Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 14-May-2018 | Report No: PIDA23850

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Guyana	P165425	First Programmatic Financial and Fiscal Stability Development Policy Credit (P165425)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
LATIN AMERICA AND CARIBBEAN	21-Jun-2018	Finance, Competitiveness and Innovation	Development Policy Financing
Borrower(s)	**Implementing Agency**		
The Co-operative Republic of Guyana	Ministry of Finance		

Proposed Development Objective(s)

Promote Sound Financial Development and Strengthen Fiscal Management

Financing (in US$, Millions)

SUMMARY

Total Financing	35.00

DETAILS

Total World Bank Group Financing	35.00
World Bank Lending	35.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. **Guyana has achieved impressive economic growth and debt reduction during the last decade, though it is heavily exposed to export concentration risks. Newly discovered oil and gas reserves add both wealth and a source of volatility.** Guyana suffered from low and volatile economic growth for decades prior to the 2000s, when the economy started to expand at a consistent pace. Offshore exploration has discovered estimated gross recoverable oil and gas resources of more than 3.2 billion barrels of oil equivalent (gross) in the Stabroek Block[1]. The resource wealth can change the structure of the economy, the Government's debt profile, and financial sector activities and risks. New macroeconomic volatilities arising from exported commodities and capital inflows must be managed well to underpin financial stability and avoid the so-called Resource Curse[2]. A fundamental challenge for the Government of Guyana will be to transform the oil wealth into human capital, physical capital, and financial assets. Physical capital investments by the public sector requires strong public investment management systems, and Guyana is at times limited in its capacity to implement public investments. Financial asset investments require effective management of investments outside of the country. Moreover, fiscal policy will need to manage the additional sources of volatility in both economic activity and fiscal revenues, as the increase in discovered wealth raises the question of intergenerational savings.

2. **The financial system provides substantial intermediation and is not under stress, but intermediation spreads are high, long term finance is poorly developed, and transactions remain predominantly cash based.** The authorities are taking measures and implementing the key recommendations of the 2016 Financial Sector Assessment Program (FSAP) to address key weaknesses in the financial sector. The market for insurance and pension products remain small albeit growing, but in spite of having long term liabilities, they do not invest in long term private sector assets in Guyana. Long-term financing is virtually inexistent outside of the residential mortgage market, and payments in the economy are overwhelmingly cash based. Banking sector vulnerabilities raise the need for ensuring consistency of bank supervisory oversight, from routine supervision to intervention and resolution which, despite some progress, needs to be improved further.

3. **The newfound wealth will increase demands on fiscal policy, long term savings, and domestic investments.** Fiscal policy has to manage the additional sources of volatility in both economic activity and fiscal revenues. The increase in discovered wealth raises the question of intergenerational savings and the extent to which revenues from extracted resources should be set aside for future generations. The increased market access of the country will also bring forward the need for modernization and streamlining of the institutional debt management framework.

Relationship to CPF

4. **In the context of IDA18 and needs expressed by the Government, the WBG has developed a comprehensive approach within the CEN framework to address the challenges in relation to the financial, the fiscal, and the emerging oil and gas sector**. This includes the proposed Programmatic Development Policy Credit (PDPC) series with a focus on both financial sector and fiscal management, as well as a technical assistance investment project to support Government efforts to build institutional capacity and enhance the fiscal, legal and regulatory frameworks for the oil and gas sector. The upcoming lending program is expected to be further supported by grant funded advisory assistance, and coordination with donor partners.

[1] Reported by Exxon-Mobil at http://corporate.exxonmobil.com/en/company/worldwide-operations/locations/guyana/about-us/project-overview.
[2] See Auty, Richard (1993): "Sustaining Development in Mineral Economies: The Resource Curse Thesis", Routledge.

C. Proposed Development Objectives

5. **The Program Development Objectives (PDOs) are to promote sound financial development and strengthen fiscal management.** The series will support several actions that stimulate well-functioning financial intermediation consistent with the Bank's strategy to maximize finance for development. The first operation will support confidence in financial institutions and ensure that risks to financial stability are well managed. The actions pertain in part to the Bank of Guyana's (BOG's) ability to manage risks in the financial system and in part by providing for efficient financial transactions that protect the interests of financial services consumers. The series will also support the development of a stabilization fund that will facilitate intergenerational savings. The operation will back improvements in the debt management strategy formulation and modernization of its' related institutions. Public investment management will be supported to strengthen the appraisal and selection of investment projects and align the public investment program with the medium-term budget framework.

