

**São Tomé and Príncipe: Joint Staff Advisory Note on the Poverty Reduction Strategy  
Annual Progress Report**

The attached Joint Staff Advisory Note (JSAN) of the Annual Progress Report on Implementation of the Poverty Reduction Strategy Paper for São Tomé and Príncipe, prepared jointly by the staffs of the World Bank and the IMF, was distributed with the member country's Annual Progress Report on Implementation of the Poverty Reduction Strategy Paper (PRSP) to the Executive Boards of the two institutions. The objective of the JSAN is to provide focused, frank, and constructive feedback to the country on progress in implementing its Poverty Reduction Strategy (PRS).

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INTERNATIONAL DEVELOPMENT ASSOCIATION  
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INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

JOINT STAFF ADVISORY NOTE ON THE POVERTY REDUCTION STRATEGY ANNUAL  
PROGRESS REPORT

Prepared by the Staffs of the International Development Association (IDA) and the  
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**I. INTRODUCTION**

- 1. São Tomé and Príncipe's Poverty Reduction Strategy Paper (PRSP) was discussed by the Executive Boards of the IDA and the IMF in April and July 2005, respectively.** The first Annual Progress Report of the PRSP was completed in September 2006. It emphasized the need for macroeconomic and political stability, continued policy reform, and substantial donor support to achieve most Millennium Development Goals (MDGs) by 2015. The second Annual Progress Report was received by the IDA and the IMF in August 2007. It covers the main challenges facing the country in promoting growth and reducing poverty.
- 2. The staffs agree with the authorities' emphasis on the importance of debt relief to boost pro-poor spending and remove one of the obstacles to economic growth.** São Tomé and Príncipe reached the completion point under the enhanced Highly Indebted Poor Countries (HIPC) Initiative in March 2007, thereby benefiting from debt relief under the HIPC Initiative and the Multilateral Debt Relief Initiative (MDRI). Paris Club creditors agreed in May 2007 to cancel all their outstanding claims on the country. Continued policy of refraining from new external borrowing on non-concessional terms is needed to ensure external debt sustainability.
- 3. The authorities' commitment to implement the PRSP through a Priority Action Program (PAP) is welcome.** The staffs agree with the PAP's call for strengthened policy implementation and greater coordination with the country's development partners. In particular, the authorities have appropriately given high priority to fiscal and regulatory reforms, along with measures to improve infrastructure, build human capital, and encourage more private sector participation. However, the second Annual Progress Report of the PRSP would have benefited from an inclusion of a discussion on the progress made in implementing previous

recommendations of the IMF and IDA on the first Annual Progress Report.<sup>1</sup> In particular progress on strengthening monitoring and management capacities of domestic institutions and on setting up strong institutions to transparently manage prospective oil revenues, as envisaged by the Oil Revenue Management Law (ORML).<sup>2</sup>

4. **The Annual Progress Report appropriately stresses the need for maintaining macroeconomic stability and strengthening structural reforms, in order to achieve the objectives of the PRSP.** Moreover, improving the business climate and utility provision remains essential to allow the private sector to thrive and promote growth. The authorities are aware of the need to increase aid absorption capacity (only 68 percent of the 2006 Public Investment Plan was actually executed) and to improve the efficiency and transparency of using public resources, including from the HIPC/MDRI debt relief and possible future oil revenues in order to achieve the PRSP objectives.

5. **The PRSP monitoring and evaluation system provides insufficient information and late data and needs to be strengthened.** The authorities are encouraged to implement an action plan that ensures appropriate and timely data gathering and publication and increase coordination among different institutions and departments in charge of PRSP supervision.

## II. MACROECONOMIC PERFORMANCE AND THE MEDIUM-TERM FRAMEWORK

6. **The Report's assessment of economic performance and near-term prospects is broadly in line with the staffs' evaluation.**<sup>3</sup> Real GDP grew at an estimated 6.7 percent in 2006, led by public expenditures and foreign investment in construction, commerce, and services. In 2007, real GDP is estimated to grow at 6 percent. The staffs note that annual inflation increased to 27.6 percent at the end of 2007, from 24.6 percent in 2006, reflecting higher domestic prices of petroleum products and utilities and currency depreciation. Future reports would benefit from a clearly articulated medium-term macroeconomic framework.

