PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

<table>
<thead>
<tr>
<th>Operation Name</th>
<th>Public and Natural Resource Management Development Policy Supplemental Grant</th>
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<tr>
<td>Region</td>
<td>AFRICA</td>
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<tr>
<td>Sector</td>
<td>Central government administration (80%); Oil and gas (20%)</td>
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<td>Project ID</td>
<td>P116178</td>
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<td>Borrower(s)</td>
<td>SAO TOME AND PRINCIPE</td>
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<td>Implementing Agency</td>
<td>INISTRY OF FINANCE</td>
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<tr>
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1. Key development issues and rationale for Bank involvement

STP’s economic prospects have deteriorated since the PNRMD program was approved in June 2008 (see Table 1 attached for a comparison of the main economic indicators projected when the PNRMD program was approved and the current projections), as a consequence of the changing international environment resulting from the financial/economic downturn. In addition, the country was hit hard in 2008 by the increase in international food and fuel prices that had a large impact on food security, poverty and the macroeconomic environment. GDP growth has remained at 5.8 percent in 2008, driven by construction services fuelled by FDI particularly to the tourism sector, but below the 6.0 percent projected in the PNRMD, and is expected to fall to 5.5 percent in 2009. FDI will drop sharply in 2009 with the completion of hotels and resorts construction in 2008.

Implementation of the PNRMD program accelerated with the new government formed in June 2008 and a recently completed Implementation Status Report rated the overall Project Implementation Progress as moderately satisfactory. A new corporate tax law, personal income tax law and urban tax law have been approved by the National Assembly in October 2008 and the government is preparing the regulations to the new laws with assistance from Portugal and the Millennium Challenge Corporation (MCC). The government has finalized the draft procurement law in line with international best practices and expects to submit it to the National Assembly this legislative period. Significant progress was also made in 2008 in revising the legal framework to initiate the bidding process for oil exploration rights at the Exclusive Economic Zone. Directors of the National Petroleum Agency (NPA) have been appointed and the Handbook of Oil Management Law and the Petroleum Sector Development Strategy have been published on the website of the NPA. The National Assembly has also approved the establishment of the Public Registration and Information Office to centralize and disseminate oil related information and is finalizing its institutional statute. However, challenges remain in the implementation of reforms in public finance management regarding i.e. Public Assets Management, Treasury, State Owned Enterprises, the IT SAFE-e system that will facilitate budget implementation and compilation of the public accounts, and the preparation of a new PRSP that aims to foster pro-poor growth.

Poverty, employment and social protection. The World Food Program (WFP) estimates that the food crisis in 2008 has deepened poverty significantly increasing the number of vulnerable people (those for whom food is inadequate or at the limit) by 10-15 percent. Given STP’s small size and insularity the government has limited instruments to face the international economic downturn and is focusing on improving its social safety net to provide assistance to the vulnerable population. The challenge in providing additional social protection however is daunting given the large financial and administrative needs.

External sector and reserves. The rise in food prices has translated into increasing import costs and a widening of the current account balance before official transfers to 58.8 percentage of GDP in 2008 compared to 52 percentage of GDP projected in the PNRMD program in June 2008. This impact is expected to be felt over the
medium term even though international food prices have stabilized as domestic food and energy prices have adjusted to higher levels in nominal terms. The gains in export earnings seen in 2008 are expected to be reversed in 2009 with overall exports expected to decline by 9 percent due mostly to lower re-exports of petroleum products because of lower fuel prices. On the other hand, as part of the government investment program to respond to the crisis, imports are expected to rise by 40 percent, widening the current account deficit (before official transfers) to 69.7 percent of GDP in 2009 compared with 49.2 percent projected under the original PNRMD program.

To respond to the deteriorating external position in the near term and as part of its long term strategic plan in the energy sector, the government accelerated in 2008 the sale of a controlling stake of 35 percent in the local Petroleum Import Company (ENCO) to Sonangol, the Angolan oil company. This increased official gross foreign exchange reserves from US$26.3 million in 2007 to US$46.5 million in 2008 (equivalent to 6.6 months of imports), well above the US$31.8 million projected in the PNRMD program. The Government aims to use US$8 million of the sale proceeds to finance a large investment program in infrastructure, agriculture development and food security.

