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Report No. 96219-CV

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A PROPOSED DEVELOPMENT POLICY CREDIT

IN THE AMOUNT OF SDR 7.2 MILLION
(US$10 MILLION EQUIVALENT)

TO THE

REPUBLIC OF CABO VERDE

FOR THE

NINTH POVERTY REDUCTION SUPPORT CREDIT (PRSC IX)

May 20, 2015

**Global Practice - Macroeconomics and Fiscal Management**
**Africa Region**

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**Currency Equivalents**

(Exchange Rate Effective as of April 30, 2015)

| | | |
|---|---|---|
| Currency Unit | = | Cabo Verdean Escudo |
| US$1.00 | = | CVE 100.12 |
| US$1.00 | = | SDR 0.71 |

**Weights and Measures**

Metric System

**Fiscal Year**

January 1 – December 31

## ABBREVIATION AND ACRONYMS

| | |
|---|---|
| AMP | Port and Maritime Agency |
| AAC | Domestic civil aviation regulator (*Agência de Aviação Civil*) |
| ASA | Airport Security Administration (*Agência de Segurança Aeroportuária*) |
| BCV | Central Bank of Cabo Verde *(Banco de Cabo Verde*) |
| BSG | Budget Support Group |
| CEM | Country Economic Memorandum |
| CPIA | Country Policy and Institutional Assessment |
| CPS | Country Partnership Strategy |
| CVE | Cabo Verdean Escudos |
| DB | Doing Business |
| DeMPA | Debt Management Performance Assessment |
| DGA | General Directorate of Environment |
| DGT | General Directorate of the Treasury |
| DNP | National Directorate of Planning (*Direção Nacional de Planejamiento*) |
| DSA | Debt Sustainability Analysis |
| EIA | Environmental Impact Assessment |
| ELECTRA | Public Water and Electricity Company (*Empresa de Electricidade e Água*) |
| ENAPOR | National Port Authority (*Empresa Nacional de Administração dos Portos*) |
| ESW | Economic and Sector Work |
| ETS | Economic Transformation Strategy |
| EU | European Union |
| FDI | Foreign Direct Investment |
| FIR | Regional Flight Monitoring |
| GDP | Gross Domestic Product |
| GNI | Gross National Income |
| GPRSP | Growth and Poverty Reduction Strategy Paper |
| IATA | International Air Transport Association |
| IBRD | International Bank for Reconstruction and Development |
| ICR | Implementation Completion Report |
| IDA | International Development Association |
| IDF | Institutional Development Fund |
| IE | Roads' Management Agency (*Instituto de Estradas*) |
| IFH | Real Estate and Housing Fund (*Imobiliária Fundiaria e Habitat*) |

| | |
|---|---|
| IFRS | International Financial Reporting Standards |
| ILO | International Labor Organization |
| IMF | International Monetary Fund |
| INE | National Statistics Office (*Instituto Nacional de Estatisticas*) |
| JSAN | Joint Staff Advisory Note |
| LDC | Least-Developed Country |
| LDP | Letter of Development Policy |
| LIC | Low-Income Country |
| M&E | Monitoring and Evaluation |
| MDG | Millennium Development Goal |
| MFI | Microfinance Institution |
| MoFP | Ministry of Finance and Planning |
| MIC | Middle-income Country |
| MoU | Memorandum of Understanding |
| NIS | National Investment System |
| NLTA | Non-Lending Technical Assistance |
| ODA | Official Development Assistance |
| PBMC | Performance Based Management contract |
| PBMtC | Performance Based Maintenance contract |
| PDO | Program Development Objective |
| PEFA | Public Expenditure and Financial Accountability |
| PEMFAR | Public Expenditure Management and Financial Accountability Review |
| PFM | Public Financial Management |
| PIP | Public Investment Program |
| PPP | Public Private Partnership |
| PRSC | Poverty Reduction Support Credit |
| PSI | Policy Support Instrument |
| RREWSP | Recovery and Reform of the Electricity and Water Sectors Project |
| SDR | Special Drawing Rights |
| SIGOF | Integrated Budget and Financial Management System (*Sistema Integrado de Gestão Orçamental e Financeira*) |
| SMECBEGP | Small and Medium Enterprises Capacity Building and Economic Governance Project |
| SOE | State-Owned Enterprises |
| SPE | State Services Participation (*Serviço de Participações do Estado*) |
| TA | Technical Assistance |
| TACV | Cabo Verde Airlines (*Transportes Aéreos de Cabo Verde*) |
| TBC | Tax Benefits Code |
| TSRP | The second is the Cabo Verde Transport Sector Reform Project |
| TVET | Technical and Vocational Education and Training |
| UN | United Nations |
| WBG | World Bank Group |
| VAT | Value-Added Tax |

| | |
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**REPUBLIC OF CABO VERDE**

**NINTH POVERTY REDUCTION SUPPORT CREDIT (PRSC-IX)**

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## ANNEXES:




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## SUMMARY OF PROPOSED CREDIT AND PROGRAM

## REPUBLIC OF CABO VERDE

## NINTH POVERTY REDUCTION SUPPORT CREDIT (PRSC IX)

| | |
|---|---|
| **Borrower:** | The Republic of Cabo Verde. |
| **Implementing Agency:** | Ministry of Finance and Planning (MoFP). |
| **Financing Data:** | IDA Credit, Standard IDA terms: 40-year maturity with a 10-year grace period. |
| **Operation Type:** | Single-Tranche Operation of SDR 7.2 million (US$10 million equivalent). Second in a programmatic series of 3 operations. |
| **Main Policy Pillars and Program Development Objective(s):** | The proposed operation will cover two pillars: (i) Enhancing macro-fiscal sustainability; and (ii) strengthening Cabo Verde's competitiveness. The development objective of the first pillar is to strengthen Cabo Verde's fiscal position, rebuilding fiscal space, and thus securing macro-fiscal sustainability. The development objectives of the second pillar are to enable the private sector and strengthen Cabo Verde's economic growth potential. Both macro-fiscal stability and private sector-led growth are necessary conditions to eradicate poverty and boost shared prosperity. |

**Result Indicators:**

| | **Original baseline* 2012/13** | **Revised baseline* 2012/13** | **Original target* 2016** | **Revised target* 2016** |
|---|---|---|---|---|
| Total Financing -to-GDP (%, including on-lending to SOEs) | 13.5 | 14.4 | lower than 10 | lower than 10 |
| Domestic Revenue to GDP ratio (%) | 21.0 | 21.6 | 24.0 | 23.0 |
| Percentage of ministries and government entities in the Single Treasury Account | 0 | 0 | 100 | 100 |
| New public investment projects financed by the budget appraised by the NIS (%) | 0 | 0 | higher than 50 | higher than 50 |
| Consolidated Balance of 5 main SOEs (in million CVE) | -491 | -1,583 | positive | positive |
| Electra technical and commercial losses as a share of total energy generation (%) | 26.2 | 28.7 | lower than 20 | lower than 20 |
| Number of ports with Public Private Participation arrangements in place | 0 | 0 | 3 | 3 |
| ASA revenues (in million CVE) | 648 | 5,598 | higher than 750 | higher than 6,000 |
| TACV net result (in million CVE) | -3,211.5 | -3,211.5 | higher than -1,000 | higher than -1,000 |
| Time to import (days) | 18 | 18 | <15 | <15 |
| Number of protected areas with legal boundaries and management plans defined | 3 | 3 | >40 | >40 |

| | |
|---|---|
| **Climate and disaster risks:** | *(i) Are there short and long term climate and disaster risks relevant to the operation (as identified as part of the SORT environmental and social risk rating)? Yes* [x] *No* [ ] |
| **Overall risk rating:** | Moderate |
| **Operation ID:** | P147015 |

* For changes of result indicators from PRSC VIII see Table A3 of Annex 2, and for other details, see Results Framework, Annex 1.

**IDA PROGRAM DOCUMENT FOR A**

**PROPOSED NINTH POVERTY REDUCTION SUPPORT CREDIT TO THE REPUBLIC OF CABO VERDE**

# 1. INTRODUCTION AND COUNTRY CONTEXT

1.1 **The Ninth Poverty Reduction Support Credit (PRSC IX) is the second in a programmatic series of three operations, supporting Cabo Verde's progress on its Third Growth and Poverty Reduction Strategy Paper (GPRSP III).** Cabo Verde is currently a blend International Development Association (IDA)-International Bank for Reconstruction and Development (IBRD) country. It graduated from the United Nations (UN) list of Least Developed Countries (LDCs) in 2008. The GPRSP III covers the period 2012-2016 and represents a comprehensive and coherent medium-term development strategy to successfully address the challenges faced by Cabo Verde as it moves toward a more mature, competitiveness-driven growth model, in a weak global environment, especially in Europe. The PRSC IX will support the government's policies toward reducing poverty and its pursuit of stronger economic growth, translating into higher incomes for the poorest 40 percent. It will provide budget support of US$10 million in 2015.

1.2 **Cabo Verde has made impressive progress on social development indicators, including poverty reduction. It is also a country with strong institutions.** Between 2002 and 2008, the poverty rate (at US$1.25/day) dropped by 7.3 percentage points (p.p.) to 13.7 percent. The share of income of the bottom 40 percent increased from 12.4 percent to 15.3 percent over the same period, according to recent World Bank figures. The country also made considerable progress on increasing basic services, including in health and water and sanitation, it ranks 123rd in the 2014 Human Development Report, and it is one of the few countries on track to achieve all Millennium Development Goals by 2015. These achievements have been supported by strong institutions: Cabo Verde continues to have the highest Country Policy and Institutional Assessment (CPIA) score (3.9) among IDA countries. Strong democratic institutions are arguably Cabo Verde's most precious asset, having both facilitated accountability—important for pro-poor policies—and attracted considerable Foreign Direct Investment (FDI).

1.3 **Sustaining and building on these achievements has turned increasingly difficult for this small open island economy, vulnerable to persistent global economic headwinds and natural disasters.** Cabo Verde's rapid economic ascent that had facilitated immense poverty reduction between 2002 and 2008 came to a sudden halt with the global financial crisis and, given the country's close linkages with European economies, persistent economic weakness in the Eurozone. Economic growth in real terms fell from an average 7 percent between 2002 and 2007 to 2 percent between 2008 and 2013, as FDI dropped from a peak of 13 percent of GDP in 2007 to 2 percent in 2013. Growth in 2014 was 2.7 percent and the estimate for 2015 is 3.5 percent. Expansionary fiscal policy, focusing exclusively on public investment, provided some support to the economy but, given a small multiplier, its short-term stimulus effect was limited; yet it increased macro-fiscal vulnerabilities as public debt surpassed 100 percent of GDP in 2013. Given continued economic weakness, unemployment remains high, at 15.8 percent, and the rate of poverty reduction is estimated to have slowed. In 2014, Cabo Verde experienced a drought, negatively affecting the harvest. On 23rd November 2014 Cabo Verde, was hit by yet another shock, as a volcano erupted in Fogo island, the country's second poorest, home to about 8 percent of Cabo Verde's population of 500,000, triggering a national emergency. The PRSC IX provides vital financial support to Cabo Verde in these difficult times of heightened vulnerability.

1.4 **One challenge for Cabo Verde will be to rebuild fiscal space to strengthen the country's resilience and support the implementation of the GRPSP III.** For a small open economy with a relatively rigid labor market and a fixed exchange rate regime (pegged to the Euro), fiscal policy is the main instrument for the government to counter shocks. It is also a condition for the government to be able to implement its policies under the GPRSP III. Expansionary fiscal policy of the past was motivated by two assumptions. First, with its graduation from LDC status, Cabo Verde would gradually lose access to concessional financing. The government decided in 2008 to utilize remaining concessional resources to address multiple market failures that were intrinsic to a volcanic archipelago fragmented across nine inhabited islands, removed from major global markets, thus laying the foundations for future growth. Second, in light of the global and domestic economic downturn, expansionary fiscal policy was intended to be counter-cyclical, providing some—although limited—support to a weak economy. Yet double-digit fiscal deficits were unsustainable and the government began decelerating its public investment program in 2013. Given the high public debt and continued pressures on the deficit and financing needs, the PRSC IX will support the government in strengthening macro-fiscal resilience.

1.5 **Nurturing the conditions for private sector-led economic growth is another challenge. It lies at the heart of the GPRSP III.** Government investment and capital accumulation have played a key role in Cabo Verde's development. With an Atlas GNI per capita of US$3,620 Cabo Verde is an aspiring middle income country which needs to rely more on growth driven by a competitive and efficient private sector. The growth model based on public investment is yielding to a greater emphasis on productivity. This is especially true in the context of limited government resources. The country already boasts considerable achievements in attracting foreign investors in the tourism sector, the driver of the economy and also the engine behind poverty reduction. However, the tourism sector exhibits only limited forward and backward linkages with the rest of the economy. To leverage the effect of the tourism sector for the maximum benefit of Cabo Verdeans, especially the poor, and to diversify the economy from its risky reliance on one single sector, considerable efforts are needed, as acknowledged in the GPRSP III. First, it will be crucial to ensure that the government's tremendous investments in the country's infrastructure of the past years provide the anticipated services to the private sector and yield their expected returns. Second, improving the investment climate will enable entrepreneurs, while a sound banking sector, currently weakened by the economic downturn, will provide supporting financial services. Finally, it will be important to ensure environmental sustainability to protect the country's natural beauty, the main attraction for tourists—and tourism revenue. Economic growth is crucial to raise household incomes and offer opportunities in the labor market, including for women whose labor market participation currently lags significantly behind that of men and who have been experiencing particularly long periods of unemployment in this recent period of weak growth.

1.6 **The PRSC IX supports two pillars: (i) enhancing macro-fiscal sustainability, and (ii) strengthening Cabo Verde's competitiveness. Key risks for the success of the operation center on shocks from the global economy, natural disasters, and the 2016 general election.** These two pillars mirror those of the new Country Partnership Strategy (CPS) of the World Bank Group (WBG), covering the years 2014-2017. The PRSC series is the WBG's main financial instrument for achieving the objectives of the CPS. Risks to achieving the anticipated outcomes of both the PRSC series and the CPS center on continued global economic weakness but also on natural catastrophes, such as the recent volcanic eruption, which can undermine efforts toward enhancing fiscal stability and which may reverse some of the gains on poverty reduction. A second risk stems from the general elections in 2016. Campaigning has already begun. The country still has to make a number of tough decisions, some of which may only yield benefits with a time lag, making them unpopular in the short-term. Sustained political will to reform will be a crucial ingredient for the success of this operation.

# 2. MACROECONOMIC POLICY FRAMEWORK

## A. RECENT ECONOMIC DEVELOPMENTS

2.1 **As a small open economy, Cabo Verde continues to be adversely impacted by the weak external economic environment.** The country is highly dependent on developments in the EU, traditionally its main source of FDI, Official Development Assistance (ODA), and remittances. The European Union (EU) is also Cabo Verde's most important trade partner and comprises virtually all source countries for tourists visiting the archipelago. Cabo Verde's growth thus closely mirrors that of Europe and the double-dip recession in the Eurozone translated into a recession in 2009 and an average growth rate of 2.1 percent between 2010 and 2014, much lower than the 7.7 percent of the five years pre-2009. FDI, mostly in the tourism sector, was the key driver behind rapid growth before the crisis. FDI fell for five consecutive years, reversing this trend only in 2014. Similarly, as European countries faced pressures on their own budgets during the Eurozone crisis, grants provided to Cabo Verde have been falling. Since the onset of the crisis, three development partners have stopped providing budget support and others have reduced their commitments. Remittances have been relatively resilient and there is evidence that they provide some relief to families—and to the balance of payments—when economic shocks hit the country. Growth in 2014 was 2.7 percent, up from 1.0 percent in 2013. 2015 growth is estimated at 3.5 percent as the country shows signs of recovery.

