020, o Governo instalará mais centrais de geração de energia que permitirá à EMAE restabelecer a produção de energia ao nível da procura, terminando com os cortes, e permitindo a mesma fazer a manutenção periódica dos geradores sem a necessidade de cortes. O Governo entende que essa é uma solução temporária e de curto-prazo e que a solução de longo prazo requer a participação do sector privado e a utilização de energias renováveis. Nesse sentido, o Governo aprovou recentemente o plano de desenvolvimento de menor custo do sector energético (Ação Prévia #6), que contou com apoio do Banco Mundial, para guiar a expansão e o investimento privado no sector energético.

O Governo também tem consciência que para atrair o sector privado para o sector energético é necessário ter uma companhia energética saudável do ponto de vista financeiro e operacional. Para isso, a EMAE conta com um plano de melhoramento de gestão que foi aprovado pelo Conselho de Ministros (Ação Prévia #6) e o compromisso do Governo para saldar as suas contas em atraso com a empresa e a fornecedora de combustível (ENCO). O aumento dos preços dos combustíveis visou recompor o diferencial positivo entre os preços domésticos e internacionais de forma a gerar recursos para saldar a dívida com a ENCO. Uma negociação para saldar essas dívidas de maneira sustentável também está em curso.

Outra medida que está sendo tomada para reduzir os prejuízos financeiros da EMAE no curto prazo é reduzir os custos por meio do aumento da eficiência no consumo de eletricidade pelo usuário final por meio de um programa governamental de incentivo do uso de lâmpadas LED mais eficientes (Ação Prévia #5) e da gradual proibição da importação de lâmpadas incandescentes de menor eficiência. O Governo está a trabalhar nas especificações técnicas do programa como tipos e números de lâmpadas e logística com vistas a uma implantação célere. Actualmente, mais de 70 porcento do consumo corrente de energia em São Tomé e Príncipe é direcionado a iluminação em todos os seguimentos de consumidores. A implantação de um programa de gestão da procura de energia baseado em um programa de distribuição em larga escala de lâmpadas LED em São Tomé e Príncipe será a maneira mais rápida de resolver os cortes de energia, melhorar a viabilidade financeira do sector elétrico e também gerar co-benéficios climáticos por meio da redução da emissão de gases causadores do efeito estufa. Espera-se que o programa reduze a procura em 8 MW e 15 GWh do consumo de energia, ou seja, 15 porcento da produção actual de energia até meados de 2020.

Por último, ainda no sector de energia, o Governo vem trabalhando para melhorar a regulação sectorial. O progresso mais recente foi a aprovação do contracto de concessão de energia entre o Estado e a EMAE (Ação Prévia #7), que visa formalizar o marco e as condições aplicáveis ao serviço de energia pela

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concessionária (direitos e obrigações, regulação da qualidade dos serviços e económica, regime para monitoramento de desempenho e fazer cumprir as regras de conformidade). Essa contratualização melhorará o planeamento das actividades de fiscalização da agência regulatória e também servirá como guia para o melhoramento da EMAE.

Do lado fiscal, o Governo vem trabalhando numa série de medidas para ampliar as receitas como a já mencionada introdução do IVA, mas também para melhorar a gestão das empresas públicas e dos investimentos públicos. Ainda que ações relativas a essas duas áreas não constem mais da matriz de políticas da terceira operação, o Governo continua comprometido com as mesmas. Foi seleccionada recentemente um consultor internacional para apoiar a implantação do plano de reforma das empresas públicas, e a equipa da Direcção do Planeamento vem trabalhando na revisão do quadro legal e formulários e metodologias para avaliação do investimento público.

Por último, ressalto a importância de dotar o país de um sistema moderno de proteção social com programas focalizados e os pagamentos feitos por rede bancária e meios electrónicos (Ação Prévia 9), de forma a garantir a integridade do programa e fomentar a inclusão financeira. O Governo já castrou quase todos os beneficiários e os pagamentos iniciarão brevemente.