Key Results

6. **The programmatic series will pursue stronger institutions and financial and fiscal outcomes.** Arrangements to manage failing banks will be developed to curb fiscal outlays and losses to the State, financial authorities and deposit insurance scheme when applying resolution tools to resolve failing financial institutions. A new deposit insurance system seeks to cover a large majority of individual depositors. Another goal of the program will be to preserve financial stability and avoid cross sectoral contagion by reducing the number of financial institutions going into direct insolvency due to short term liquidity issues. The result of the insurance oversight reforms will both be a financially sounder sector and growing provisions of insurance services. Improvements to the national payment system should improve efficiency and increase usage by retail clients. Increased effectiveness of the AML-CFT regime will ensure that enforcement can be effective and thus sustain trust in financial transactions keep the country off the Financial Action Task Force's (FATF) grey list. On the fiscal front, the establishment of a medium-term debt strategy will strengthen the alignment between borrowing and macroeconomic policy. The establishment of a sovereign wealth fund will be a milestone for the country, which will allow to make prudent use of the wealth.

D. Project Description

7. **The proposed Programmatic Development Policy Credit (PDPC) series supports Guyana's reform efforts to reinforce sound financial sector development and to strengthen fiscal management.** The proposed operation is the first in a series of two operations. The series builds on three pillars of policy reform. The first pillar supports the Bank of Guyana's (BoG's) ability to manage financial stress including establishing a deposit insurance scheme. The second pillar supports both regulatory reform for the insurance sector as well as domestic and international payment transactions. The third pillar supports stronger fiscal management through a sovereign wealth fund (SWF) for intergenerational savings, better debt management, and enhanced public investment management. The first credit will be in the amount of US$35 million. The PDPC forms part of a developing engagement with Guyana spanning financial sector, fiscal, and oil and gas sector management. Complemented by the IDA18 enhancement, this policy dialogue led to the development of the PDPC series as well as a now planned FY19 Systematic Country Diagnostic (SCD) and Country Partnership Framework (CPF).

8. **Maintaining financial stability is important for growth, protecting fiscal resources, and for protecting the poor**. Financial crises are associated with deep economic contractions and fiscal outlays that often exceed 10 percent of GDP[3]. Despite progress, Guyana still needs to improve financial sector oversight arrangements to reduce the risk and improve

[3] Laeven and Valencia (2012): "Systemic Banking Crises Database: An Update", IMF WP 12/163.

the ability to manage financial crises. The 2016 FSAP identified that crisis management tools were inadequate. For example, the range of options for resolving failing banks was inadequate, and the procedures for providing emergency liquidity to failing banks was not fully developed. In this context, the Government has submitted to Parliament amendments of the Financial Institutions Act as well as modifications to the BOG Act to establish effective an emergency liquidity assistance framework. Additionally, Guyana does not have deposit insurance, which is not only a protection for depositors and facilitates trust in financial institutions, but is also an important tool to manage crises by retaining trust and funding for the financial sector in times of stress. The Government has submitted to Parliament the Deposit Insurance Act in April 2018, to establish deposit insurance and a deposit fund. As for the second pillar, several microeconomic reforms will ensure that financial sector development reaches a larger segment of the population with relevant and efficient services. These reforms are specific to different aspects of the financial sector, but are each important building blocks for inclusive financial development. A well-functioning insurance sector offers risk transfer, but trust in the insurance sector in Guyana was rattled by the failure of the life insurance company CLICO. The Government responded by issuing a new insurance law, and the BOG has recently issued the regulations to support it. Moreover, Guyana's economy remains largely cash based despite good access to accounts. A National Payment System law draft was submitted to Parliament to increase safety and efficiency of the system and thus stimulate usage of electronic payment and settlement transactions. Furthermore, inadequate implementation of AML-CFT arrangements placed Guyana on the FATF grey list, which undermined trust in the financial system, and banks were losing access to the international payment system. In July 2017 the Government has amended the Anti-Money Laundering and Countering the Financing of Terrorism (Amendment) Act to enhance enforcement. As for the third pillar, the government is strengthening its fiscal management systems to address the risks associated with the upcoming oil revenues, with the aim of ensuring macroeconomic stability and harnessing the oil and gas sector for long-term economic growth and development. The government efforts to establish a fund for savings and stabilization. The government is working along several dimensions—establishing a fund for savings and stabilization, consolidating and modernizing debt management legislation, and strengthening the public investment management system.