2.2 **Arguably the most important effect of the crisis was on the tourism sector, although the sector is expected to recover faster as well.** Falling FDI means that fewer hotels were being built, reducing the volume of tourists which only grew by about 1 percent in 2014.[1] Recently, deflation in some European countries has had a negative effect on Cabo Verde's real effective exchange rate, making the sector less competitive, especially with respect to European travel destinations. Cabo Verde's tourism sector responded by cutting prices. Yet tourism is expected to rebound: FDI is returning, having grown by 13 percent in 2014. FDI projects amounting to about US$200 million over the course of their implementation have recently been initiated and investors have registered total interests amounting to over US$1 billion. Over two thirds of registered projects are in the tourism sector.

2.3 **Weak external demand has been compounded by domestic fragility, including in the financial sector. Recent monetary loosening has not yet revived private credit growth.** Cabo Verde's financial sector was highly exposed to tourism-related real estate. As FDI in the sector retrenched, Cabo Verde's banks saw asset quality decline and their profitability fall. As banks repair their balance sheets and the economy remains weak, both supply and demand for bank credit

[1] There is also some evidence that the break-out of Ebola in some continental West African countries may have hit tourism flows to Cabo Verde in the third quarter of 2014, even though there was no Ebola in Cabo Verde.

are suppressed. The central bank cut the policy rate by 150 basis points in March 2014 and another 50 basis points in August 2014. Yet, the effect on credit growth so far has been modest. Credit to the economy in 2014 contracted. Accordingly, domestic investment remained weak. Both domestic credit and investment are expected to recover modestly in 2015, supported by further monetary loosening in February 2015, when the central bank reduced the reserve requirement from 18 to 15 percent and made another cut to the policy rate.

2.4 **The volcanic eruption has caused economic damage in Fogo island.** While a full damage and loss assessment is currently underway (supported by the Bank), it is already known that lava and accompanying earthquakes have destroyed homes, businesses, and the country's vineyards. The disruption to economic activity on Fogo island, the second poorest island in Cabo Verde, is likely to be considerable. The volcanic eruption is the second natural shock that occurred in 2014, following a poor harvest due to drought.

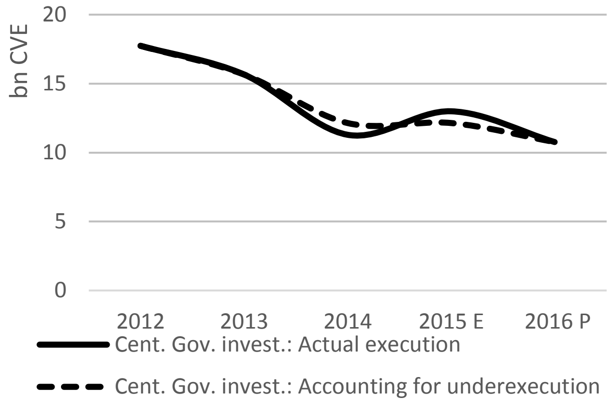
2.5 **Exports were outpaced by imports in 2014, leading to a widening current account deficit. However, due to a solid financial account, the international reserve position remains robust.** Depressed by a fall in tourism receipts, total exports in 2014 were low—notwithstanding an increase in fish exports, Cabo Verde's most important merchandise export. Goods exports in 2014 increased by 35 percent; yet they only account for a quarter of total exports. Given the weak economy, imports fell in 2012 and 2013. They increased in 2014, driven by capital and intermediate goods imports. Consumption good imports continue to decline. Remittances grew by 10 percent in 2014 while government grants continued to fall. The net effect of income flows on the current account is negative, as foreign investors remit profits home. The financial account is dominated by FDI, public external borrowing, and cross-border transactions of commercial banks, including deposits from the country's diaspora in accounts they hold in local banks. Taken together, the overall balance in 2014 remained positive and international reserves are estimated at 4.9 months of prospective imports, well within the interval of the IMF's external balance assessment of 3.7 to 5 months.

2.6 **Inflation in Cabo Verde is traditionally low, supported by the currency peg with the Euro. Prices stagnated in 2014 at a technical deflation of -0.2 percent.** Since early 2014, food prices have been falling, joining a global trend of falling food prices. Energy price inflation, too, has been suppressed largely due to global developments. Core inflation is stagnating. While weak inflation is expected to somewhat support private consumption and thus growth by reducing price pressures on real wages, it increases the real interest rate and thus discourages investment. Low inflation does however moderate the appreciation of Cabo Verde's real effective exchange rate (against low inflation in Europe), and thus in turn the loss of external competitiveness.

2.7 **With regards to fiscal policy, the public investment program is retrenching.** Annual growth of public investment of the central government has been falling since 2013 and the execution of the public investment pipeline suggests a continuation of this trajectory (Figure 1). Public investment is expected to fall from its peak in 2012 of 11.8 percent to 6.2 percent in 2016 (Table 2). The government is executing a pipeline of projects which has not been expanded since 2013. The central government's public investment program has been accompanied by considerable SOE investments, financed through onlending, passing on the favorable financing terms of concessional loans to public companies. Onlending, too, has begun retrenchment in 2014 (Table 2). By 2018, on-lending is projected to fall below 1 percent of GDP. The deceleration of public investment is expected to be uneven—the government under-executed in 2014 and is expected to compensate through over-execution in 2015, leading to a temporary, small increase in financing needs in 2015. However, the overall trajectory of fiscal retrenchment is clear.

**Figure 1: The public investment program is decelerating**

(public investment by the central government and supported by onlending in national currency terms)




Source: World Bank staff calculations based on Ministry of Finance and IMF data.

2.8 **The government is committed to containing current expenditures.** Over the past years, the government generally maintained a roughly balanced operational budget, meaning that it financed all current expenditures with revenue and financed public investment with debt. Since 2012, the government has been reducing subsidies, which fell from 0.7 percent of GDP in 2011 to less than 0.1 percent in 2014. The government has strongly controlled public wages. To gain agreement for this with the trade unions it was agreed in 2011, as part of a civil service reform initiative, that in return for a freezing of wages and hiring, a one-off increase in wages would be granted. The implementation of this took place in phases. A one-percent increase in wages and limited new hiring in crucial sectors, namely education, health, security, and public finance (including tax administration), was planned for 2014 but is now expected for 2015. In return, the continued freezing of salaries will ensure that, as a percentage of nominal GDP, the wage bill will fall again from 2016 onwards, stabilizing at 10.6 percent of GDP in 2018. This is a reasonable level for such a small country.

2.9 **The government has taken considerable efforts to counter falling revenue trends.** As the economic crisis affected profits, income taxes fell, at an annual average of -0.8 percent between 2009 and 2014 in nominal terms. Taxes on goods and services also performed poorly as private consumption was depressed. In 2013 and 2014, responding to falling revenue, the government introduced five new revenue raising measures: (i) it levelled the national VAT rate of 15 percent across all sectors, raising it from a preferential rate of 6 percent for hotels and restaurants; (ii) it also broadened the VAT base, now also covering water, energy, communications, and road transportation services; (iii) it levied an additional fee of two Euros per day on tourists; and it increased collections from trade taxes through the (iv) statistical and (v) ecological taxes. The government also reformed the fiscal incentives system (supported by the PRSC VIII), abolishing tax holidays and replacing it with a system of tax credit. These reforms were bold although the effects of these measures on collections materialize slowly. For example, the new VAT rate can only be applied to contracts with tour operators made after January 2014; the new fiscal incentives code will only apply to new FDI projects and the abolition of tax holidays will be reflected in higher revenue once these new investments are completed and yield profits.

2.10 **Reforms in the tax administration are still ongoing, further increasing collections efficiency. Revenue collections for Q1 2015 are encouraging.** Legislation supported by this PRSC series has strengthened the mandate and enforcement authority of the tax office, and is reducing tax loopholes. The IMF and other development partners are providing TA to increase the efficiency of the tax office, with a complete reorganization, including the introduction of a large taxpayers unit, and capacity building. The interplay of reforms to tax policy and tax administration are expected to yield considerable revenue gains—further supported by a brighter economic outlook. Between a trough in 2014 and 2017, domestic revenue is expected to gradually increase by 2.7 p.p. of GDP, which will result in a 2017 tax-to-GDP ratio comparable to the years 2006 or 2011. Results from Q1 2015 suggest that some of these reforms are beginning to bite: tax revenue increased by 9.5 percent. In addition, the recovery of revenue may further be supported by sales of state participations in domestic enterprises which the government is increasingly pursuing through a newly established Public Private Partnership (PPP) unit.

**Table 1: Selected Economic Indicators**

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Est. | | Proj. | | | | |
| | | | | (Annual percent change) | | | | | | |
| **National accounts and prices** [1] | | | | | | | | | | |
| Real GDP | 4.0 | 1.1 | 1.0 | 2.7 | 3.5 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 |
| GDP deflator | 2.7 | 0.5 | 0.5 | -0.8 | 1.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Consumer price index (annual average) | 4.5 | 2.5 | 1.5 | -0.2 | 1.5 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| Consumer price index (end of period) | 3.6 | 4.1 | 0.1 | -0.4 | 2.0 | 2.5 | 2.5 | 2.5 | 2.5 | 2.5 |
| **External sector** | | | | | | | | | | |
| Exports of goods and services | 17.4 | 8.4 | 6.9 | 4.6 | 7.0 | 9.0 | 10.0 | 10.2 | 10.2 | 10.3 |
| *Of which:* tourism | 26.5 | 21.4 | 8.6 | -9.4 | 10.0 | 10.0 | 10.0 | 10.5 | 10.5 | 10.5 |
| Imports of goods and services | 17.9 | -6.2 | -5.7 | 7.4 | 9.0 | 8.0 | 6.2 | 6.0 | 6.0 | 2.7 |
| | | | | (Change in percent of broad money, 12 months earlier) | | | | | | |
| **Money and credit** [2] | | | | | | | | | | |
| Net foreign assets | -7.7 | 4.6 | 6.6 | 6.7 | 1.3 | 1.3 | 0.6 | 0.3 | 0.0 | 4.2 |
| Net domestic assets | 12.2 | 1.7 | 4.8 | 0.7 | 7.3 | 8.3 | 8.2 | 8.2 | 7.6 | 3.5 |
| Net claims on the central government | 4.0 | 3.3 | 1.8 | 2.1 | 1.7 | 1.7 | 1.6 | 1.6 | 1.0 | 0.7 |
| Credit to the economy | 10.8 | -0.1 | 1.5 | -0.7 | 5.5 | 6.5 | 6.5 | 6.5 | 6.5 | 2.6 |
| Broad money (M2) | 4.6 | 6.3 | 11.4 | 7.4 | 8.5 | 9.6 | 8.8 | 8.5 | 7.7 | 7.7 |
| | | | | (Percent of GDP, unless otherwise indicated) | | | | | | |
| **External sector** | | | | | | | | | | |
| External current account (including official transfers) | -16.3 | -12.6 | -4.9 | -7.5 | -10.4 | -11.2 | -10.4 | -8.6 | -6.6 | -2.7 |
| External current account (excluding official transfers) | -20.0 | -16.0 | -8.0 | -11.7 | -12.6 | -12.9 | -11.4 | -9.5 | -7.5 | -3.5 |
| Overall balance of payments | -2.9 | 2.7 | 3.7 | 5.1 | 2.1 | 1.5 | 0.8 | 0.5 | 0.3 | 4.5 |
| Gross international reserves (months of prospective imports of goods and services) | 3.4 | 4.1 | 4.4 | 4.9 | 4.9 | 4.8 | 4.7 | 4.5 | 4.5 | 4.9 |
| **Government finance** | | | | | | | | | | |
| Revenue | 25.6 | 24.4 | 24.5 | 22.7 | 24.1 | 24.5 | 25.0 | 26.1 | 26.0 | 24.6 |
| Tax and nontax revenue | 22.7 | 21.6 | 22.1 | 21.0 | 21.2 | 22.5 | 23.7 | 24.9 | 24.9 | 23.6 |
| Grants | 2.9 | 2.8 | 2.4 | 1.7 | 2.9 | 2.0 | 1.3 | 1.2 | 1.1 | 1.1 |
| Expenditure | 33.3 | 34.7 | 33.2 | 30.8 | 32.1 | 31.2 | 30.7 | 30.3 | 28.3 | 27.1 |
| Overall balance (incl. grants) | -7.7 | -10.3 | -8.7 | -8.1 | -8.0 | -6.7 | -5.7 | -4.2 | -2.3 | -2.5 |
| External financing | 6.4 | 7.4 | 7.6 | 4.2 | 4.9 | 3.7 | 2.7 | 1.2 | 0.3 | 1.2 |
| Domestic financing | 1.2 | 3.2 | 1.2 | 3.9 | 3.0 | 3.0 | 3.1 | 3.1 | 2.0 | 1.3 |
| Net other liabilities (incl. onlending) [3] | -3.4 | -4.1 | -4.9 | -4.0 | -4.3 | -3.5 | -2.5 | -0.8 | -0.1 | 0.0 |
| Total financing (incl. onlending) | 11.1 | 14.4 | 13.6 | 12.1 | 12.3 | 10.2 | 8.3 | 5.0 | 2.5 | 2.5 |
| **Public debt stock and service** | | | | | | | | | | |
| Total nominal government debt | 78.8 | 91.1 | 101.6 | 114.2 | 121.5 | 123.7 | 123.8 | 120.5 | 114.8 | 109.5 |
| External government debt | 57.2 | 68.1 | 77.3 | 87.5 | 92.8 | 93.6 | 92.2 | 87.5 | 81.6 | 76.8 |
| Domestic government debt | 21.6 | 23.0 | 24.3 | 26.7 | 28.7 | 30.2 | 31.6 | 33.0 | 33.2 | 32.7 |
| External debt service (percent of exports of goods and services) | 1.6 | 0.8 | 0.6 | 0.7 | 0.8 | 0.7 | 0.7 | 1.0 | 1.0 | 1.7 |
| ***Memorandum items:*** | | | | | | | | | | |
| Nominal GDP (billions of Cabo Verde escudos) | 147.9 | 150.4 | 152.6 | 155.5 | 163.3 | 173.9 | 185.2 | 197.3 | 210.1 | 223.7 |
| Gross international reserves (€ millions, end of period) | 263.3 | 299.1 | 347.5 | 419.7 | 450.8 | 474.2 | 488.1 | 497.3 | 502.9 | 593.2 |

Source: World Bank staff estimates and projections based on data from the IMF, Ministry of Finance, and INE.

[1] 2012-2014 National accounts data were published on April 24, 2015.

[2] Adjusted for data inconsistency in December 2011.

[3] Includes errors and omissions.