7. **The Report recognizes the need to tighten fiscal and monetary policies in order to safeguard macroeconomic stability.** Further reducing fiscal imbalances and continued implementation of a prudent monetary policy in the context of a flexible exchange rate regime will be crucial to reduce inflation. On the fiscal front, future reports could discuss the need for strict control of overall budgetary expenditures, particularly the wage bill, thereby protecting expenditure on pro-poor programs supported by HIPC and MDRI resources. Future PRSP

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<sup>1</sup> IMF document number EBD/06/118 and IDA document number 37319-STP.

<sup>2</sup> Law number 8/2004 for Oil Revenue Management was approved by the National Assembly in November 2004 and published in December 2004. The law establishes an account – the National Oil Account – in which all oil revenues are deposited directly, introducing specific mechanisms to restrict the amount of such revenues that can be used for annual budgetary expenditures.

<sup>3</sup> The authorities used old GDP statistics in the Annual Progress Report, which were revised by the Sãotoméan Institute of Statistics. In this JSAN, the staffs quote the revised statistics.

progress reports could also benefit from a discussion on public expenditure issues, particularly the changing structure of the central government budget and its impact on poverty reduction. Areas that could be further elaborated include progress towards strengthening public expenditure management and the use of oil-related and HIPC/MDRI resources. In addition, future reports could monitor progress on reforms to broaden the tax base and improve tax administration, in order to increase the tax-to-GDP ratio to create fiscal space for additional poverty-reducing spending.

8. **The Report would have benefited from a deeper discussion on the key structural reforms.** Developing the country's production and export base within a context of uncertain oil revenues will be critical to achieving sustainable growth and reducing poverty. These objectives will require more decisive implementation of fiscal policy and structural reforms. Future reports could also explore the adoption of a sound debt management strategy, in order to maintain debt sustainability after HIPC and MDRI debt relief, particularly by refraining from new external borrowing on nonconcessional terms.

9. **The Report discusses the potential impact of oil explorations.** It emphasizes that prospective oil exploration in São Tomé and Príncipe could bring with it dramatic improvements to the economy. However, the staffs are of the view that future reports should place greater emphasis on the uncertainties of oil discoveries. Exploratory drilling so far has not yet confirmed the existence of commercially extractable oil reserves. At present, foreign investors in Blocks 2 and 4 are not expected to start drilling before 2009. As such, the staffs encourage the authorities to carefully review oil prospects, with a view to maintaining fiscal discipline (prudent use of oil signature bonuses) and carefully managing the population's expectations. The staffs encourage the authorities to update their PRSP to include new developments in oil prospects and the impact on the medium term macroeconomic strategy.

### III. PRSP PILLARS

#### A. Reform of Public Institutions, Capacity-Building, and Good Governance

10. **The staffs note the continued efforts to reform public institutions, build capacity, and promote good governance and encourage the authorities to accelerate implementation to improve overall governance indicators (section 3.1.1).** Efforts so far have included the judicial sector, the National Assembly, local governments, civil society, and the civil service. Although some progress was made on the program of priority actions (Annex 1 of the Report), many others—particularly reforming and decentralizing government institutions—have stalled or were delayed, mainly due to elections that were held in 2006. Access to justice is limited, particularly outside the capital and if it concerns women. The staffs encourage the authorities to resume these reforms in order to improve governance indicators and focus efforts on controlling corruption and improving the rule of law.

11. **Economic and financial governance has significantly improved.** The 2007 budget was prepared following the new Organic Law on Public Finance Management and the decree

introducing new budget codes, including a functional classification, that were approved in 2007. An integrated budget implementation system has been set up, which facilitates budget control, monitoring, and reporting. Furthermore, planned reforms of the procurement law and procedures and internal controls should improve budget control and enhance the effectiveness of public expenditure. With these reforms, PRSP priorities and sector policies should be better reflected in the budget. PRSP implementation should also be easier to monitor. Future annual progress reports would benefit from a discussion on PRSP priorities and their associated costs, in order to better align these priorities with budget resources.