Em síntese, são essas as reformas para as quais gostaríamos de contar com o apoio do Banco Mundial. Acredito que as medidas duras tomadas na macroeconomia são exemplos concretos do nosso compromisso com a estabilidade macroeconómica. Renovo também o meu compromisso de manter-lhe informado sobre qualquer acção do Governo que possa interferir no programa ou no nosso compromisso junto as instituições multilaterais.

Ciente da sua atenção, renovo os meus protestos de elevada estima e distinta consideração.

Gabinete do Ministro do Planeamento, Finanças e Economia Azul, em S.Tomé, a 23 de Outubro de 2019.

O Ministro

OSVALDO DOS SANTOS VAZ

REPÚBLICA DEMOCRÁTICA ***DE SÃO TOMÉ E PRÍNCIPE***

Unidade – Disciplina – Trabalho

MINISTÉRIO DO PLANEAMENTO, FINANÇAS E ECONOMIA AZUL

GABINETE DE MINISTRO

Letter of Development Policy

Your Honor
David Malpass
World Bank Group President
1818 H Street, NW
Washington, DC. 20433
USA

Ref. _____ / GM / 2019
São Tomé, October 23, 2019

Mr President,

On behalf of the Government of the Democratic Republic of São Tomé and Príncipe, I am pleased to submit to your high consideration the document for the third operation of the program in support of the strengthening of growth and fiscal policy of São Tome and Príncipe (STP). This operation and its respective grant are a continuation to the World Bank's support the to the country's efforts to implement reforms conducive to economic growth, mobilization of own-resources for development financing, and the improvement of quality of public spending.

The current government took office in December 2018, after a parliamentary election that led to power a coalition of parties, which were opposed to the previous government. The program of the XVII government is based on four strategic axes: deepening of the democratic rule of law; robust economic growth and accelerated job creation; improvement in health quality and social protection; and foreign policy at the service of development. All actions of the 17th Government aim to achieve two objectives: to create the conditions for the relaunch of an average economic growth of more than 7%, and to strengthen social cohesion.

Nonetheless, the government has a much more urgent task facing given the terrible macroeconomic reality with visible social impacts found after taking office. In 2018, São Tome and Príncipe faced an energy crisis

that at its peak reduced the country's energy production by up to 75%. The energy crisis has drastically reduced the country's level of economic activity and food availability with serious consequences for tax collection, inflation, and the well-being of the population. In addition, the actual government found a lot of expenses that were made by the previous government without the necessary financial backing or resorting to bank loans to pay even the payroll and that were not properly recorded in government accounting. As a result, this government spent one considerable amount of time earlier this year only to get a true picture of the real macroeconomic situation of the country. And believe me, this photograph was not pretty.

The current government has since been trying to gradually solve the problems inherited. Inflation declined from over 10% at its peak in October 2018 to 7% in July 2019. And monetary aggregates' growth, which partially explained inflation, fell from growth rates of 15-20% to values near zero or negative. International reserves have been partially restored, and tax revenues are already showing slight growth in 2019. The government has resumed payments on its energy and telephone bills and has been trying to curb public spending. This task, however, is proving extremely difficult given the country's absolute low level of public expenditure, the volume of overdue expenses, and salary increases approved by the previous government to take effect in 2019. The public debt-to-GDP ratio rose not because of new loans, but due to the recognition of debts due to payments in arrears to suppliers, bank credit, and debt to the water and electricity company (EMAE) and the fuel supply company (ENCO), which for the first time were incorporated into the public debt stock as a way of giving greater transparency to public debt.

This government is committed to a sound macroeconomic policy and has not hesitated to take tough measures to achieve fiscal balance such as raising fuel prices, raising existing taxes and introducing the value added tax, which is one of the actions supported by this operation (Prior Action #8). The Tax Directorate has been preparing for the introduction of VAT through international expert missions, study tours, and hiring new staff. With the approval of the law, the Directorate will now engage in the communication campaign, systems development, and employee training. As a result of this work, the government has not resorted to bank loans to pay wages. It is also a commitment of this government not to borrow in excess of its repayment capacity, but above all to make the private sector the engine of economic growth. In recognition to this effort, the International Monetary Fund recently approved a new program to STP, which will allow the release of other grants from international partners.