## Table 2: Statement of Operations of the Central Government in percent of GDP

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|
| | | | | Est. | | Proj. | |
| **Revenue** | **25.6** | **24.4** | **24.5** | **22.7** | **24.1** | **24.5** | **25.0** |
| Taxes | 20.0 | 18.3 | 18.2 | 17.6 | 18.1 | 19.2 | 20.3 |
| Taxes on income and profit | 5.9 | 5.7 | 5.6 | 5.2 | 5.2 | 5.6 | 6.0 |
| Taxes on goods and services | 9.4 | 8.3 | 8.4 | 8.3 | 8.8 | 9.5 | 10.1 |
| Taxes on international trade | 4.2 | 3.8 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 |
| Other taxes | 0.6 | 0.4 | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 |
| Grants | 2.9 | 2.8 | 2.4 | 1.7 | 2.9 | 2.0 | 1.3 |
| Other revenue | 2.7 | 3.3 | 4.0 | 3.4 | 3.1 | 3.3 | 3.4 |
| Of which: Fees and penalties | 0.2 | 0.2 | 0.3 | 0.5 | 0.5 | 0.5 | 0.6 |
| **Expenditure** | **33.3** | **34.7** | **33.2** | **30.8** | **32.1** | **31.2** | **30.7** |
| **Expense** | 23.4 | 22.9 | 22.9 | 23.5 | 24.2 | 25.0 | 24.1 |
| Compensation of employees | 10.6 | 10.6 | 10.8 | 10.9 | 11.5 | 11.2 | 11.0 |
| Use of goods and services | 3.5 | 3.3 | 3.1 | 3.3 | 3.1 | 3.6 | 3.5 |
| Interest | 1.5 | 1.9 | 2.2 | 2.2 | 2.6 | 2.6 | 2.6 |
| Subsidies | 0.7 | 0.2 | 0.1 | 0.1 | 0.1 | 0.3 | 0.2 |
| Current transfers | 3.1 | 2.7 | 2.7 | 2.8 | 2.9 | 2.8 | 2.6 |
| Social benefits | 2.5 | 2.6 | 2.7 | 2.8 | 2.5 | 2.7 | 2.5 |
| Other expense | 1.4 | 1.6 | 1.8 | 1.5 | 1.6 | 1.7 | 1.7 |
| **Net acquisition of nonfinancial assets** | 9.9 | 11.8 | 10.3 | 7.3 | 8.0 | 6.2 | 6.6 |
| **Overall balance** | **-7.7** | **-10.3** | **-8.7** | **-8.1** | **-8.0** | **-6.7** | **-5.7** |
| **Net financing** | **7.7** | **10.3** | **8.7** | **8.1** | **8.0** | **6.7** | **5.7** |
| **Net foreign borrowing for budget** | **6.4** | **7.4** | **7.6** | **4.2** | **4.9** | **3.7** | **2.7** |
| **Net domestic credit** | **1.3** | **3.2** | **1.2** | **3.9** | **3.0** | **3.0** | **3.1** |
| **Net errors and omissions** | **0.2** | **-0.3** | **-0.1** | **0.0** | **0.0** | **0.0** | **0.0** |
| **Net other liabilities** | **-3.2** | **-4.4** | **-5.1** | **-4.0** | **-4.3** | **-3.5** | **-2.5** |
| Of which: Onlending | **-3.2** | **-3.7** | **-4.7** | **-4.0** | **-4.3** | **-3.5** | **-2.5** |
| **Total financing (incl. onlending)** | **11.1** | **14.4** | **13.6** | **12.1** | **12.3** | **10.2** | **8.3** |
| ***Memorandum items:*** | | | | | | | |
| Net foreign borrowing (incl. onlending) | 9.6 | 11.8 | 12.9 | 9.4 | 9.2 | 7.1 | 5.2 |
| Net acquisition of nonfinancial assets (incl. onlending) | 13.1 | 15.5 | 15.0 | 11.2 | 12.3 | 9.6 | 9.1 |
| GDP at current market prices (billions of Cabo Verde escudos) | 147.9 | 150.4 | 152.6 | 155.5 | 163.3 | 173.9 | 185.2 |

Source: World Bank staff estimates and projections based on data from the IMF, Ministry of Finance, and INE.

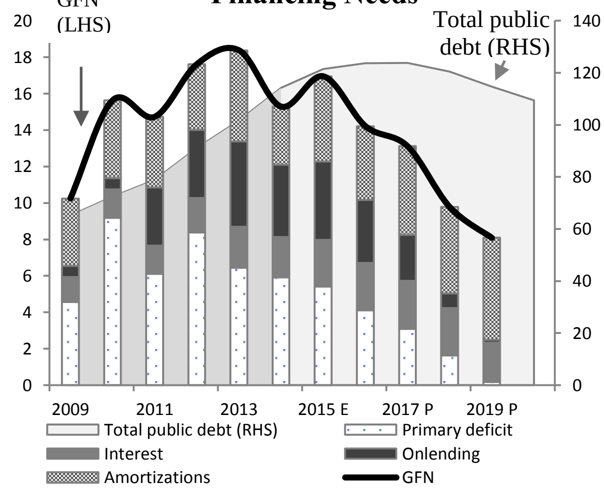
2.11 **The 2015 budget includes an increase in the VAT rate by 0.5 p.p. to finance the recovery efforts after the volcanic eruption in Fogo Island.** In 2014, the government financed expenditures in relation to the emergency efforts for the island of Fogo out of savings in other expenditures. The expected reconstruction costs in Fogo are yet to be determined but the government is already setting resources aside, financed by an additional increase in the VAT rate from 15 to 15.5 percent (except for water and energy).

2.12 **Overall, the deficit is falling, as fiscal policy becomes less expansionary, decelerating public debt dynamics, and rebuilding fiscal space needed to reduce poverty and foster inclusive and accelerated growth.** The fiscal deficit is expected to fall from a peak of 10.3 percent in 2012 to 8.0 percent in 2015, 6.7 percent in 2016 and 4.1 percent in 2018. Financing needs, including on-lending to SOEs, are also falling from 14.4 percent in 2012 to 12.3 percent in 2015, 10.2 percent in 2016 and 4.9 percent in 2018. Building fiscal space will be crucial for the government to continue its progress on the GPRSP III, ensure that it can continue to provide vital public services, and create fiscal buffers to attenuate future shocks from the global economy or from natural disasters.

### B. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

2.13 **The outlook for 2015 is cautiously optimistic.** As a small open economy, Cabo Verde depends strongly on the global economy, especially Europe. According to the April 2015 World Economic Outlook growth in the Eurozone will accelerate from 0.9 percent in 2014 to 1.5 percent in 2015. This remains below potential but the modest improvement may provide some impetus to Cabo Verde's economy. Deflation in Europe is a bigger threat as it reduces the country's relative competitiveness which could hit tourism exports, although recent quantitative easing measures by the European Central Bank appear successful in averting deflation in the Eurozone. Reason for optimism derives from the return of FDI. In addition, the recent monetary loosening, combined with the progress banks are making on repairing their balance sheets, is expected to eventually revive credit growth and thus stimulate private investment. 2015 growth is expected at 3.5 percent.

**Figure 2: Public debt and Gross Financing Needs**




*Source:* MoFP, IMF, and World Bank.

2.14 **In the medium term, growth is expected to recover to an average rate of 4 percent, below the rate of the boom years before the global financial crisis.** Although the persistent economic weakness of the years 2009-2014 is likely to end as the global economy recovers, the high growth rates of 6-8 percent from the time before the economic downturn in 2009 are unlikely to return. Publicly driven capital accumulation will no longer be a major driver of growth and, as the tourism sector matures, more moderate growth rates will continue to support the economy overall but at a more modest pace.[2] Further, fostering linkages between the tourism sector and the local economy will contribute to future growth. In addition, much hinges on the pay-offs from past public investments which were aimed at addressing the binding constraints of the country. Garnering the proceeds of the new infrastructures, improving their efficiency and productivity and linking them to economic activity will be decisive for future growth. The PRSC series and accompanying TA are supporting the government in these areas, to strengthen the foundations of private sector-led growth.

2.15 **Risks to debt sustainability have increased.** Public debt is currently expected to peak at 123.8 percent of GDP in 2017 and then decline gradually. Since the deficit (including onlending) already peaked in 2012, the delayed peak of public debt is driven by amortizations, especially as

[2] There is still much potential for growth in tourism. The Canary Islands receive 9 million tourists per year compared to 500,000 in Cabo Verde.

grace periods end (Figure 2). While the public debt is high, a deceleration has begun, driven by the primary deficit. The latest IMF-IDA DSA was published in September 2014, based on an IMF mission of January 2014. The risk rating was moderate. Although the rating may move to high in the next DSA,[3] the government may avert this—as it has done in the past—by decelerating the execution of public investment projects, and projects for a potential deceleration have already been identified. The government is strongly committed to maintaining a moderate risk of debt distress in the DSA.

2.16 **To address heightened debt vulnerability the government is increasing its efforts to improve debt management and reduce roll-over risk.** The government has expressed interest in a World Bank TA which will provide a new Debt Management Performance Assessment (DeMPA) in 2015 and will set out a road-map to further strengthen the debt office. The TA will also provide additional training to the government on conducting its own DSA on a regular basis. Similar training had already been provided in September 2014, in conjunction with training on the Medium-Term Debt Strategy (MTDS) which the government applies competently and regularly. In addition, the TA will focus on identifying new sources of external financing. This is crucial for the government against the backdrop of (i) increasing debt service due to the high debt stock, especially as grace periods end, (ii) a pegged exchange rate, (iii) the phasing out of concessional financing, and (iv) no access to international capital markets. The government is taking roll-over risk seriously and the TA will reduce the probability of a potential liquidity crunch for the government. Interest payments are expected to remain relatively low.

2.17 **The government's strong efforts to enhance the financial sustainability of SOEs reduce the potential for shocks to the debt trajectory stemming from contingent liabilities.** As a consequence of considerable structural reforms—including considerable cost recovery measures—SOE performance has been improving. Of the major five SOE's, only the Public Water and Electricity Company (ELECTRA) and Cabo Verde Airlines (TACV) reported deficits in 2013 and for both companies it is important to acknowledge the noticeable deficit reduction (by about 60 percent in the case of TACV). In 2014, TACV was at least temporarily profitable, due to the successful sale of its ground-handling operations. Cabo Verdean SOEs do not have a history of default. This means that neither commercial debt nor debt contracted through onlending from the central government is likely not to be serviced. However, SOE debt does constitute a contingent liability—not included in the baseline DSA—which needs to be contained. The government is further strengthening its oversight capacity and is entering into performance based management contracts (PBMCs) with SOEs to contain these risks—actions supported by this PRSC series. The WBG is also in the process of preparing a TA on SOE governance to further reduce the risk of contingent liabilities stemming from SOEs.

2.18 **The macroeconomic framework is adequate for budget support.** Cabo Verde was hit by a number of shocks, including spill-overs from the slow economic recovery in Europe and natural disasters. Economic performance has been weak, although GDP numbers released for 2013 and 2014 on April 24, 2015 exceeded estimated growth by 0.5 percentage points for 2013 and 1.7 for 2014 (while the deflator had been overestimated). The macro scenario assumed under this PRSC series can be considered conservative. In addition, the government is making considerable efforts to stabilize the fiscal accounts, decelerating the public investment program, containing

[3] Although Cabo Verde's exposure to the US dollar is small, the recent appreciation of the dollar increased the Present Value of the country's public debt.

current expenditures, raising new domestic revenue, improving debt management, and pursuing ambitious structural reforms. In an environment of strong economic headwinds, adequate policies, if implemented, are in place to counter them.

## C. IMF RELATIONS

2.19 **There is currently no IMF program in Cabo Verde.** After the second review of the Policy Support Instrument (PSI) in February 2012, Cabo Verde did not renew the program with the IMF. However, the IMF has been providing technical assistance both to the tax department and the central bank. Moreover, the government and the IMF agreed to strengthen Article IV surveillance and an IMF team has been visiting the country twice a year. The latest Article IV mission took place in February 2015.

## D. THE GOVERNMENT'S PROGRAM

2.20 **The GPRSP III reflects a consistent and broad consensus on the country's development strategy.** This consensus has been spelled out in various documents including the long-term Economic Transformation Strategy (ETS), prepared in 2003, and the first and second Growth and Poverty Reduction Strategy Papers adopted between 2004 and 2012. These strategies have consistently identified seven economic clusters designed to broaden Cabo Verde's economic base and strengthen the linkages of the prosperous tourism sector with the rest of the economy.

2.21 **While preserving consistency with the government's long term development vision, the GPRSP III includes several important policy shifts from earlier strategies.** The most important change is the greater emphasis on the structural reforms to foster productivity necessary for a more competitive and dynamic economy conducive to sustainable, inclusive and broad-based growth. Indeed, the GPRSP III sets out an ambitious agenda to improve the efficiency of public-sector investment and the management of SOEs, enhance the investment climate, enhance the functioning of the labor market and facilitate private-sector development.

2.22 **A second notable shift is the focus on eliminating extreme poverty through the development and modernization of the agriculture and fisheries sectors and promoting sharing prosperity through strengthening the linkages of the tourism sector with these primary sectors.** Because of the untapped potential of the agricultural sector, and, given the strong incidence of extreme poverty in rural areas, the GPRSP III directs special attention to enhancing agricultural productivity and its linkages with the tourism sector. Efforts to increase water mobilization, agriculture productivity and interconnectivity between tourist islands and the agricultural ones aim to increase the supply of domestic agriculture products to the tourism sector. In addition, policies on human capital development, in particular fostering technical, vocational education and training (TVET), are deemed as priority areas to boost shared prosperity.

2.23 **A third policy shift is the role of the private sector as the main protagonist of the new growth model.** The GPRSP III recognizes that recent economic growth and the need to smooth the effects of the external crisis on economic activity have resulted in a greater participation of the public sector in the economy. Due to the hard financial constraints faced by the public sector and the need to increase efficiency, the GPRS III clearly indicates that the private sector is expected to be the new driver of economic growth in the upcoming years.

2.24 **The GPRSP III supports the development of seven economic clusters through interventions organized under five axes:**

(i) Infrastructure. Policies under this axis are designed to alleviate remaining infrastructure bottlenecks by completing the government's public investment program in the areas of transportation, energy and irrigation networks, with an emphasis on interisland connectivity.

(ii) Human Capital. Objectives include: (a) to create a more competitive labor force, boosting employability and improving income distribution; (b) to strengthen competitiveness in technology-intensive industries; and (c) to enhance social protection policies.

(iii) Good Governance**.** The objective is to improve public financial management (PFM) by: (a) consolidating recent progress; and (b) supporting new initiatives in the national planning system, public investment management, monitoring and evaluation (M&E), development of statistical capacities and SOE reform.

(iv) Support to the Private Sector. The overarching goal of the GPRSP III is to shift the emphasis from public investment to private-sector growth through measures to enhance the business climate, expand trade openness and promote financial-sector stability and access to credit.

(v) Global Partnerships. In an environment of declining aid flows and reduced access to concessional financing, the government has responded with a comprehensive plan to diversify its trade and development relationships to include new partners, such as China, Brazil, the Arab world and the West Africa Region.