12. **Although oil production is not envisaged in the short run, the staffs encourage the authorities to step up efforts to adhere to the principles of the Extractive Industries Transparency Initiative (EITI) and develop institutions to supervise a potential oil sector, in line with the Oil Revenue Management Law.** The authorities' commitment to the EITI and the Abuja Declaration is commendable. The Petroleum Oversight Committee and the Public Registration and Information Office set up by the National Assembly aims to audit and monitor oil revenue flows and disseminate oil-related information. To continue developing institutions for oil sector supervision in line with EITI, the staffs encourage the authorities to finalize the petroleum sector legal and contractual framework and complete the technical and economic studies on bidding for blocks in the Exclusive Economic Zone, early in 2008.

13. **The staffs welcomed the sector roundtables on education, infrastructure, and governance held in 2006 and encourage the authorities to coordinate more closely with the country's development partners.** Execution of projects remains low because domestic resources and institutional capacity are limited. The roundtables emphasized the need for the authorities to mobilize resources by better coordinating with foreign donors and improving the capacity to implement projects. The staffs recommend that future PRSP annual progress reports present a discussion on the authorities' outreach program and the extent of the participatory process of the PRSP with stakeholders.

## **B. Broad-Based Economic Growth**

14. **The staffs agree on the need to create a more conducive business environment that attracts private investment and fosters growth (section 3.1.2).** São Tomé and Príncipe ranks among the bottom 15 countries on the World Bank's 2008 Ease of Doing Business report. For example, it takes 144 days to register a business in the country, compared to the regional average of 56 days. In this regard, the law on voluntary arbitration and the recently established Arbitration Center should help streamline the judicial process for commercial disputes and improve the business environment. While these achievements are welcome, renewed efforts are needed to implement the recommendations of the Diagnostic Trade Integration Study completed in 2006, particularly setting up a "single window" (one-stop-shop) to streamline business licensing procedures and make them more transparent. In addition, setting up an export promotion agency can help encourage nontraditional exports, particularly in sectors with high poverty.

15. **The authorities' efforts to reform the tax and investment laws are important steps forward.** A new investment code, submitted by the government to the National Assembly (NA), would eliminate discriminatory treatment of foreign investment. A set of tax reform laws were also submitted by the government to the NA aiming to modernize the tax code and tax procedures and simplify and improve corporate and personal income taxes. Speedy approval by the National Assembly would keep these reforms on track to be implemented in 2008. Further efforts will be needed to simplify and speed up the process of paying taxes and broaden the tax base by improving audits and administrative procedures.

16. **The staffs welcome the government's efforts to promote private sector participation in the utility sector.** Even with the recent increase in domestic prices of petroleum products and utility tariffs, the finances of state-owned enterprises remain precarious. These enterprises have also accumulated large arrears among themselves and with their suppliers and the government. In recent years, this has resulted in the lack of investment and maintenance, poor service provision and coverage, high tariffs, and large actual and contingent liabilities for the government. Efforts to promote public private partnerships in infrastructure and strengthen the regulatory framework are important pillars of a strategy to improve public infrastructure under a constrained budget. The staffs suggest that the government moves quickly to ensure closer coordination between sector ministries and the Ministry of Planning and Finance and to approve an action plan to redefine the state's participation in utility services, moving it from a direct service provider to a policymaker and supervisor of the utility sector. Any such steps will need to be compatible with the government's debt management strategy, including by avoiding government guarantees for public-private partnerships in the utility sector.

17. **The renewed efforts of the authorities to invigorate rural development will help accelerate redistributive growth. These efforts should be supported by the implementation of a rural sector strategy (section 3.1.3).** Projects in the PAP to rehabilitate irrigation systems and rural infrastructure, diversify agriculture and livestock, support marketing foodstuffs, and improve fish processing could improve local production and living standards. More broadly, adoption of an agriculture and rural sector strategy could help the government focus its efforts to promote broad-based economic growth and create income for the poor. The strategy could also highlight needed public resources to support the agricultural sector.