**Government program to address the food and financial crisis impact.** The government would like to protect rural employment as a buffer against deepening poverty and raise domestic food supply. While accounting for only 17 percent of STP’s GDP, the agriculture sector occupies about one third of the population and provides about 55 percent of staple food. To address the low productivity in the agriculture sector, increase domestic food crops and food security, improve rural income and employment and reduce poverty the new Government has approved a 2009 Budget that includes a large investment program in infrastructure and agriculture, partially financed with proceeds from the sale of ENCO. Bank and IMF agreed with the government on a revised macroeconomic framework that will be supported by a new IMF PRGF approved in March 2009. The GoSTP is committed to full transparency in the execution of this investment program and, as part of the PRGF, it has requested the Bank and the IMF to monitor it in order to increase public investment efficiency. The government also remains committed to macroeconomic stability and will continue to contain current spending, notably the wage bill, while making an efficient use of international reserves to finance its large investment program. However, the rapid deterioration of the tourism sector and its associated FDI combined with the non materialization of expected budget support from the EU has seriously limited the government’s ability to address the economic downturn without additional external support.

**Government revenue and spending under the program.** The primary fiscal deficit exceeded its initial target of 5.2 percent of GDP in 2008 by almost one percentage point, with domestic payment arrears approaching 4.5 percent of GDP, mainly due to a shortfall in domestic revenue and higher than planned utility and scholarship bills. The deficit target for 2009 is 4.5 percent of GDP in 2009 close to the 4.2 percent of GDP projected in the PNRMD program. Most of the fiscal adjustment is expected from curbing the growth in current expenditures, especially the wage bill, while using some of the proceeds from the privatization of ENCO. Originally, the remaining financing need was expected to be filled through EU support to be channeled through the Bank’s supplemental financing. However, the EU decided to channel its support to NGO instead, and the resulting financing gap would affect the capacity of the authorities to implement its reform program in a non-inflationary manner. In addition, further expenditure pressures may arise if the government has to address increasing food insecurity and rupture of food stocks.

Without additional and rapid support, the government would either have to forgo key elements of its crisis response program (including investment in food security and social protection) or face a rapidly rising external deficit with a direct impact on inflation, exchange rate, poverty and the fiscal balance. These impacts, which call for an immediate response, include:

- Disruption of economic activity as a result of severe foreign exchange shortages, lack of essential imported goods, and rapid depreciation of the STP Dobra.
- Severe cuts in basic social spending and investments if government is unable to mobilize support to fill the remaining financing needs and is forced to cut back spending under its cash budgeting system.
cuts could in particular affect already limited social protection benefits, and investment programs to rehabilitate the deteriorated rural sector and agricultural production.

- Inability to maintain basic services (water, electricity) if government does not honor its payment obligations to EMAE, the service provider and the latter runs out of cash.
- Serious economic and social dislocations resulting from the rapid increase in the price of imported items (notably, food and fuel) and rupture of stock associated to the lack of import credit.

Any additional shock on the economy is likely to create considerable volatility in an already unstable political environment.

2. Proposed objective(s)

The proposed supplemental financing to the PNRMD Policy Grant will assist the government of STP (GoSTP) in implementing the country’s poverty reduction strategy while coping with the economic/financial downturn that have had a negative impact on STP’s balance of payments, inflation, fiscal deficit and poverty rates. The Government has reiterated its commitment to preserve macroeconomic stability through a follow up PRGF program approved in March 2009 while taking a proactive approach to the economic downturn, implementing a large public investment program to develop domestic agriculture and improve food security to protect the vulnerable population from potential trade disruptions stemming from scarce trade credit, high transportation costs, etc. However, the reform program remains underfunded and there could be a continued macroeconomic deterioration given the growing uncertain international economic environment. The proposed supplemental financing operation to the PNRMD will support GoSTP in implementing the 2009 Budget that continues the reforms supported by the PRNMD in terms of public finance management (PFM) and transparency and accountability in the petroleum sector and, in addition, (i) help to fill the financial gap of the 2009 Budget; and (ii) maintain a stable macroeconomic framework.

3. Preliminary description

It is proposed to support the government with a supplemental financing of US$2 million to the PNRMD grant that was approved in June 2008, to be prepared under OP/BP 8.60. The proposed operation, which represents less than 30 percent of the IDA-15 allocation, would contribute to maintaining the sustainability of the overall reform program of the Government while ensuring that the 2009 Budget remains fully financed. In addition, this support will assist the authorities in pursuing the original objectives of the PNRMD -- (a) strengthen budget preparation, execution, and control, including enhanced tax legislation and stronger impact of public expenditures on poverty; and (b) raise the standard of petroleum governance in line with international standards of transparency and competition as well as the Extractive Industries Transparency Initiative (EITI) --while responding to the challenges of the crisis and maintaining a stable macroeconomic stance.