# 3. THE PROPOSED PRSC IX

## A. LINKS TO THE GOVERNMENT'S PROGRAM AND OPERATIONAL DESCRIPTION

3.1 **The PRSC IX closely mirrors the policy priorities identified in the GPRSP III.** In line with the goal of strengthening fiscal sustainability, the PRSC IX does not support new investments in infrastructure, which has been the main driver behind fiscal deficits and public debt. However, the PRSC IX does focus on infrastructure, and notably on the maintenance of infrastructure and better service delivery of public infrastructure services. This includes reforms of SOEs such as the port and airport SOEs, ENAPOR and ASA, aiming to make them financially sustainable, including through more private sector involvement, and to make them more accountable to government. Jointly, this will enable them to sustainably provide vital public services. On good governance, the PRSC supports several reform initiatives, both in the area of Public Financial Management (PFM), national planning, and SOE governance. Support to the private sector features strongly in the PRSC series with a number of initiatives aimed at improving the business climate (e.g. 'single window' systems for investments and trade), a strengthened financial sector, and the refund to businesses of outstanding claims for tax refunds.

3.2 **The two pillars of the PRSC IX, on enhancing macro-fiscal stability and the economy's competitiveness, are well aligned with the government's priorities.** Bolstering macro-fiscal resilience is an essential part of good governance which will strengthen the environment for the government to regain fiscal space for policy responses to shocks that may threaten the country's past and future achievements. A key challenge for future governments will be the debt service associated with the ambitious infrastructure upgrading. Rebuilding fiscal space is also important to ensure future governments' solvency. The PRSC IX's emphasis on competitiveness is closely aligned with the priorities of the GPRSP III which re-affirms the need to move toward a new economic growth model, based on competitiveness rather than capital accumulation.

3.3 **The design of the PRSC IX draws on a number of lessons learned from Cabo Verde's experience with previous operations in the PRSC series**. The ICR of the previous series (PRSC V to VII) prepared in FY13 highlighted that actions supported by TA and/or analytical work were more likely to succeed. The WBG's new CPS for 2014-2017 puts the PRSC at the center of the Bank's engagement in Cabo Verde, but makes considerable resources available to support the policy program with analytical work and TA, including in the areas of PFM, SOE governance, tourism, and the financial sector. The actions under PRSC IX and X have been streamlined to be better aligned with the WBG activities envisioned by the CPS. For example, emphases on labor market reform, social protection, and external auditing have been replaced with activities supported by WBG TA, such as the tourism board and laws governing insolvency and the supervision of microfinance institutions (MFIs). Another lesson from the ICR highlights the importance of strong donor coordination. The PRSC series continues its strong coordination mechanism for donors providing budget support through the joint review missions of the Budget Support Group, encompassing the World Bank, the African Development Bank, the European Union, as well as the development agencies of Luxembourg, Portugal, and Spain.

## B. Prior Actions, Results and Analytical Underpinnings

**Pillar 1: Enhance Macro-fiscal sustainability**

3.4 **This pillar reflects pillar 1 of the 2014-2017 CPS and focuses on strengthening macro-fiscal sustainability in Cabo Verde.** Aligning this pillar with the CPS implies a subtle alteration of the first pillar of the PRSC VIII which focused on 'good governance and public sector efficiency'. Under this area, social protection, which was envisioned as a supported area by the PRSC VIII, was dropped as it is not included in the WBG's program. This also means that the associated results indicator foreseen by the PRSC VIII was dropped. The UN is supporting the government on social protection. Pillar 1 focuses on domestic revenue mobilization, fiscal efficiency, and reducing contingent liabilities in SOEs, as key focus areas for strengthening fiscal resilience. Most prior actions for the PRSC IX and triggers for the PRSC X under this pillar reflect those envisioned by the PRSC VIII. Annex II provides an overview of the changes made, most of which are fine-turning or related to re-alignment with the pace of government reforms (which has been faster than expected in some areas). There are no substantive changes under this pillar from the PRSC VIII, apart from dropping the emphasis on social protection and on the Court of Accounts as foreseen for PRSC X, neither of which are supported by any WBG activities under the current CPS.

*a) Domestic revenue mobilization*

3.5 **Major reforms in support of domestic revenue mobilization were implemented under PRSC VIII. PRSC IX continues this focus.** Over the past years, the government added a number of new revenue measures, including new taxes and fees, and the increase and broadening of existing taxes. However, new tax measures only yield the expected results if the tax authority can work effectively. **Prior action 1** for the PRSC IX thus focuses on three new pieces of legislation that strengthen the tax authority: the General Tax Code, the Judicial Procedures for Taxation, and the Tax Execution Code. These codes are expected to enable the tax authority to expedite collection procedures, reduce tax evasion, and accelerate the clearance of tax arrears. **Prior action 2** is complementary to this focusing on new codes for individual and corporate income tax. They align income tax legislation with other new tax legislation, including the new tax benefits code and general tax code. They also serve to broaden the tax base, to reduce scope for tax avoidance, and to reduce the scope for legal disputes between the tax authorities and taxpayers. These prior actions are informed by the recent Country Economic Memorandum.

**Prior action 1:** Promulgated and published the General Tax Code, the Judicial Procedures for Taxation and the Tax Execution Code.

**Prior action 2:** Promulgated and published the Individual Income Tax Code and the Corporate Income Tax Code.

3.6 **PRSC X will round off the tax reform agenda by focusing on taxpayer services.** To ensure a well-balanced relationship between the tax authorities and taxpayers, especially in light of the additional efforts to raise additional domestic revenue, the government is improving its efficiency in dealing with taxpayers by enhancing its IT system, which will allow for a faster processing of tax claims. The system is supported by a TA by the IMF, and the World Bank is engaging on it through dialogue with the authorities. Operationalizing this IT system will be the *trigger* for PRSC X.

*b) Public Financial Management & National Investment System*

3.7 **PRSC IX continues the focus of PRSC VIII on budgeting and national planning, including a focus on establishing the National Investment System (NIS).** Among the key advances on the PFM agenda is the introduction of more efficient and transparent expenditure management systems, including program-based budget management system, together with a better M&E system, which is currently receiving further support through World Bank TA. The 2015 budget was presented on a programmatic basis for the first time. A new <u>budget framework law</u> is intended to institutionalize these major reforms which are currently not enshrined in law. The new <u>planning law</u> complements the budget framework law, mandating new planning tools, including the NIS which is being introduced with support of World Bank TA. The system is expected to be operational by late 2015/early 2016. Although Cabo Verde currently does due diligence on large investment projects, feasibility studies have considerable shortcomings, including a lack of (i) shadow prices, (ii) an automatized evaluation procedure to reduce decision bias, and (iii) an integrated link with national investment priorities. The new NIS is expected to increase the average realized return on future public investment projects due to a better appraisal system. Especially in an environment where fiscal resources are scarce and the government will need to do more with less, the NIS will play a crucial role in the national planning and budgeting process.

3.8 **With respect to procurement, the government has made noticeable progress in the past, but mechanisms for internal and external control are still relatively weak.** In particular, with respect to internal audit, further revisions to the legal framework for procurement are still required, as well as the extent of coverage and the system of controls and audits. Contradictions between the procurement code and other regulations as well as other loopholes are of particular concern. The government has thus prepared an important new <u>legislative package on procurement</u> to strengthen internal audit. **Prior action 3** of PRSC IX will combine key actions that consolidate progress on the PFM agenda, notably the new package of procurement legislation and the national planning law.

| |
|---|
| **Prior action 3:** Promulgated and published a) the Public Procurement Code and b) Law of the National Planning System. |

3.9 **The associated triggers for PRSC X will complete the PFM components of this PRSC series and operationalize the National Investment System.** The government submitted the budget framework law to parliament in 2014 and the law was rejected. Submitting a redrafted budget framework law to parliament will be the first associated *trigger* for PRSC X. With regards to national planning, operationalizing the NIS will be legally mandated by the new national planning law. The second associated *trigger* is thus the establishment of a project appraisal unit in the Ministry of Finance and Planning responsible for the issuance of a public investment manual. This will operationalize the NIS.

*c) Reducing contingent liabilities in SOEs*

3.10 **SOEs play a central role in Cabo Verde as they provide nearly all basic infrastructure services—yet also imply considerable contingent liabilities for the government.** The largest Cabo Verdean SOEs are responsible for the national ports, airports, aviation, electricity and water, and a large public housing project. These five SOEs account for 70 percent of state-owned capital and hold assets equivalent to 32 percent of GDP. Their total debt reached 26 percent of GDP in 2012. While SOE's debt that is guaranteed by the state amounts to just 5 percent of GDP, the critical importance of the services they provide means that the state lends them financial support even on their non-guaranteed obligations. In the past, TACV and ELECTRA have needed considerable capitalizations (about 0.7 percent of GDP in 2013), and the former is likely to continue to do so for the next few years. Accordingly, strengthening the operational and financial performance of SOEs is one of the top priorities of the government under the GPRSP III, both to ensure efficient and sustainable service provision and reduce contingent liabilities that may threaten fiscal stability.

3.11 **To tackle contingent liabilities in SOEs, PRSC IX focuses further on strengthening the central government's oversight of its SOEs.** PRSC VIII enhanced the institutional strength and mandate of State Participations Service (SPE) at the General Directorate of the Treasury (DGT) of the Ministry of Finance and Planning, which is primarily tasked with SOE oversight through decree law No 37/2013. This is a crucial condition for the government to hold SOEs accountable, in particular through performance-based management contracts (PBMCs). In 2011, a first PBMC was signed between the government and ELECTRA, defining the responsibilities of the SOE's board of directors and the MoFP and providing a set of performance objectives measured by time-bound indicators and targets. This 2011 PBMC was already supported by PRSC VII. With the additional institutional strengthening of the SPE under PRSC VIII, PBMCs will be more effective and PRSC IX thus supports the signing of three additional PBMCs with SOEs—namely TACV, the national airport agency (ASA), and the national port agency (ENAPOR)—as **prior action 4**. The prior action includes an additional focus on TACV, traditionally the SOE with the largest losses which is being restructured, partly supported by World Bank TA. A 2-year recovery plan to support the PBMC is thus also part of this prior action. The associated *trigger* for PRSC X will be an analytical, comprehensive, annual report on all SOEs, including both key operational and financial data per SOE, which will be evidence of a fully operational and capable M&E system at the SPE.

| |
|---|
| **Prior action 4:** Approved a 2-year recovery plan for TACV, as well as performance based management contracts for TACV, ASA, and ENAPOR. |

**Pillar 2: Strengthen competitiveness**

3.12 **This pillar mirrors pillar 2 of the CPS as well as the government's endeavors to enhance the competitiveness of Cabo Verde's economy, articulated in the GPRSP III.** Activities in this area focus on the following areas: (i) infrastructure management; (ii) investment climate; (iii) financial sector stability; and (iv) environmental sustainability. While the prior actions for PRSC IX are generally the triggers envisaged by PRSC VIII, some of the triggers for PRSC X were adjusted to be better aligned with the new CPS and the WBG's program in Cabo Verde. This means that a trigger for PRSC X—and associated results indicator—on labor market reform was dropped, mainly because it is supported by the ILO.

*(a) Infrastructure management*

3.13 **Over the past 10 years, Cabo Verde has invested considerably in infrastructure, removing hard constraints to growth. It is now important to sustain it.** The government invested in energy, ports, airports, roads, dams and other infrastructure, the main reason behind the high debt-to-GDP ratio. To ensure that theses investment provide sustainable services to the economy, they have to be managed properly. In addition, there is also a fiscal dimension since maintenance costs have to be factored into the national budget. Activities under PRSC IX and X in this area broadly build on activities from PRSC VIII, especially in energy and ports, and add a focus on road maintenance, which is supported by a Bank TA.

3.14 **With respect to energy, progress has been remarkable but reforms are not yet complete**. The country's energy generation capacity is 156 MWs, of which almost 25 percent is renewable. In 2012, 95 percent and 60 percent of the population have access to electricity and running water services, respectively, and attaining 100 percent for electricity is expected for 2015. The reforms of ELECTRA have been a success story, turning the company around, addressing problems relating to (i) insufficient investment in generation capacity, which resulted in chronic power and water shortages; (ii) non-cost-recovery electricity tariffs and inadequate pricing mechanisms; (iii) heavy reliance on imported oil products for power generation; and (iv) weak governance and management structure of ELECTRA. These measures resulted in a gradually improving financial performance as well as better service delivery, witnessed, for example, by a considerable fall in electricity outages. Activities supported by PRSC VIII have helped ELECTRA reduce its arrears to suppliers. To further improve its financial ability to provide energy services it is vital to reduce commercial losses induced by widespread energy theft. **Prior action 5** thus focuses on legislation that penalizes illegal connections to the ELECTRA network in order to reduce commercial losses. The associated *trigger* will support the implementation of the law, focusing on the passing of the accompanying regulations.

**Prior action 5:** Promulgated and published the Law on the criminalization of illegal connections to the ELECTRA network.

3.15 **Considerable investments in roads have yielded impressive results—which will now need to be maintained.** Cabo Verde has a relatively dense network consisting of 1,350 km of road spread across its nine inhabited islands—334 km of road per thousand square km, compared to an average of just 81.5 km for Africa as a whole. With Bank support steady progress has been achieved in the institutional reform of the road sector. Key achievements include: (i) the creation of a road maintenance fund that generates approximately US$6m annually; (ii) the establishment of a dedicated Roads Agency (*Instituto de Estradas*, IE); and (iii) the introduction of a two-year performance-based maintenance contract (PBMtC). PRSC IX will support the signature of an additional four PBMtCs between IE and its private contractors under **prior action 6**, consolidating the achievements on road maintenance management.

**Prior action 6:** Approved Performance Based Maintenance Contracts between IE and its private contractors for the islands of Santo Antão, São Nicolau, Fogo, and Maio.

3.16 **Infrastructure service providers have increasingly been able to recover their costs. The PRSC IX is going to continue efforts in this area.** PRSC VIII supported actions to help the SOEs ELECTRA, ENAPOR, ASA and TACV to recover their costs, which is crucial to make these companies financially sound and reduce their need for government capitalizations. PRSC VIII supported the airport authority ASA in collecting a security fee of 2 euros which has supported the company's income statements. In order to further improve the financial sustainability of ASA, whilst keeping it internationally competitive, the government is committed to reviewing its policy with regards to airport fees and tariffs for regional flight monitoring (FIR). **Prior action 7** of the PRSC IX will support these fee adjustments, as ASA applies respectively to the domestic regulator (AAC) and the international regulator (IATA) for permission to adjust the fees.

**Prior action 7:** Approved applications presented by ASA for the review of airport fees and for the adjustment of tariffs for regional flight information (FIR) services to the respective regulators (AAC and IATA), and confirmed its continued commitment to review these fees and tariffs.

3.17 **One key goal of the infrastructure management agenda is increasing private sector participation. The PRSC X is going to consolidate the agenda by focusing on the operationalization of the PPP unit.** The government of Cabo Verde intends to provide certain infrastructure services in close cooperation with the private sector through PPP arrangements. This can help ensure that the national infrastructure is efficiently managed, especially if foreign investors can bring their expertise to bear. The government has set in place a PPP unit and the WBG is already supporting the government in PPP negotiations. Fully operationalizing the PPP unit will be the trigger for the PRSC X that will complete the infrastructure component of this PRSC series.