It this spirit the Government of São Tome and Príncipe requests the World Bank support for the third development policy operation. The first policy area of this operation is the financial sector. The Central Bank of STP has been developing a fruitful partnership to improve banking supervision and avoid any macro-fiscal problems arising from poorly managed banks (Prior Action #1), and to improve financial infrastructure to support private sector development, mainly tourism, financial inclusion, and development of social programs (Prior Action #2). This partnership also supported the development of the entire legal framework for the microfinance sector (Prior Action #3), aiming at financial inclusion and overcoming the credit constraint on private sector development.

Reviewing the quality of the assets of the commercial banks has enabled the Central Bank to see gaps in its supervisory activity and to verify the main vulnerabilities of the banking system, which are already being addressed by the bank supervision area. The partnership with the World Bank has allowed us to structure the Central Bank's payment system area, create all the legislation that now allows us to address system failures, and create the infrastructure necessary for its modernization such as the connection to the international credit card network and for financial inclusion.

The recently concluded Country Economic Memorandum rightly pointed to the uncertainty of land rights ownership as one of the constraints to private sector development, particularly in the areas of tourism and agriculture. In addition, the legal framework on land ownership has a major implication on gender issues, especially in a country like STP where most marital unions are informal. In this sense, this operation, together with other Bank operations, will allow the inter-operability of the main property and land cadasters in the country and safeguard women's land ownership rights (Prior Action #4). The government is digitizing all registry files, which is the first step towards interoperability that will be achieved with the new system that is under construction.

Energy is a critical issue in STP. The current government managed to gradually restore the energy production capacity to 85% of the demand. In 2020, the government will install more power generators that will allow EMAE to restore power production to meet demand, ending the power cuts, and allowing the government to make the regular maintenance of generators without the need for cuts. The government understands that this is a temporary and short-term solution and that the long-term solution requires the participation of the private sector and the use of renewable energy. In this regard, the government recently approved the least-cost power development plan (Prior Action #6), which was supported by the World Bank, to guide expansion and private investment in the energy sector.

The government is also aware that attracting the private sector to the energy sector requires a financially and operationally sound energy company. To this end, EMAE prepared a management improvement plan that has been approved by the Council of Ministers (Prior Action #6) and the government is committed to settle its overdue accounts with the company and the fuel supplier (ENCO). The increase in fuel prices aimed to recompose the positive differential between domestic and international prices in order to generate resources to amortize the debt with ENCO. Negotiations to sustainably pay off these debts are also underway.

Another step being taken to reduce EMAE financial losses in the short term is to decrease costs by improving efficiency in electricity consumption for the end-user through a government program to encourage the use of efficient LED light bulbs (Prior Action #5) and the gradual ban on the importation of inefficient incandescent light bulbs. The government is working on the technical specifications of the program such as numbers of lamps per household and its types and logistics for rapid deployment. Currently, over 70 percent of the current electricity generation in São Tomé and Príncipe (STP) is consumed for meeting the need for lighting across various consumer categories. The implementation of a demand side management (DSM) program based on large-scale LED bulb deployment in STP will be the quickest way to address power shortages, improve the financial viability of the electricity sector and also help create climate co-benefits through the reduction of green-house gas emissions. This program is expected to reduce the demand by 8 MW and 15 GWh of energy consumption, that is, 15 percent of EMAE's current generation by the summer of 2020.

Finally, the government has been working to improve energy sector regulation. The most recent progress has been the approval of the concession agreement between Government and EMAE (Prior Action #7), which aims to formalize the framework and conditions applicable to service delivery by the concessionaire (rights and obligations, economic and service quality regulations, regime for monitoring performance and enforcing compliance, etc.). Such contracting will improve the planning of the regulatory agency oversight activities and will also serve as guidance for EMAE's improvement.