### C. **Human Resource Development and Improved Access to Basic Social Services**

18. **Budget appropriations for the education, health, and labor ministries have reached about 11.0 percent of current expenses in the national budget (Annex 3 of the Report).** Government allocations for health reached 5.0 percent of current expenditure and 5.9 percent for education, in line with efforts in 2006 to expand pro-poor allocations. However, as shown in the recent public expenditure review, public expenditure needs to be better aligned with PRSP and sector strategies. The authorities also need to reform the organization and structure of the health delivery system to make it more efficient and equitable.

19. **The staffs note that the government remains committed to pursue efforts to reach the MDG of universal completion of primary education by 2015 (section 4.1).** The Education Sector Strategy Paper has recently been updated and costed, providing the basis for the country to endorse the “Education For All-Fast Track Initiative” (EFA-FTI). This process has provided an opportunity to renew the dialogue on education between the government and its development partners and to reinforce coordination among donors. Over the past few years, the government has kept overall public spending in the education sector (including capital expenditures) at about 10 percent of total government spending. While this allocation remains in line with the PRSP targets, recurrent spending tends to favor higher education (currently at more than half of the sector’s recurrent spending), mainly to pay scholarships for students abroad. Alternative strategies to finance higher education would help better balance financing for primary and secondary education.

20. **Recent trends in education are encouraging.** Consistent with the Education Sector Strategy Paper, the country has recently begun to implement policies aimed at increasing full completion of primary education and at improving quality. Efforts include the provision of additional classrooms and distribution of free textbooks to all students. In-service teacher training has been intensified and pre-service teacher training is about to be re-launched to reduce the current share of 60 percent of non-qualified teachers in primary education. These efforts have already translated into encouraging results. From 2003 to 2006, the survival rate from grades 1 to 6 increased from 47 percent to 62 percent, and the transition rate from grades 4 to 5, increased from 60 percent to 72 percent. The share of students enrolled in classes with a triple-shift regimen decreased to 4 percent in 2006, from 30 percent in 2003. However, other important reforms have lagged, including the pedagogical integration of primary education and the reduction of repetition in classrooms. The staffs suggest the government accelerates measures to unify the two cycles of primary education and reduce repetition rates from the current high level of 23 percent.

21. **In the health sector, overall and infant mortality rates have decreased and the average birth survival rates have increased in recent years (section 4.2.1).** Although still higher than the African continent’s average, such gains are important achievements. The campaign to combat malaria in 2005 suggests that additional gains are still possible. Although the Ministry of Health’s budget outlays in 2005 were US\$2.6 million—about 8.7 percent of the overall public budget—the health sector remains highly dependent on external aid, suggesting that greater harmonization and coordination among donors, along with an improved health network infrastructure remain key to improving health care provision.

22. **In line with last year’s recommendations, the staffs encourage the Ministry of Health to continue with reforms, taking into account the recommendations of the recent public expenditure review for the health sector.** Particularly, intra-sectoral allocations are unjustly biased toward tertiary health care (61 percent of budget outlays in 2005) and should be better aligned with sector and PRSP strategies to promote primary care. The Ministry of Health also needs to improve its health information system (HIS), which is neither integrated nor



uniform at central or institutional levels. A new integrated HIS would centralize information and thus make it easier to improve monitoring and evaluation in the sector.

23. **The staffs recommend that the next PRSP presents more information on the country's natural disaster risks and mitigation strategy.** Considerable progress has already been made in this area, notably the recent completion of the country's first National Adaptation Program of Action (NAPA). Efforts should be made to ensure that critical public infrastructure is resilient to disasters in order to reduce the associated risks, particularly for the poor. The authorities are encouraged to adopt the national adaptation program of action for climate change.