*b) Investment climate*

3.18 **Cabo Verde's ranks 122nd in the 2015 Doing Business (DB) rankings, following continuous improvements over the past years.** An ambitious reform agenda between 2010 and

2011 yielded considerable improvements in the investment climate. In 2011 and 2012, DB recognized Cabo Verde as one of the top 10 reformers worldwide. The 2014 DB shows a further improvement of 7 ranks, although the country slipped by 4 positions in 2015. This is a strong reminder to remain ambitious on investment climate reforms. The approval of the investment code supported by the PRSC VII eliminated the distinction between domestic and foreign investors in the law and PRSC VIII streamlined customs procedures through new regulations for the 2010 Customs Code. PRSC IX will continue supporting this agenda by focusing on a "single window system" for investments, which will significantly expedite the registry and license of operations by foreign investors, and the concession of tax benefits, which with the new investment and tax benefit codes—supported by PRSC VIII—will also be applied to domestic investors. The single window for investments is **prior action 8** of PRSC IX. The associated *trigger* for PRSC X is the establishment of a single window for international trade, integrating the port procedures of ENAPOR with the customs procedures of the General Directorate of Customs. Consolidating these systems will produce important efficiency gains for both international trade firms and public administrative agencies.

**Prior action 8**: Established a single window system for investments.

3.19 **Given the importance of enhancing private sector activity, the PRSC X envisages two additional triggers in support of a more enabling investment climate.** One trigger continues the focus on DB reforms. According to standards applied in DB, Cabo Verde does not currently have an insolvency law. Yet an orderly way to fail is a final but crucial part of a business's 'life cycle'. An insolvency informed by international good practice is also likely to have a considerable effect on Cabo Verde's DB rating. Submitting the draft insolvency law to parliament is the second associated *trigger* on the investment climate. This *trigger* is associated with TA the World Bank provided on access to finance issues, in support of the government's Financial Sector Development Strategy. The third associated *trigger* focuses on the establishment of a tourism board, which is a recommendation from a World Bank TA which was welcomed by the government. The tourism board will strengthen the voice of the private sector and other stakeholders and enhance backward and forward linkages and the overall multiplier effect of the sector on the economy.

c) *Financial sector stability*

3.20 **Vulnerabilities in Cabo Verde's financial system have heightened and need to be addressed urgently.** A 2013 Bank ESW demonstrates that the global financial crisis and following recession in the Eurozone spilled over into the Cabo Verdean economy in general and the financial sector in particular. Asset quality has deteriorated, nonperforming loans increased to about 20 percent, and credit growth all but stalled, posing a considerable constraint to private sector investment. The ESW identified the adoption of two financial sector laws as a key condition for the Central Bank of Cabo Verde (BCV) to adequately carry out its monitoring and supervision duties, as they would expand the regulatory and supervisory powers of the BCV, limit BCV-financing of deposit insurance schemes to exceptional circumstances—on a temporary basis only and with adequate safeguards—and consolidate onshore and offshore banking regulations into a harmonized financial code. PRSC VIII thus made these laws a trigger and PRSC IX maintains it as **prior action 9**.

3.21 **A sound banking system is important to provide financial services to businesses. Improving access to finance will consolidate the financial sector-related activities of this PRSC series.** To further support credit growth, and in particular to smaller businesses that currently cannot easily obtain credit, the associated *trigger* for PRSC X will focus on measures to improve access to financing, including but not exclusively in relation to microfinance and MFIs. The Bank is providing TA to BCV, supporting the design of a Financial Sector Development Strategy aimed especially at improving access to credit. The adoption by the government of this strategy—and implementation as evidenced by submitting the MFI law to parliament—will be the trigger for PRSC X.

**Prior action 9:** Promulgated and published the Financial Institutions Law and the Basic Financial System Law.

*d) Environmental sustainability*

3.22 **Sustaining Cabo Verde's natural assets is crucial, not least because they are the foundation for agriculture and a major attraction for tourists, the drivers of growth and poverty reduction.** Coastal erosion, soil degradation, deforestation and the mismanagement of limited water resources all have a severely negative effect on the country's growth prospects, and the cost of environmental damage will likely be borne most heavily by the poor. In addition, as a small-island nation Cabo Verde faces significant additional challenges associated with climate change, especially rising sea levels and the increased frequency of severe weather patterns, which may provoke increasing droughts and flooding. Cabo Verde has established a number of important laws and regulations to control environmental degradation. Cabo Verde has made steady progress on improving its environmental framework, including issuing decrees that define protected areas and requiring environmental impact assessments to be completed for all public and private investment projects. However, weak enforcement capability, a lack of coordination among government entities, poor management of environmental issues and a lack of complementary regulations prevent the full application of the legal framework for environmental protection.

3.23 **PRSC IX and X will further support measures to strengthen environmental protection.** PRSC VIII supported the establishment of 14 protected areas which was crucial to delimit areas for environmental preservation and halt activities that erode it (including those stemming from the tourism sector). PRSC IX will turn to the financing of environmental protection. A recent PEMFAR noted that while environmental spending had been relatively high, the decline in donor support put environmental spending at risk. The government is taking important steps in this area. The reform of the Ecological Tax approved in August 2012 represents a significant improvement over the previous law of 2010, and revenues generated by the tax will be allocated to the Environmental Fund, which finances environmental projects at the national and municipal levels. **Prior action 10** of PRSC IX will be the definition of the Environmental Fund's project-selection procedural manual. The associated *trigger* for PRSC X will focus on enforcing a new legal framework that bans activities that undermine environmental sustainability, such as beach-sand extraction—since beaches are the main natural asset attracting tourists in Cabo Verde. This consolidates the environment-related activities supported by this PRSC series, ranging from the legal framework in PRSC VIII, to making the Environmental Fund operational in PRSC IX, to the enforcement of environmental laws under PRSC X.

**Prior action 10:** Approved the procedural manual for the selection of projects under the Environmental Fund.

3.24 **The proposed PRSC IX is based on a number of analytical studies and technical assistance activities produced by the Bank over the last three years**. These studies provide a solid analytical foundation for identifying prior actions and triggers supported by the two remaining operations of the PRSC series (see Table 3 below).

3.25 Table A4 in Annex 2 provides an overview of the status of the prior actions.

**Table 3: Analytical Underpinnings and Prior Actions and Triggers**

| ESW, NLTA, Policy Notes | Contribution to PRSC series and Accompanying Program Document |
|---|---|
| Cabo Verde: Country Economic Memorandum (2013) Chapter 4 on Tax Incentives, Chapter 7 on Tourism and Environment | PRSC IX prior actions 1, 2, and 10; PRSC X triggers 1 and 11. |
| Cape Verde: A Diagnosis of Cape Verde's Public Investment Management System (2012) | PRSC IX prior action 3 and PRSC X trigger 3. |
| Cape Verde: Public Expenditure Management and Financial Accountability Review - PEMFAR (2012) | PRSC IX prior action 3 and PRSC X triggers 2 and 3. |
| Policy Note on SOEs institutional arrangements (2012) | PRSC IX prior action 4 and PRSC X trigger 4. |
| Cape Verde: Inter-island Transport Study (2011) | PRSC IX prior action 6. |
| Review of the air and port sectors in Cape Verde (IFC), (2012) | PRSC IX prior action 7. |
| Cape Verde : Policy Note on Macro-Financial Sector Vulnerabilities (2013) | PRSC IX, prior action 9 and PRSC X trigger 9. |
| Tourism Development in Cape Verde: Is it Time to Abandon the All-Inclusive Model? (2013) | PRSC X trigger 9. |
| Cabo Verde: Financial Sector Development Strategy (2014, draft) | PRSC X triggers 8 and 10. |
| Country Economic Memorandum (2013), ESW on Macro-financial sector vulnerabilities (2013), TA report on debt management (2014) | Adequacy of the macroeconomic framework |

## C. LINKS TO THE CPS AND OTHER BANK OPERATIONS

3.26 **The PRSC IX is aligned with the new CPS for 2014-2017.** In fact, the two pillars of the PRSC IX—on enhancing macro-fiscal stability and competitiveness—are identical to those of the CPS. Moreover, the PRSC series will be the main vehicle for the WBG's engagement in Cabo Verde, devoting 75 percent of the available IDA envelope to budget support.

3.27 **A number of WBG activities will be complementary to the PRSC series.** The first is the IBRD's Cabo Verde Recovery and Reform of the Electricity and Water Sectors Project (RREWSP) designed to support the comprehensive recovery of the energy sector. The second is the Cabo Verde Transport Sector Reform Project (TSRP) that provides TA to the government for the design and implementation of improvements in the management of SOEs responsible for air and maritime transportation, as well as a set of reforms designed to increase the participation of the private sector in the delivery of transport services, and is also offering assistance on the PPPs. The third is the Cabo Verde's Small and Medium Enterprises Capacity Building and Economic

Governance Project (SMECBEGP), which supports improvements in trade facilitation and the investment climate by financing the single-window systems for investments and trade. An Institutional Development Fund (IDF) is supporting the design and operationalization of the NIS. A TA on the government's Financial Sector Development Strategy has accompanied the preparation of the PRSC IX and is expected to be concluded in late 2014. Some of the recommendations will be followed up through a new TA focused on enhancing the country's competitiveness. Finally, a new governance project is currently being prepared which will support the implementation of the M&E system of the SOE unit in the SPE, amongst others.

### D. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

#### Consultations

3.28 **The PRSC IX draws on the GPRSP III which was prepared in a highly participatory manner", according to the 2014 Joint Staff Advisory Note (JSAN).** Several workshops were held on the GPRSP III and a Bank delegation attended the fourth such workshop in January 2014. The PRSC IX also builds on the insights of the 2nd National Forum on the Transformation Agenda which was organized by the Cabo Verdean Prime Minister's office in May 2014 and reinforced the need to move toward a competitiveness-driven economy. Finally, the policy matrix was discussed with the Department of National Planning (DNP) at the Ministry of Finance during the budget support group review mission in November 2014.

#### Collaboration with Development Partners

3.29 **Cabo Verde's major bilateral and multilateral donors are coordinating their engagement and resources through the 6-member Budget Support Group (BSG).** The BSG is governed by a Memorandum of Understanding (MoU) in 2006. Under this MoU, the "Partnership Framework between Budget Support Partners and the Government for the Provision of Budget Support", the BSG supports the GPRSP III jointly, with two annual supervision missions per month. The joint review enhances donor coordination and harmonization. The Bank is the current BSG coordinator and in the absence of an IMF program, the Bank has assumed the responsibility of providing macroeconomic assessments to the other BSG members.

## 4. OTHER DESIGN AND APPRAISAL ISSUES

### A. POVERTY AND SOCIAL IMPACTS

4.1 **The evidence base on poverty and poverty dynamics in Cabo Verde needs to be strengthened. The World Bank is increasing its efforts in this area.** The latest poverty data are based on a representative household survey from 2008. A poverty map was prepared in 2012, combining data from the 2008 expenditure survey and the 2010 census. Capacity and financing constraints in the national statistics office (INE) have resulted in a lack of expenditure surveys since, which means that there is little information on poverty in Cabo Verde. While it is likely that poverty has increased in response to the economic downturn after the global financial crisis, there is no evidence base to evaluate the extent. The World Bank is providing a Non-Lending Technical Assistance (NLTA) that works with INE both to improve access to poverty data and an effort will be made to impute poverty dynamics from annual multi-objective surveys through survey-to-survey imputations. These surveys have been carried out since 2011.

4.2 **In spite of the absence of poverty data, the reform program supported by this operation is expected to have positive long-term impacts on poverty and social conditions in Cabo Verde.** Considerable poverty reduction between 2002 and 2008 coincided with a period of high economic growth, fuelled by large inflows of FDI. This supports the notion that growth has a considerable pass-through for poverty reduction, and it is corroborated by the poverty map which demonstrates that the touristic islands, i.e. the main beneficiaries of FDI, have the lowest poverty rates. The PRSC series supports the government in returning to the growth rates that have facilitated the progress on human development outcomes, including poverty and shared prosperity, in the past. Growth will also support the livelihoods of the more vulnerable members of society, including women. Although the unemployment rate for women is lower than for men (15.2 percent compared to 16.3 percent for men), female labor force participation is 14 percentage points below male participation and women are jobless for a significantly longer time than men, according to 2014 data from INE. Women thus have particularly much to gain from economic growth and job creation.

4.3 **Better public service delivery, supported by this PRSC series, is crucial for alleviating poverty.** This PRSC series has a strong emphasis on the delivery of services. Improving the efficiency of infrastructure and expanding social-service delivery is expected to benefit the poor through increased access to essential services, reduced transportation costs, lower import costs, and the economic integration of less-developed islands through improved inter-island transport services. Better public services, as well as support to public goods, such as environmental preservation, are also good for sustainable growth, and in turn, poverty reduction.

## B. Environmental Aspects

4.4 **The specific actions supported under the proposed PRSC IX are likely to have positive effects on the country's environment, including the integrity of its agricultural land, forests, fisheries and other natural resources**. Protecting the country's natural assets is vital to maintain the national wealth and also to continue attracting tourists to the archipelago. The PRSC IX focuses on the operationalization of the Environmental Fund which is currently being replenished with resources from the Environmental Tax (supported by PRSC VIII). The Environmental Fund supports investments by the central government as well as municipalities in environmentally important projects and also makes resources available for environmental education.

4.5 **Improving evaluation mechanisms for public investment projects is expected to further enhance the preservation of natural assets.** The NIS will include environmental impact assessments as an important criterion for public investment decisions. The BSG is also concerting its efforts to improve the M&E framework for environmental aspects.

## C. PFM, Disbursement and Auditing Aspects

4.6 **PFM and procurement systems in Cabo Verde are generally sound.** PFM was one of the core policy areas of the previous PRSC series, and improvements in this area have been highly satisfactory. A recent PEMFAR prepared in 2012 highlighted the substantial improvements that have been made in recent years and designed a reform plan for further improvements. The budget laws are published on time, fiscal reporting is regular and the coverage of the budget is reasonable. The successful implementation of the reform agenda defined in the 2004 Country Procurement Assessment Review and a major capacity-building program to train public-sector staff on new procurement procedures have been highly successful and the country has one of the most sophisticated and transparent procurement systems in the Africa region. However, performance in other critical areas, such as accounting, external audits and legislative oversight, still requires improvement. The recent BSG mission recommended the adoption of an action plan to clarify government priorities and inform donor offers of technical assistance, in line with the upcoming Public Expenditure and Financial Accountability (PEFA) assessment. Indeed, the proposed PRSC series supports the adoption of budget programming and the review of the procurement code.

4.7 **The IMF's most recent assessment of the BCV was carried out in 2008 and the central bank has since been making considerable progress on the reform recommendations.** The assessment found that while the BCV has taken steps to strengthen its safeguard framework since the previous assessment. Further measures that have since been undertaken to strengthen the safeguard framework include the adoption of International Financial Reporting Standards (IFRS), the development of reserves-management procedures, the introduction of an internal audit function, and the rotation of external auditors. Notwithstanding these advancements safeguard challenges remain. The BCV adopted remedial actions to address these issues, as verified during the most recent IMF mission in 2015. The fiduciary risk is considered low and Cabo Verde's PFM system is adequate for the operation. There is no need for additional fiduciary measures, such as a dedicated account.

4.8 **Disbursement.** The proposed operation would consist of a single tranche of SDR 7.2 million (US$10 million equivalent) to be made available upon effectiveness and disbursed on the basis of a withdrawal application. The credit will follow the Bank's disbursement procedures for development policy financing. Once the credit becomes effective and provided IDA is satisfied with the Country's macroeconomic framework and with the program being carried out by the Recipient, the credit will be deposited at the BCV into an account that forms part of the country's official foreign-exchange reserves. The Recipient shall ensure that upon the deposit of the credit into said account an equivalent amount in Cabo Verdean Escudos (CVE) is credited in the Recipient's budget management system in a manner acceptable to IDA. The Recipient will report to IDA on the amounts deposited in the foreign-currency account and credited to the budget-management system. If the proceeds of the credit are used for the ineligible purposes, as defined in the Financing Agreement, IDA will require the Recipient to refund an amount equal to the amount of said payment to IDA promptly upon notice from IDA. Amounts refunded to the Bank upon request shall be cancelled.