9. **The financial support provided by the PDPC series has been and will be systematically supported with technical assistance**. The Country Engagement Note (CEN) recognizes the importance of linking, from the outset, financial support with systematic technical and training support in light of Guyana's institutional and fiduciary capacities needs. The 2016 Financial Sector Assessment Program (FSAP) offered detailed guidance on priorities in financial sector reform. Moreover, the Bank has provided FIRST Initiative funded technical assistance on insurance supervision and is currently providing assistance on the development of a national payment systems strategy, the payment system law and implementing regulations as well as on consumer protection for financial services. The Bank has also assisted the country in its national risk assessment of AML-/CFT. IMF's Caribbean Regional Technical Assistance Centre (CARTAC) has provided technical assistance on crisis management. A recently approved FIRST Initiative grant will assist in the development of deposit insurance. A continued advisory engagement will strengthen the outcome of the operation.

E. Implementation

Institutional and Implementation Arrangements

10. **The proposed credit will follow the Bank's standard procedures for disbursement and auditing arrangements for development policy support.** The proceeds of the credit will be disbursed against satisfactory implementation of the program (specified prior actions achieved) and maintenance of an adequate macroeconomic policy framework. The Bank will disburse the loan proceeds, denominated in USD, into the Government's foreign exchange account at the BoG. BoG will then immediately ensure that, upon deposit in said account, an equivalent amount in Guyanese dollars will be credited into the Government's account, which will become available to finance budgeted expenditures. Within 30 days of the

funds transfer, the Government, through its MOF, will provide the Bank with written confirmation of the amount deposited into the foreign currency account at the BoG, and that the equivalent amount has been credited in the borrower's accounting system to an account that finances budgeted expenditures. BoG's financial management is adequate and no specific audit of the deposit of the credit proceeds will be required.

F. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

11. **The PDPC is expected to have a positive poverty and social impact through the actions supporting financial stability.**[4] Financial instability and financial crises affect poverty through several channels, including the effect of economic slowdowns on unemployment and fiscal outlays, negative distributive effects of depreciations and vulnerable middle-income groups falling into poverty. Prior actions under Pillar 1 will support financial stability and thus are expected to have indirect positive poverty and social impacts, and though adverse distributional effect can potentially arise from generous deposit insurance schemes, the moderate coverage level envisaged in Guyana keeps the emphasis on low- and middle-income savers. Deposit insurance is a critical element of the financial safety net that can reduce the probability of a crisis and contribute to keep fiscal contingent cost at bay. Moreover, Pillar 2 will promote the usage of electronic payment systems, which is expected to benefit poor and rural areas as an inclusive infrastructure and customer base is established. Guyana is a cash-based economy. According to the World Bank's Guyana "Cost of Cash" study, it is estimated that the annual cost of cash for consumers is equivalent to 2.45% of GDP. Electronic payment systems are much cheaper than paper-based systems and allow financial services to be extended to low income populations. Finally, an improvement in insurance inclusion from current low levels could help protect the poor against vulnerability and livelihood risks. Improved competition and penetration in the insurance industry could help extend positive effects to low income populations by increasing access of the poor to insurance instruments.

Environmental Aspects

12. **The proposed DPC measures are not expected to have adverse effects on the environment or natural resources.** The policy measures supported by the DPC are designed to promote financial stability and development and to strengthen fiscal management with no impact on the environment.

G. Risks and Mitigation

13. **Risks to the operation are substantial reflecting the risk exposures to the small economy and still developing capacity to manage them, and the project aims to support the management of such risks.** The high and growing exposures to commodity shocks exposes the country to shocks. The project aims to better manage financial risks and their impact therefore depends on the effective implementation of the project. Moreover, implementation risks arise where the policy actions are not twinned with advisory services. A substantial multi-year advisory program is supporting the Government's financial sector reform program.

[4] Development Research Group, 2008, "Lessons from World Bank Research on Financial Crises," Policy Research WP 4779, World Bank.

CONTACT POINT

World Bank

Steen Byskov, John Daniel Pollner, Philip M. Schuler
Senior Financial Sector Economist

Borrower/Client/Recipient

The Co-operative Republic of Guyana

Implementing Agencies

Ministry of Finance

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Steen Byskov, John Daniel Pollner, Philip M. Schuler

Approved By

Country Director:	Sabine Hader	17-May-2018