#### **D. Monitoring and Evaluation**

24. **Little progress was made to improve the system headed by the Poverty Monitoring Unit to monitor and evaluate the implementation of the PRSP (section 5).** Although changes in staff at sector ministries after the 2006 elections have stymied progress, limited administrative and technical capacity and insufficient coordination with other stakeholders (such as the Directorate of Planning and the National Statistical Institute) have also stood in the way. For example, the system's data on poverty indicators are inadequate and impede monitoring of MDGs. The staffs emphasize the need to improve the monitoring and evaluation system and encourage the government to set up the technical and advisory monitoring councils needed to foster coordination among institutions and departments. In addition, the authorities should conclude the National Strategy for the Development of Statistics with specific recommendations for the monitoring and evaluation of the PRSP and put in place an action plan for its implementation. The staffs welcome the National Statistical Institute's development of a database (DevInfo), with assistance from the Economic and Statistical Observatory of Sub-Saharan Africa (AFRISTAT) that will be used as a monitoring tool for the MDGs, which in turn will help the country monitor and evaluate its Poverty Reduction Strategy. While the National Statistical Institute's plans to carry out a new survey to update the poverty situation are welcome, its results (as well as those of previous surveys) should be made available to the public. As the 2005 JSAN on the PRSP described,<sup>4</sup> the preparation of the PRSP benefited greatly from an extensive consultative process. In the same vein, consultation of stakeholders during implementation of the strategy would bring value to the policy framework for poverty reduction. It would be beneficial if the next poverty implementation report could be underpinned by a continuous consultative process led by the Poverty Monitoring Unit.

25. **As the Priority Action Plan for 2006-08 comes to an end, the authorities should consider taking stock of the achievements of the PRSP and update it in view of oil and growth prospects.** A new PRSP should build on the lessons learnt from the implementation of the current PRSP. Furthermore, a more candid description of oil prospects and a growth diversification strategy should be incorporated.

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<sup>4</sup> IMF document number EBD/05/336 and IDA document number 31726-STP.

#### IV. CONCLUDING REMARKS

26. **The staffs believe that the second Annual Progress Report is appropriately selective and focused on the main challenges facing the authorities.** It also candidly evaluates progress on implementing the PRSP, while conveying the authorities' commitment to meet its objectives.

27. **The Report's focus on consolidation of macroeconomic stability is key.** With rising international oil prices and an uncertain oil outlook, the staffs are of the view that the authorities should carefully manage the population's expectations about potential oil revenues. In addition, efforts are needed to strengthen public financial management and broaden the tax base to help reduce aid dependency. To further bring inflation down, a prudent monetary policy in the context of a flexible exchange rate regime must be maintained.

28. **Staffs agree with the Report's emphasis on the importance of debt relief to boost pro-poor spending and remove one of the obstacles to economic growth.** To ensure external and public debt sustainability, continued policy of refraining from new external borrowing on non-concessional terms is needed.

29. **The staffs encourage the authorities to carefully review oil prospects in future reports.** Exploratory drilling so far has not confirmed the existence of commercially extractable oil reserves. With rising pressures for public expenditures, the staffs emphasize the importance of maintaining fiscal discipline (prudent use of oil signature bonuses) and careful management of the population's expectations.

30. **The staffs agree on the need to create a more conducive business environment that attracts private investment and fosters growth.** Measures to promote private sector participation and strengthen the regulatory framework are important pillars of a strategy to improve public infrastructure under a constrained budget. While progress was made in some areas, there is room to reduce the costs of investing and doing business through regulatory reform and measures to deepen the financial sector.

31. **The government remains committed to pursuing efforts to reach the MDGs by 2015.** The staffs are of the view that more emphasis is needed on strengthened implementation of public financial management reforms and greater alignment between public expenditure and PRSP objectives to bring São Tomé and Príncipe closer to achieving the MDGs, particularly in health and education. While budget resources allocated to education are within the PRSP targets, recurrent spending tends to favor higher education. Similarly, while improvements in the health sector are encouraging, spending allocations currently favor the more costly tertiary care. The authorities should consider alternative strategies to finance primary and secondary education, including the Education for All- Fast Track Initiative, as well as to promote primary health care, as emphasized in the PRSP.

32. **The staffs are of the view that there is room to improve the PRSP monitoring and evaluation system.** To ensure an effective and successful implementation of the PRSP, the

authorities need to enhance monitoring and evaluation by implementing an action plan to ensure appropriate data gathering and publication. Moreover, to better fight poverty, increased coordination among different institutions and departments remains critical.

33. **An update of the PRSP in line with new developments in oil prospects and a growth diversification agenda seems desirable.** The update should build on the lessons learnt in the implementation of the current PRSP.