4.9 **Auditing.** Through the MoFP the Recipient will: (i) report, within 30 days from the date of receipt, the exact sum received into the account; (ii) ensure that all withdrawals from the Single Treasury Account are for budgeted public expenditures, excepting military expenditures or other items on IDA's excluded expenditure list; and (iii) provide IDA with evidence that the Cabo Verdean currency (CVE) equivalent of the Credit proceeds were credited to the Single Treasury Account and that disbursements from that account were for budgeted public expenditures. The CoA is expected to provide IDA with its annual report to Parliament on the public accounts by the end of the year following the execution of the budget. IDA will reserve the right to request an audit of the Single Treasury Account should the need arise. If an audit is requested, a legally registered audit firm will be contracted to perform the audit in accordance with terms of reference to be agreed upon with the government. Audit costs will be met by the government. The administration of this credit will be the responsibility of the Ministry of Finance and Planning. The closing date of the credit is December 31, 2015.

### D. IMPLEMENTATION, MONITORING AND EVALUATION

4.10 **The DNP at the MoFP will be responsible for the overall implementation of the proposed operation and for reporting on its progress.** The Bank will vet the prior conditions for effectiveness and disbursement. It will be the responsibility of the DNP to present this information in a timely manner and in a format satisfactory to the Bank.

4.11 **The M&E system that supports the implementation of the GPRSP III will be instrumental to assessing progress on the reforms included in the proposed PRSC series.** Since the previous PRSC series, the World Bank team has worked in close collaboration with the Government and its budget support partners to ensure adequate monitoring and evaluation. There are still shortfalls in the country's M&E system and the BSG has established a working group to resolve these issues jointly. The World Bank is supporting the improvement of the M&E system through a Trust Fund for Statistical Capacity Building.

4.12 **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 Development Policy Operation 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.

4.13 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.

4.14 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

## 5. SUMARY OF RISKS AND MITIGATION

5.1 **The overall risk rating for the PRSC IX is 'moderate', with four sources of risks associated with a moderate or higher risk rating.** The risk ratings in Table 5 follow the four-point rating scale from low (L), to moderate (M), substantial (S), and high (H). The identified risks for this operation relate to (i) political and governance risks, (ii) macroeconomic risks, (iii) institutional capacity for implementation and sustainability, and (iv) environmental and social risks. Other risks with a rating of 'low' are considered residual. The following sections describe risks that are considered 'moderate' or higher, also highlighting mitigation mechanisms where applicable.

**Table 4: Risk Assessment**

| Risk categories | Rating (H, S, M, or L) |
|---|---|
| 1. Political and governance | M |
| 2. Macroeconomic | H |
| 3. Sector strategies and policies | L |
| 4. Technical design of project or program | L |
| 5. Institutional capacity for implementation and sustainability | M |
| 6. Fiduciary | L |
| 7. Environmental and social | M |
| 8. Stakeholders | L |
| **Overall** | **M** |

*Political and governance risks*

5.2 **Political risks are considered to be moderate in light of the 2016 elections.** Governance is strong in Cabo Verde, but political risks in relation with the upcoming legislative, municipal and presidential elections, jointly to be conducted in 2016, cannot be discounted. A large number of academic studies demonstrates that fiscal policy tends to be expansionary when elections loom.[4] This could undermine the fiscal consolidation effort supported by this PRSC series, and especially pillar I on macro-fiscal stability. Evidence of pre-electoral fiscal expansions in Cabo Verde is weak, however. For example, in 2011, during the last round of elections, the fiscal deficit was lower than in 2010 and 2012. The Bank, in close coordination with the IMF and also members of the BSG, will support mitigation of these risks through active policy dialogue with the government.

*Macroeconomic risk*

5.3 **The fragile economic recovery poses a high risk to the operation.** Compared to the high growth figures of the time before the global financial crisis, the expected average growth of about 4 percent in the medium term is conservative. However, economic realities have changed as the country switches to a new development model driven by competitiveness. The success of this new model partly hinges on the public investments of the past eventually yielding the expected growth dividends. This will also be important to ensure that SOEs are able to service their debt obligations resulting in considerable contingent liabilities to the government. Moreover, the private sector has to be able to respond to the associated new economic opportunities, which is difficult in an environment where the financial sector focuses on repairing its balance sheets. Finally, the global economy, including European economies, remains fragile and Cabo Verde's fiscal space to absorb further shocks has been exhausted. Deflation in Europe threatens the economic health of Cabo Verde both through the channel of external competitiveness and a low GDP deflator which results in lower than expected ratios of fiscal variables (including public debt) to GDP. Although the threat of deflation in the Eurozone appears to have been averted through the European Central Bank's quantitative easing program, it is important to remain vigilant. Unexpected economic headwinds have the potential to imperil the development objective of enhancing macro-fiscal stability and fostering private sector-led growth.

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[4] See, e.g. M. Hanusch and P. Keefer (2014) 'Younger parties, bigger spenders? Party age and political budget cycles', *European Economic Review*, 72:1-18.

5.4 With respect to realizing the expected returns of the infrastructure agenda, the government is making a considerable effort to strengthen its oversight of SOEs and to further engage the private sector in infrastructure management through PPPs, efforts that are supported by the PRSC series and WBG TA. This TA will also help contain the large contingent liabilities in SOEs which can result in shocks to the trajectory of public debt-to-GDP. With respect to enabling the private sector, the government is—with accompanying WBG TA—supporting activities such as establishing a tourism board, an SME finance project, a Financial Sector Development Strategy, and the passing of the insolvency law.

*Institutional capacity for implementation and sustainability*

5.5 **Capacity of the civil service is relatively high Cabo Verde. However capacity gaps exist, justifying a 'moderate' risk rating on institutional capacity for implementation and sustainability.** Cabo Verde's 2013 CPIA score on the cluster 'public sector management and institutions' is 4.1 which is high for IDA countries. However, it is important to bear in mind that Cabo Verde continues to be a lower middle income country, and it experiences capacity shortfalls in some areas as do its peers in that income category. Weak capacity in some areas constitutes a moderate risk for this operation in many ways. It can undermine the goal of fiscal sustainability if capacity building TA in the tax office does not yield the expected results; it can limit the effectiveness of the government's oversight capacity of SOEs if capacity building in the SPE falls short of expectations. Strengthening the government's capacity to monitor policy outcomes through a functional M&E system will be crucial to eventually implement program-based budgeting. Whilst all these areas constitute risks, mitigation efforts are in place for all of them, building capacity through World Bank TA and/or policy dialogue, in close coordination with a large number of other development partners.

*Environmental and social risks*

5.6 **Cabo Verde is highly vulnerable to natural disasters, which can pose a moderate risk to the PRSC series.** The most recent eruption of the volcano in Fogo island has demonstrated the country's vulnerability to natural hazards. Information provided by the UN (based on information from *PreventionWeb*) suggests that natural hazards that have affected Cabo Verdeans the most between 1980 and 2010 are: (i) drought (46.2 percent of the population affected), (ii) epidemics (37.6 percent), (iii) storms (8.9 percent), and (iv) volcanic eruptions (7.3 percent). Indeed, in 2014, Cabo Verde experienced another drought, adversely affecting the incomes of farmers and especially the poor. Natural disasters, such as the recent eruption of the Fogo volcano, can also undermine the conditions for private sector activity—when destroying vital infrastructure—and put pressure on the national budget in view of emergency recovery and reconstruction needs. Cabo Verde has disaster risk management plans in place and when natural disasters materialize the government receives strong support from humanitarian agencies. The WBG has systems in place to support recovery assessments and longer-term recovery efforts (currently ongoing for the case of Fogo), thus moderating the impact of natural disasters.

## Annex 1: Policy and Results Matrix

| Component | Prior Actions PRSC 8 | Prior actions PRSC 9 | Indicative Triggers PRSC 10 | Results Framework | 2012 Baseline | 2013 | 2014 | 2015 | 2016 Target |
|---|---|---|---|---|---|---|---|---|---|
| **Pillar 1:** ***Enhance Macro-Fiscal Sustainability:*** *rebuilding macroeconomic buffers to absorb external shocks and enhancing public sector efficiency.* | | | | | | | | | |
| **Domestic Revenue Mobilization** | | | | | | | | | |
| | **1.** Approval by the Recipient's Parliament of the 2013 Budget Law No 23/VIII/2012 which contains measures to augment domestic revenues, including: (i) increasing the value added tax (VAT) rate applied to hotels and restaurants from 6 percent to the standard rate of 15 percent; (ii) increasing the VAT collection base for energy, water, communications and road-transportation services; (iii) expansion of the tax base of the Ecological Tax; (iv) establishing a "tourism fee" of Euro 2 per guest-night; and (v) establishing a statistical fee for custom services<br><br>**2.** Approval by Parliament of the Tax Benefit Code (TBC) | **1.** Promulgated and published the General Tax Code, the Judicial Procedures for Taxation and the Tax Execution Code<br><br>**2.** Promulgated and published the Individual Income Tax Code and the Corporate Income Tax Code | **1.** Implement the planned IT infrastructure to improve taxpayer services | Domestic-revenue-to-GDP ratio (%)<br><br>Overall deficit to GDP ratio (%)<br><br>Total Financing including on-lending to SOEs to-GDP ratio (%) | 21.6<br><br>10.3<br><br>14.4 | 22.1<br><br>8.7<br><br>13.6 | 21.0<br><br>8.1<br><br>12.1 | | 23.0<br><br>lower than 7<br><br>lower than 10 |

| Component | Prior Actions PRSC 8 | Prior actions PRSC 9 | Indicative Triggers PRSC 10 | Results Framework | 2012 Baseline | 2013 | 2014 | 2015 | 2016 Target |
|---|---|---|---|---|---|---|---|---|---|
| **Public Financial Management & National Investment System** | | | | | | | | | |
| | **3.** Approval by the Recipient's Council of Ministers of Decree-Law No 20/2013, establishing the legal framework for the Single Treasury Account which introduces a unified document for the collection of taxes and non-tax revenues and consolidates all bank accounts held by different ministries and public agencies into a single account held by the Recipient's General Directorate of the Treasury (DGT). | **3.** Promulgated and published a) the Public Procurement Code and b) Law of the National Planning System | | Percentage of ministries and government entities in the Single Treasury account | 0 | 80 | | | 100 |
| | | | **2.** Submission to parliament of the re-drafted budget framework law | Percentage of Sector Ministries implementing Programmatic-Based Budgeting | 0 | 0 | | | 100 |
| | | | **3.** Establishment of a project appraisal unit at the National Directorate of Planning (DNP) responsible for the issuance of a public investment manual | Percentage of new public investment projects in the budget appraised by the NIS | 0 | 0 | 0 | | higher than 50 percent |
| **SOE's Oversight and service delivery quality** | | | | | | | | | |
| | **4.** (a) Adoption by Council of Ministers of the Decree-Law No 37/2013 which expands the mandate of the Recipient's State Participations Service (*Servico de Participacoes do Estado (SPE)*; (b) issuance of the State Owned Enterprises (SOEs)s Aggregate Contingent Liability Report of 2012; and (c) | **4.** Approved a 2-year recovery plan for TACV, as well as performance based management contracts for TACV, ASA, and ENAPOR | **4.** An analytical, comprehensive, annual report on all SOEs, including both key operational and financial data per SOE | Consolidated net result of the 5 major SOEs (in CVE million) | -1,583 | -1,773 | | | Positive |
| | | | | Contingent liabilities of SOEs (in CVE billion) | 18.2 | 30.0 | | | lower than 15 |

| Component | Prior Actions PRSC 8 | Prior actions PRSC 9 | Indicative Triggers PRSC 10 | Results Framework | 2012 Baseline | 2013 | 2014 | 2015 | 2016 Target |
|---|---|---|---|---|---|---|---|---|---|
| | presentation of the 2012 audited financial statements of ASA, ELECTRA, ENAPOR, IFH and TACV. | | | Number of SOEs with result-based management contracts | 1 | 3 | 6 | | 5 |
| **Pillar 2:** ***Strengthen Competitiveness:*** *Improve the management of infrastructure assets, enhance the investment climate, strengthen financial sustainability, and maintain the country's most important natural asset— the environment.* | | | | | | | | | |
| **Infrastructure Management** | | | | | | | | | |
| | **5.** Approval by Parliament of Law No 24/VIII/2013 establishing the Public Illumination Fee and regulations to facilitate the recovery of arrears to ELECTRA; | **5.** Promulgated and published the Law on the criminalization of illegal connections to the ELECTRA network | **5.** Issue regulations for the implementation of the law penalizing illegal connections to ELECTRA network | Electra net result (in million CVE) | -823.5 | -349.8 | | | Positive |
| | | | | Electra technical and commercial losses as a share of total energy generation (%) | 28.7 | 27.0 | | | Lower than 20 |
| | **6.** Adoption by TACV Board of measures to improve the operational and commercial performance of TACV, including the: (a) closure of five unprofitable international routes; (b) approval of regulations limiting the concession of travel facilities; and (c) adoption of Act No 2/2013 by TACV's General Assembly of Stakeholders approving the spin-off of TACV's ground-handling services. | **6.** Approved Performance Based Maintenance Contracts between IE and its private contractors for the islands of Santo Antão, São Nicolau, Fogo, and Maio | | Roads in good and fair condition as a share of total national roads (%) | 50 | 50 | 50 | | 80 |
| | | | | TACV's net result (in million CVE) | -3,211.5 | -1351.4 | Pos. | | higher than -1,000 |
| | | | | TACV's cabin factor (%) | 60 | 62 | | | 70 |

| Component | Prior Actions PRSC 8 | Prior actions PRSC 9 | Indicative Triggers PRSC 10 | Results Framework | 2012 Baseline | 2013 | 2014 | 2015 | 2016 Target |
|---|---|---|---|---|---|---|---|---|---|
| | **7.** (a) Approval by the Recipient's Maritime and Port Agency of the Deliberative Act No 12/CA/2013 establishing a new tariff policy for services provided by ENAPOR; (b) Approval by the Recipient's Civil Aviation Agency of Regulation No1/2013, establishing a security fee of Euro 2 levied on domestic and international flights to be collected ASA. | **7.** Approved applications presented by ASA for the review of airport fees and for the adjustment of tariffs for regional flight information (FIR) services to the respective regulators (AAC and IATA), and confirmed its continued commitment to review these fees and tariffs | | ASA revenue (in million CVE) | 5,598 | 4,911 | | | higher than 6,000 |
| | **8.** Approval by the Council of Ministers of the Legislative Decree No 1/ 2013 amending the Law of Ports approved on November 1, 2010, along with new statutes for the Maritime and Port Agency AMP and ENAPOR, a concession agreement between ENAPOR and the Ministry of Infrastructure and Maritime economy (MIEM) and revised regulations for concessions in the port sector. | | **6.** Fully operationalize the PPP unit, including a strategic plan for PPPs for PPPs and privatizations | Number of ports with Public Private Participation arrangements in place | 0 | 0 | 0 | | 3 |