On the fiscal side, the government has been working on a series of measures to increase revenues such as the aforementioned introduction of the VAT, but also to improve the management of public enterprises and public investments. Although actions relating to these two areas are no longer in the policy matrix of the third

operation, the government remains committed to them. It was recently selected an international consultant to support the implementation of the state-owned enterprises reform plan, and the team from the Directorate of planning has been working on the revision of the legal framework and forms and methodologies for evaluation of public investment.

Finally, I would like to highlight the importance of providing the country with a modern social protection system with focused programs and payments permanently made through the banking network and electronic means (Prior Action 9) in order to ensure the integrity of the program and foster financial inclusion. The government has already registered almost all beneficiaries and payments will start shortly.

In short, these are the reforms for which we would like to have the support of the World Bank. I believe that the tough macroeconomic measures taken are concrete examples of our commitment to macroeconomic stability. I also renew my commitment to keep you informed of any action of the government to interfere in the program or not our engagement with multilateral institutions.

Aware of your attention, I renew my protests of high esteem and distinguished consideration.

The minister

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Osvaldo dos Santos Vaz

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior actions	**Significant positive or negative environment effects (yes/no/to be determined)**	**Significant poverty, social or distributional effects positive or negative (yes/no/to be determined)**
Pillar A: Introduce growth-enabling reforms in the financial sector, business environment, and infrastructure		
Prior Action #1: The Recipient, through BCSTP, has approved the Report for the São Tomé and Príncipe Banking System Asset Quality Review, as part of its efforts to improve financial soundness of commercial banks.	No significant positive or negative environmental effects are expected.	No
Prior Action #2: The Recipient, through: (i) its National Assembly, has passed the legal framework for payment services providers and payment system operators, which outlines the oversight framework, duties and powers of BCSTP; and (ii) BCSTP, has passed the key implementing regulations under the National Payments System Law, which provide for the legal protection of the electronic transfer of funds and the licensing and supervision of payment institutions and payment system operators.	No significant positive or negative environmental effects are expected.	Yes
Prior Action #3: The Recipient, through BCSTP, has passed key regulations, which establish the minimum entry, operation requirements, risk management minimum requirements, and supervisory and reporting procedures for microfinance institutions.	No significant positive or negative environmental effects are expected.	Yes
Prior Action #4: The Recipient, through its Council of Ministers, has approved the institutional structure for enabling interoperability between the land property register *(Registo de Propriedade)* and the cadaster *(Registo Cadastral)*.	No significant positive or negative environmental effects are expected.	Yes

Prior Action #5: The Recipient, through the Presidency of the Republic, has instituted an energy demand management program, which includes the exchange of low efficient bulbs with higher efficient ones.	Yes. Positive environmental effects are expected because the deployment of LED bulbs can contribute to significant energy savings, lower pollution, and reduce GHG emissions.	Yes
Prior Action #6: The Recipient, through its Council of Ministers, has approved: (a) a Least-Cost Power Sector Development Plan, which provides the basis for a competitive process for all power generation activities; and (b) a Management Improvement Plan for the EMAE, which aims to improve EMAE's operational performance.	Yes. Positive environmental effects are expected. Power generation activities shall to follow the prescriptions integrated in the Least Cost Power Development Plan including compliance with environmental standards.	No
Prior Action #7: The Recipient, through AGER, has signed a concession contract with EMAE, which stipulates the obligations of the Recipient and the licensee, including rules on tariffs and sanctions.	No significant positive or negative environmental effects are expected.	No
Pillar B: Generate fiscal resources and savings and improve the quality of expenditures		
Prior Action #8: The Recipient, through the National Assembly, has passed the Value Added Tax Code which sets forth provisions aimed at broadening the tax base and generating more own-source revenues.	No significant positive or negative environmental effects are expected.	Yes
Prior Action #9: The Recipient, through the Ministry of Finance, has instituted a financial system-based (non-cash) payment mechanism to allow for the tracking and reconciliation of funds allocated to social protection payments.	No significant positive or negative environmental effects are expected.	Yes