The proposed Supplemental Financing meets Bank requirements for Supplemental Financing under OP 8.60. The food crisis and subsequent international economic downturn are exceptional and unexpected external shocks beyond the control of STP’s authorities, threatening original program objective absent a government response. IMF and World Bank evaluated the program adjustments proposed by government and consider them adequate and a new three year PRGF was approved by the IMF in March 2009. The grant would meet the requirements of OP 8.60 as follows:

(a) The program is being implemented in compliance with provisions of the Grant Agreement: STP is currently implementing the PNRMD reform program in full compliance with all covenants.

(b) The borrower is unable to obtain sufficient funds from other lenders on reasonable terms and in a reasonable time:

The Government was able to enlist support from Japan and Taiwan, Province of China, for urgent food imports in 2008 and the AfDB will provide budget support in 2009. However resources have yet to be fully identified to ensure that the 2009 Budget that support food security, agriculture development and social protection is fully implemented. The Supplemental Financing will contribute to meeting the
financing needs of the GoSTP to implement the 2009 Budget especially the planned efforts to boost food production and food security.

(c) *The time available is too short to process a further freestanding Bank credit:*
In view of the severe impact on STP's balance of payments, inflation, national budget and poverty of the compounded fuel and food price crises and the additional burden of the financial/economic downturn, it would not be possible to wait for a new freestanding Bank operation, particularly an investment operation in the agriculture sector to respond to the urgent needs raised by the authorities this fiscal year. STP is a small country with very little spare capacity in place especially at the level of its public administration.

(d) *The borrower is committed to the program and the implementing agencies have demonstrated competence in carrying it out:*
The GoSTP continues to implement much needed structural reforms as evidenced by the recent approval of new tax legislation, and the significant steps taken in drafting a new procurement law and preparing a new PRSP. It has successfully concluded a first PRGF with the IMF demonstrating commitment and capacity to implement a far-reaching reform program, and is currently negotiating a new PRGF that will assist the authorities to face the uncertain international economic environment.

This proposed additional financing grant aims at supporting STP’s macroeconomic stance by providing budgetary support to:

- **Finance assistance programs/invest projects to increase agricultural productivity in rural areas.** These include subsidizing essential inputs to farmers and fishermen that could include petroleum and fuel products, fertilizers and improved seeds. The grant will also support the Government’s effort to finance labor-intensive public works in infrastructure and agriculture in order to cushion the employment impact of reduced economic activity. This financing will come on top of the support already provided by the EU under its Road Maintenance Road. These projects will help to sustain rural employment and income earnings and to improve rural poverty rates and the food security situation. There are additional benefits that could arise from developing the agriculture sector such as increased regional food trade linkages, local innovations, and reduced risks.

- **Finance basic social services.** The proposed operation could provide additional finance to support the new vulnerable population affected by the rising food insecurity. Taking into account the limited spare capacity of the administration, the government is considering outreaching to international organizations such as the WFP, and NGOs.

- **Finance recurrent costs and/or arrears for basic utilities.** By covering expenditures for public utility bills and/or arrears, this component would avoid the collapse of basic utilities notably EMAE, the national electricity and water and sanitation utility provider, of which the Government is the main customer. The impact of the increasing fuel prices in 2008 left significant arrears of the State with EMAE and additional resources are necessary to ensure that the utilities will not suffer from State unpaid bills in 2009. Absent regular payment of water and electricity bills, these utilities would continue to face rapidly deteriorating financial outlooks with concomitant decline in their services.

The proposed operation would complement the PRGF program of about US$3.8 million over three years approved in March 2009. Additionally, the AfDB has approved a US$ 1.5 million budget support in January 2009 to support food security. The proposed operation is fully consistent with the main objectives of the IDA Financing Crisis Response (IDA-FCR) Fast-Track Facility approved by the Board on December 9, 2008, as it will: (a) assist STP’s government in mitigating the negative effects of the financial crisis on its economy; (b) provide financial support for continued public investment projects to ensure that long-term development opportunities are not compromised; and (c) support the on-going government efforts to improve public and natural resources management in line with the PNRMD program approved in 2008. Additionally, under its three components, the proposed operation would finance expenditures needed to maintain economic stability, sustain growth and protect the poor.
4. Environment Aspects

The team considers that the agriculture reform and the policies supported by the grant are not likely to have significant adverse consequences on the environment. The specific policies supported under the proposed supplemental financing grant address primarily institutional reforms and basic infrastructure to improve food security and enhance the social safety net to protect vulnerable people of the economic downturn. However, the Bank team will appreciate guidance about additional work to ensure that potential environmental effects are taken into account under the program and through program monitoring.

5. Tentative financing

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<td>International Development Association (IDA)</td>
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<td>Total</td>
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6. Contact point

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