| Component | Prior Actions PRSC 8 | Prior actions PRSC 9 | Indicative Triggers PRSC 10 | Results Framework | 2012 Baseline | 2013 | 2014 | 2015 | 2016 Target |
|---|---|---|---|---|---|---|---|---|---|
| **Investment Climate** | | | | | | | | | |
| | **9.** Adoption by the Council of Ministers of regulations related to the 2010 Customs Code designed to further streamline customs procedures. | **8.** Established a “single window” system for investments | **7.** Establishment of a “single window” system for trade | Time to import (days) | 18 | 18 | | | lower than 15 days |
| | | | **8.** Submit the insolvency law to parliament. | Time to export (days) | 19 | 7 | | | lower than 12 days |
| | | | | Number of investment projects processed through the single window for investment | 0 | 0 | 0 | | 30 |
| | | | **9.** Establishment of the tourism board | Tourism board established | No | No | No | | Yes |
| **Financial Sector Stability** | | | | | | | | | |
| | | **9.** Promulgated and published the Financial Institutions Law and the Basic Financial System Law | **10.** Adoption by the government of the Financial Sector Development Strategy, and implementation as evidenced by submitting the MFI law to parliament | Capital adequacy ratio (Basel 1) for the overall financial sector | 12.5 | 15.3 | | | higher than 12 percent |
| | | | | Non-Performing Loans (NPL) as a share of total loans | 14.8 | 20.6 | | | lower than 15 |

| Component | Prior Actions PRSC 8 | Prior actions PRSC 9 | Indicative Triggers PRSC 10 | Results Framework | 2012 Baseline | 2013 | 2014 | 2015 | 2016 Target |
|---|---|---|---|---|---|---|---|---|---|
| **Human Capital Development, Labor Market and Social Protection** | | | | | | | | | |
| | **10.** (a) Adoption by the Council of Ministers of the Letter of Integrated Education, Training and Employment as evidenced by the *Boletim Oficial* No 59, dated November 1, 2013; (b) Capitalization of the Training Support Fund (TSF) approved in the 2013 Budget Law No 23/VIII/201; (c) Adoption by the Council of Ministers of TSF operational manual. | | | Number of beneficiaries of TVET program | 1,500 | 1,670 | | | higher than 5,000 |
| **Environment** | | | | | | | | | |
| | **11.** Approval by the Council of Ministers of the Regulatory Decrees No 4 through 17 defining the legal boundaries of 14 protected areas in the islands of Boa Vista, Sal, Santa Antão and São Vicente. | **10.** Approved the procedural manual for the selection of projects under the Environmental Fund | **11.** A report from DGA's inspection services on construction activities, detailing the origin of sand for all entities inspected | Percentage of new projects with EIA audited by DGA<br><br>Number of protected areas with legal definition published in the Official Bulletin | 10<br><br>3 | <br><br>17 | <br><br>40 | | 70<br><br>Higher than 40 |

## Annex 2: Changes to Prior Actions and Result Indicators from PRSC VIII and Explanations

### Table A1: Prior actions for PRSC IX compared to triggers in PRSC VIII

| Component | Original Trigger for PRSC IX (from PRSC VIII) | Prior Action for PRSC IX | Reason for change |
|---|---|---|---|
| **Pillar 1:** ***Enhance Macro-Fiscal Sustainability:*** *rebuilding macroeconomic buffers to absorb external shocks and enhancing public sector efficiency.* | | | |
| **Domestic Revenue Mobilization** | Approval by Parliament of the General Tax Code, the Judicial Procedures for Taxation and the Tax Execution Code | Promulgated and published the General Tax Code, the Judicial Procedures for Taxation and the Tax Execution Code | - |
| | Submission to Parliament of the reform of the Individual and Corporate Income Taxes | Promulgated and published the Individual Income Tax Code and the Corporate Income Tax Code | Both laws have not only been submitted to parliament but also been approved. |
| **Public Financial Management/ National Investment System** | 1) Parliamentary approval of the revised Budget Framework Law<br>2) Submission to the Parliament of a new organic law for the government's planning system that establishes the legal basis for the National Investment System | Promulgated and published a) the Public Procurement Code and b) Law of the National Planning System | PFM and the NIS were rationalized into one category, as some initiatives, e.g. the planning law, are the foundation for both the consolidation of PFM reforms and the NIS. The new prior action for PRSC IX combines previously separate triggers as they can be considered part of the same effort to modernize the PFM system. The government submitted the budget framework law in 2014 to parliament which rejected it. Submitting a redrafted law will be a trigger for PRSC X. |
| **SOE's Oversight and service delivery quality** | The signature of at least three additional result-based management contracts with the major SOEs | Approved a 2-year recovery plan for TACV, as well as performance based management contracts for TACV, ASA, and ENAPOR. | Rationalize prior actions between SOE oversight and infrastructure management. The restructuring of TACV is more of a fiscal issue than one of infrastructure management. |
| **Pillar 2:** ***Strengthen Competitiveness:*** *Improve the management of infrastructure assets, enhance the investment climate and labor productivity, strengthen financial sustainability, and maintain the country's most important natural asset— the environment.* | | | |
| **Infrastructure Management** | Enactment of legislation penalizing illegal connections to ELECTRA network | Promulgated and published the Law on the criminalization of illegal connections to the ELECTRA network | - |

| Component | Original Trigger for PRSC IX (from PRSC VIII) | Prior Action for PRSC IX | Reason for change |
|---|---|---|---|
| | Signature of at least four PBMtCs between IE and its private contractors | Approved Performance Based Maintenance Contracts between IE and its private contractors for the islands of Santo Antão, São Nicolau, Fogo, and Maio | - |
| | Upward review of airport fees and the adjustment of tariffs for regional flight information (FIR) services provided by ASA | Approved applications presented by ASA for the review of airport fees and for the adjustment of tariffs for regional flight information (FIR) services to the respective regulators (AAC and IATA), and confirmed its continued commitment to review these fees and tariffs | Regulators (both domestic and international) are independent entities. Submission of an application to them to raise the fees is more directly attributable to government action. |
| | Approval of a 2-year recovery plan for TACV with associated management contract signed by the SPE, the Ministry of Transport and Maritime Economy (MIEM) and the TACV Board of Directors | None. | Rationalize prior actions between SOE oversight and infrastructure management. The restructuring of TACV is more of a fiscal issue than one of infrastructure management. |
| **Investment climate** | Establishment of a “single window” system for investments | Established a single window system for investments | **-** |
| **Financial sector stability** | Parliamentary approval of the Financial Institutions Law and the Basic Financial System Law | Promulgated and published the Financial Institutions Law and the Basic Financial System Law | **-** |
| **Human Capital Development, Labor Market and Social Protection** | None. | None. | - |
| **Environment** | Definition of the Environmental Fund’s project-selection procedural manual | Approved the procedural manual for the selection of projects under the Environmental Fund | **-** |

**Table A2: Triggers for PRSC X under PRSC IX, compared to triggers envisioned under PRSC VIII**

| Component | Original trigger for PRSC X (from PRSC VIII) | Revised trigger for PRSC X (from PRSC IX) | Reason for change |
|---|---|---|---|
| **Domestic Revenue Mobilization** | Satisfactory implementation of the tax administration strategic plan | Implement the planned IT infrastructure to improve taxpayer services | Reworded for more clarity. It may require further fine-tuning before it becomes a prior action, in coordination with the IMF TA, the BSG missions, and the government. |
| **Expenditure efficiency in social protection systems** | Operationalization of the URB and the approval by the government of a law it institutionalizes | None. | This category was dropped as it is not well aligned with the CPS and the government program. The UN is providing support in this area. |
| **Public Financial Management & National Investment System** | Parliamentary approval of amendments to the Government's procurement system legal framework | Submission to parliament of the re-drafted budget framework law | The procurement law was moved forward as a prior action of PRSC IX. The budget framework law was submitted to parliament in 2014 and rejected. Resubmission of a re-drafted law is now a trigger for PRSC X. |
| | Parliamentary approval of the proposed CoA law | - | This trigger was dropped as it is not supported by the CPS or the WB program. The EU, Portugal, and other BSG partners are following up on this action more closely. |
| | Establishment of a project appraisal unit at the National Directorate of Planning (DNP) responsible for the issuance of a public investment manual | Establishment of a project appraisal unit at the National Directorate of Planning (DNP) responsible for the issuance of a public investment manual | - |
| **SOE's Oversight and service delivery quality** | Establishment of an M&E system at the SPE for monitoring SOEs' financial, technical and service-delivery indicators | An analytical, comprehensive, annual report on all SOEs, including both key operational and financial data per SOE. | The trigger was refined to more concretely provide evidence of a functioning M&E system for SOEs. |
| **Infrastructure Management** | - | Issue regulations for the implementation of the law penalizing illegal connections to ELECTRA network. | This component could not be completed during the PRSC IX. To round it off, the PRSC X will focus on the implementation of the law criminalizing energy theft and operationalizing the PPP unit. This will |
| | | Fully operationalize the PPP unit, including a strategic plan for PPPs for | |

| Component | Original trigger for PRSC X (from PRSC VIII) | Revised trigger for PRSC X (from PRSC IX) | Reason for change |
| --- | --- | --- | --- |
| | | PPPs and privatizations. | increase the likelihood of meeting the expected results. |
| **Investment climate** | Establishment of a "single window" system for trade | Establishment of a "single window" system for trade | - |
| | - | Submit the insolvency law to parliament. | This component receives a stronger weight in the PRSC series, in line with the realization, both explicit in the CPS and policy dialogue with the government, that strengthening the private sector agenda will be important to achieve the expected outcomes of the CPS, the PRSC series, and the GPRSP III. The two components that were added are supported by WBG TA. |
| | - | Establishment of the tourism board | |
| **Financial sector stability** | Adoption by the government of the Financial Sector Development Strategy | Adoption by the government of the Financial Sector Development Strategy, and implementation as evidenced by submitting the MFI law to parliament | This trigger was refined in WBG TA on the Financial Sector Development Strategy |
| **Human Capital Development, Labor Market and Social Protection** | Approval by the Parliament of a labor code reform | None. | This trigger was dropped as it was not well aligned with the WBG program under the new CPS. The ILO is providing support on labor market reform. |
| **Environment** | Approval of revised legal framework for environmental protection to strengthen enforcement | A report from DGA's inspection services on construction activities, detailing the origin of sand for all entities inspected. | The trigger was reworked to capture the application of the new legal framework rather than the legal framework alone. |

**Table A3: Changes to results indicators**

| Indicator PRSC VIII | Indicator PRSC IX | Reason for change |
|---|---|---|
| Domestic-revenue-to-GDP ratio (%):<br>Baseline: 21.0; Target: 24 | Domestic-revenue-to-GDP ratio (%):<br>Baseline: 21.6; Target: 23.0 | Government revisions to the fiscal accounts for 2012 resulted in a higher baseline. The target was adjusted to reflect the current IMF forecasts for revenue, accounting for recent tax reforms. |
| Overall deficit to GDP ratio (%)<br>Baseline: 9.9; Target lower than 6 | Overall deficit to GDP ratio (%)<br>Baseline: 10.3; Target lower than 7 | Reflects government revisions to fiscal accounts for revenue and expenditure for 2012, resulting in a larger deficit in the baseline. Target reflects latest IMF forecasts, accounting for recent tax reforms. |
| Total Financing including on-lending to SOEs to-GDP ratio (%)<br>Baseline: 13.5; lower than 10 | Total Financing including on-lending to SOEs to-GDP ratio (%)<br>Baseline: 14.4; lower than 10 | This change to the baseline is a consequence to the revisions to the fiscal deficit explained above. No change to the target. |
| Consolidated net result of the 5 major SOEs (in CVE million)<br>Baseline: -491.3; Target: positive | Consolidated net result of the 5 major SOEs (in CVE million)<br>Baseline: -1,583; Target: positive | Correction of the baseline number based on the latest contingent liability report of the government. |
| Electra technical and commercial losses<br>Baseline: 26.2; Target: <20 | Electra technical and commercial losses<br>Baseline: 28.7; Target: <20 | Correction of 2012 baseline based on 2013 ELECTRA operations report. |
| ASA revenue (in million CVE)<br>Baseline: 648; Target: 750 | ASA revenue (in million CVE)<br>Baseline: 5,598; Target: higher than 6,000 | The baseline was corrected based on ASA's 2013 annual report and the target was adjusted to reflect a realistic increase. |
| Number of social protection programs using the URB | None. | Dropped as the associated trigger was dropped in line with the new CPS which does not support social protection issues. |
| Non-Performing Loans (NPL) as a share of total loans:<br>Baseline: 20; Target 12. | Non-Performing Loans (NPL) as a share of total loans:<br>Baseline: 14.8; Target 15. | The revised baseline is in accordance with the central bank's 2014 Financial Stability Report. The revised target reflects greater realism based on the assessment of a recent mission of the Finance & Markets Global Practice in November 2014. |
| Rigidity of Employment (0 best–100 worst) | None. | Dropped as the associated trigger was dropped in line with the new CPS which does not support labor market issues. |
| Firing / Hiring Flexibility (1 best–7 worst) | None. | Dropped as the associated trigger was dropped in line with the new CPS which does not support labor market issues. |

## Annex 3: Letter of Development Policy

Ministério das Finanças e do Planeamento | A MINISTRA

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29th April 2015

**Topic: Letter of Development Policy**

Mr. Jim Yong Kim
President of the World Bank
1818 H Street, NW
Washington, DC 20433
US.

Dear Mr. Kim,

On behalf of the Government of Cabo Verde (GOCV), I am requesting a development policy credit in the amount of US$10 million from the International Development Association (IDA) to support our program of structural reforms included in our Third Growth and Poverty Reduction Strategy Paper (GPRSP III) covering the period 2012-16. The aforementioned development policy credit is the second operation of a series of 3 programmatic development policy operations and will help us to meet financing needs the GOCV faces for the implementation of our GPRSP III in a context of an adverse global performance that has been reflected in our country in less robust GDP growth and impacting adversely government revenues.

This letter briefly describes the main objectives of the GPRSP III, ongoing macroeconomic adjustment efforts and the structural reform agenda that we are implementing.

**The GPRSP III**

Based on the assessment of Cabo Verde's comparative advantages and recognizing the difficult external environment facing Cabo Verde and the transition to middle-income country (MIC) status, the GPRSP-III aims at operationalizing through structural reforms and programs the government's objective of "building a dynamic, competitive and inclusive economy".

The GPRSP III is an instrument that implements the Agenda for Economic Transformation by structuring, in the multiannual framework, measures and actions for meeting the objectives laid down in the Government Program of the 8th Legislature for 2011-16. The main goal of the Agenda and the Program is to promote shared and a more robust economic growth with opportunities for all as the driver of poverty and inequality reduction. In this framework, macroeconomic stability and good governance, job creation, improvements in human capital development and an enhancement role of the private sector, which is expected to become the economy's main engine, are key pillars of the GPRSP.

**Macroeconomic situation and government policies**

Regarding the macroeconomic front, the context of the uncertain international economic environment has taken a toll on the caboverdean economy and the budget policy that has been followed in the last years has sought to compensate the impacts of the global economic and financial crisis. The recent historical GDP data disclosed by the National Institute of Statistics (INE), covering the period until 2013 which reveals somehow the impact from the economic crisis on national output , has further added to the case for the use of counter cyclical stimulus to the economy. The Government's support to the economy through the investment program attempted to mitigate the negative impacts of the crisis on national demand and investment. Furthermore, the investment program is a necessary condition to increase competitiveness by alleviating chronic infrastructure bottlenecks and reducing the cost of factors in the medium-long term.

Additionally, the Public Investment Program (PIP) is heavily connected with Cabo Verde's graduation from the United Nations (UN) Least Developed Countries' list in 2008. By occasion of the transition to a Middle Income Country Status, development partners agreed in the establishment of a transition window that enabled the country to continue access concessional resources to fund infrastructure projects that would alleviate chronic bottlenecks to the development of Cabo Verde. This window also provided a fundamental and sustainable source of funding to adopt anti-cyclical measures to counter the effects of the international crisis on the caboverdean economy.

Recent GDP data released by INE reflects an initial trend of a gradual recovery of caboverdean economy (real GDP is preliminary estimated on 2.7% for 2014) even under stressed conditions from external environment. Revenues, after a period of shortfall, started to positively responding to the reforms, presenting good performance in the first quarter of 2015. It's important to mention that, since the beginning of 2013, the GOCV has been adopting revenue enhancement measures including a broad tax reform on our Value Added Tax (VAT), establishment of a touristic fee, improvements on tax administration (technically supported by the IMF) and the increase of cost recovery measures for the services provided from our main State Owned Enterprises (SOEs). On the expenditures, tight controls on recurrent spending and the cancellation of some of our investment projects are expected to reduce total spending, resulting in the reduction of our overall deficit.

The 2015 budget and the mid-term programming (2015-2018), taking into account recent developments, reflect conservative estimates on revenue performance and a containment effort on the expenditure side in order to safeguard the principles of public debt sustainability and the alignment of the economic activity with the potential growth of the economy.

Fiscal Consolidation

One of the main goals of the Government and that is reinforced on the 2015 State Budget is the gradual program of fiscal consolidation, based on four major axes:

• Gradual phasing out of the Public Investments Program;

• Containment and optimization of public spending, (the focus of the reforms implemented during the period 2006 to 2011 and continued until now);

• Recentralization/Refocusing of the revenue centers, highlighting the consolidation of the *bancarização* and the tax administration process on the period covering 2011 to 2016;

• A strong program of institutional reforms.

As a result of the clear assumption of the fiscal consolidation program by the Government, the management of public finances in Cape Verde reached, in the last decade, from high government standards levels. It is now important to consolidate the gains at all levels of the reform to undertake a new stage.

Cape Verde faces new challenges in an environment marked by great adversity, greater budgetary stringency and rigor. Therefore, it is crucial to adopt measures that promote the efficiency and effectiveness of revenue and public spending, ensuring thus a sustained fiscal consolidation in the medium term.

The focus on fiscal consolidation effort reinforces the implementation and the deepening of the structural reforms and the reconciliation of these two aspects are the guideline of economic policy of the Government. In fact, the IMF recently evaluated the consolidation strategy presented by the Government and it confirmed its alignment with the recommendations made for the necessary medium-term fiscal consolidation.

The economic reforms aim the improving of the competitiveness of the economy and in this way boosts endogenous capacity to generate revenue with enterprises more competitive and laboring in an enabling environment of investment and growth. On the other hand, tax reform, which is also based on tax evasion and fraud combating, must underpin the enlargement of the tax base, allowing the Government to increase revenue collection, helping to reduce the budget deficit. However, important challenges remain. In other words, the successful implementation of the tax reform is a key factor of the fiscal consolidation program. Improving tax administration efficiency in the collection and payment of taxes surveillance enforces this same administration to adopt stringent measures to collect the necessary resources in order to finance the development process of Cabo Verde and also generate flows to remunerate and repay credits already hired. To this end, it is expected a gradual improvement in the quality of leadership of the Tax Administration as well as the technical teams (a National Directorate was been created in order to better administrate this process).

In 2015 year, it is expected that tax revenues register a positive performance over the previous year, particularly due to the behavior expected of VAT, results of measures taken both in terms of fiscal policy (alignment of the effects) or on Tax Administration (dematerialisation and later Electronic Declaration) as well as the projected recovery in economic activity. The preliminary data of the first quarter of 2015 shows a first sign of recovery on the revenue side with an increase around 10% comparing with same period of 2014.

In addition to the reforms that will ensure that the State improve their capacity to collect revenues, another front which should allow the deficit reduction will be the containment/optimization of public spending. On this front, the Government, given the structure of expenditure, will continue to invest in the implementation of programs with the greatest impact on growth and poverty reduction. To that end, according to the current Medium Term Fiscal Framework, efforts of fiscal consolidation will be continued, which has been marked by a high level of commitment on the expenditure side, for example by incorporating measures in the area of human resources, social benefits, transfers and investment. In addition, measures are envisaged aimed at the efficient functioning of the public administration towards its reorganization and centralization of resources. Regarding the investments, it is important to highlight the gradual phasing-out of the public investment program undertaken by the government, without neglecting economic growth, while the public debt sustainability is guaranteed. The public investment program should continue aimed at the promotion and diversification of the economic base of the country, but creating space for engaging the private sector in boosting the country's economy and strengthening its growth potential.

On the real economy front, some signals of recovery have been observed. Positive results were noted in important economic sectors in 2014. We highlight the excellent performance of export sector, mainly the fisheries sector and a recovery on the FDI. Tourism has been affected indirectly by the Ebola nevertheless Cabo was free of this disease, but with the reforms planned for this sector (the WB is working with the Government on a project that will enhance the competitiveness of the tourism sector) we expect better performance during this year.

In the agriculture sector investments focus on the increasing collect, storage and distribution of spring-fed and rain-fed water resources, enabling farmers to irrigate their fields trough new efficient technologies which are contributing to improve agricultural productivity and promoting agri-business. Extension of irrigated land and increasing water supply reliability are facilitating a shift from low-value, rain-fed subsistence agriculture (such as corn and beans) to high-value horticultural and fruit crops.

In the transport sector, we register a recovery in passengers and containers flows in caboverdean ports. The national airports are receiving more international flights. Concerning the energy sector, Cabo Verde is striving to overcome one of its major development challenges – reduce dependence on fossil fuel for energy generation, nevertheless the country has already attained its goal of 25% energy generation from renewable resources. Large investments in the sector resulted in an increased from 89 MW to 156MW in 2012 and an increase in the coverage increased from 85 percent to 96 percent. Moreover, renewable energies represent 25 percent of our installed electricity capacity. Last but not the least, institutional, regulatory and managerial reforms supported by the World Bank in recent years are beginning to generate positive results reflected in the improvement of the financial situation of our Electricity and Water utility ELECTRA which will enable to sustain the improvements described here.

Concerning the investment program specifically, it should be noted that some of new projects will not be pursued in the near future considering the priorities of debt consolidation and sustainability. The current focus now is the conclusion of ongoing investments. Certain recently commissioned projects such as the Praia international airport expansion or the technology park remain on the pipeline in the context of the development strategy and were considered in the debt sustainability analysis prepared by my team with the support of the World Bank. The National Investment System is being put in place during 2015 with the World Bank financial support and it will enable to improve the quality of future investments opportunities. With the support of donors, the government is undertaking studies to determine the potential of new dams and will only move forward with new projects in this area once the strategy for the development of associated rural areas and agribusiness clusters is properly conceived and safeguarded.

**Structural reform agenda**

The Third Growth and Poverty Reduction Strategy Paper (GPRSP III) aims at accomplishing the goal of creating a dynamic, competitive and sustainable economy in order to enable an environment for inclusive growth that will reduce poverty. Considering its cross-sector nature, the GPRSP III imposes several simultaneous structural reforms that will aim to empower the development of the private sector around the anchor sectors of competitiveness – agribusiness, tourism and the sea cluster The agribusiness sector for example will open up opportunities to rural populations by interlinking the production capacity with tourism demand for products and services, hence enabling the reduction of unemployment and poverty in areas traditionally hardest hit by lack of economic opportunities. A PPP Unit has been recently created with the propose to prepare the necessary conditions for the PPP and privatization process of some services (concessional port and airport services, especially) and national companies.

On the sea cluster, an important set of reforms is taking place on the fisheries sector seeking to leverage the good export results in recent years. The strategy will seek to promote a national value chain for competitive endemic species. Specific measures will include enhanced quality control and product certification; investments in modern freezer facilities (a competitive advantage in the sub-region); consolidation of the ongoing investments in modern ports facilities; attracting foreign and domestic companies, amongst others. The tourism sector, a defining anchor of the country's service economy as it is, will comprehend a broad set of measures seeking to diversify the tourism product into new high potential niches (rural, adventure, sports) and improving authorities' capacity to conduct proper monitoring and evaluation of existing projects with a strong focus on safeguarding environmental sustainability.

In effect, the nature and substance of the public investment program effort converges with the vision for competitiveness of the national economy. Furthermore, the investments will continue supporting key projects in enhancing the quality of education and health services and sponsoring cross sector reforms in the area of good governance (e-governance, state reform, and judicial system).

In simultaneous with competitiveness clusters specific reforms, the overall reform agenda will look to tackle and advance cross sector issues. The first great pillar of the agenda is the maintenance and enhancement of good macroeconomic governance. In order to face the new challenges brought on by a more volatile international environment, it is important that several key reforms ongoing in the area of public finance management be continued and complemented in order to increase the country's macro-fiscal resilience. Other important advances are related tothe fiscal legislative front that are expected to increase revenue and achieve a better fiscal balance anchored in the approved revision of the investment code and associated tax benefits diploma. The implementation of additional revenues sources such as the tourism surcharge and the statistical tax are expected to diversify the base of revenue. Still on the legislative dimension, the overhaul of major fiscal diplomas continues – e.g. *Código Geral Tributário; Código de Execuções Tributárias; Código de Processo Tributário* – approved as well by the Parliament.

Other key reforms in the public finance management area continue to advance and will aim to increase the efficiency of resource planning at the central administration level according to the newly updated PEMFAR based reform action plan. The operation of the single treasury account has already made significant advances in improving the Government's cash flow management and predictability. In 2013, we introduced program-budgeting which represent a strong improvement in our public finance management and for the first time we presented the State Budget on a programmatic base.

The consolidation of this process is reflected in the approval of the new planning law in later September 2014 and the submission of a new budget organic law expected by the end of this semester and that will make legal the changes in budget management that are already in place. The overall debt management reform will seek to increase and broaden the marketability of government debt securities to domestic and international savers and hence reduce the costs of indebtedness. The aspect of strengthening the in-house assessment and management of debt risks is also a priority (particularly those related to state owned enterprises). The area of public procurement has seen noted advance in the regulatory and legislative front and is now advancing toward e-procurement solutions that can further increase transparency, reduce the costs of transactions and broaden the scope of potential suppliers to the Government.

The establishment of a new National Planning System (SNP) provides a more ample framework to understand the full scope of public finance management reforms. The creation of a solid mechanism for policy creation, analysis and implementation remains a challenge that will "make or break" a successful implementation of the GPRSP III and the achievement of its vision. The SNP is made up for a group of integrated subsystems. The first is monitoring and evaluation seeking to link the resource allocation to measures of physical execution and outcomes. The programmatic reform of the State

Budget to include all GPRSP III programs, each with a logical framework for indicators and outcomes, is a significant step in that direction. Significant challenges remain considering the complexity of this reform, the associated in-house development of the necessary information technology platform, and the learning curve involved with all sectors.The national investment system will seek to promote a comprehensive framework for *ex ante* cost benefit analysis and *ex post* impact assessment of capital expenditure. This will be essential in order to look for those projects which will yield the highest return on investment and ensure that scarcer public investment resources are used to the highest possible utility to the population and economic agents. The system will also deal with the careful analysis of recurrent costs associated with some of the major infrastructure projects and will examine new cost sharing mechanisms such as public private partnerships. The , national statistics system will aim to enhance the timeliness and quality of output data across a range of socioeconomic domains. This is absolutely critical to ensure that policy makers and other economic agents, including donors and creditors, have access to the right information for decision making purposes – with a special focus on the essential monitoring and evaluation of the GPRSP III. Concrete actions are already being taken which include the institutional strengthening of INE and the timely provision of the required national accounts data outputs. The geographic information system will seek to leverage information technologies to resolve the issue of territorial planning by creating an information platform easily accessible to public, private and civil society stakeholders for issues of land use, regulations and custody amongst others.

The reforms above mentioned in the area of overall macroeconomic and PFM will continue to require close support from our development partners, especially those in the Budget Support Group which is currently led by the World Bank. The GPRSP III furthers highlights as a part of its reform agenda a critical area for improvement – ownership and control of state owned enterprises (SoEs) – that constitutes a multidimensional challenge spanning not only the management of the contingent fiscal risk but also the service level of these companies as key enablers of the competitiveness of the country. The signature of performance management contracts with key public utilities – Electra has been a key and successful step and we replicated it to other biggest SOEs (TACV, ASA, EMPROFAC and IFH). The overall broad reform of the SoEs and strengthening of the Government's ownership and control capacity remains however a dense challenge and further measures are required. These companies must be able to utilize and achieve returns on many of the public infrastructure projects recently concluded. Only then will a private sector driven economy around the above mentioned clusters be possible.

In this sense, the transport and energy SoE infrastructure companies are receiving heightened attention in these reform processes aiming to improve the associated efficiency and service delivery level. Specifically on transport, a series of measures were published in a sector policy letter and the amendment of the law on ports, which will enable concessions (including the restructuring of port operator ENAPOR), the review of the port authority, a tariff revision already executed by the port operator, to foster the participation of the private sector. The focus on transports is also prioritizing the restructuring of the national airline TACV. The spin-off of handling activity is an important accomplishment. The energy sector is already seeing significant changes, specifically in the ability of the utility ELECTRA to collect and we aim to enhance the capacity to cut losses and increase the overall efficiency of energy and water production and distribution.

Additional critical areas of reform of noted importance were those related with the labor market. A series of diagnosis documents have shown that the rigidity of the labor laws favors informality and reduces the competitiveness of the critical labor production factor. An appropriate balance must be sought between the protection of the workers and the ability of firms to easily contract and manage their workforce according to principles of good performance and meritocracy. In this regard, the revision of the labor code was already been approved by the Government after some discussions with the union and the private sector representation. in early 2015.

Still in the scope of human capital, education is to remain an area of maximum priority. Over the past decade, Cabo Verde has made noted progress in expanding the coverage of its conventional education system nationwide under a banner of low cost universal access to all. The effort was also noted in the university higher education system. However, the paradigm is shifting towards the reinforcement of quality and the proper enabling of a technical and vocational education and training system that can provide skilled employees to service private sector operators especially in the areas of competitiveness of the GPRSP III, although the progress made in this front.

**Conclusion**

To conclude, it is in this scenario of important challenges that the Government of Cabo Verde reaffirms once again its commitment with fiscal sustainability and a broad-band structural reform agenda. In this sense we hope to continue receiving the important support of the World Bank through this development policy credit and the technical assistance which is critical for the implementation of our reform agenda The World Bank's support over the past years has been instrumental and remains a necessary condition to ensure a continuing transformation of Cape Verde during this difficult international environment.

Reiterating once again our desire on maintain an excellent collaboration between the World Bank and Government of Cabo Verde, please accept my best regards.

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Minister of Finance and Planning