PROGRAM-FOR-RESULTS INFORMATION DOCUMENT (PID) CONCEPT STAGE

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Program Name	*State Owned Enterprise Reform Program*
Region	*Africa*
Country	*Cabo Verde*
Sector	*Governance*
Lending Instrument	*Program for Results (P4R)*
Program ID	*P160896*
{If Add. Fin.} **Parent Program ID**	*{Same as in AUS}*
Borrower(s)	*Government of Cabo Verde*
Implementing Agency	*Ministry of Finance*
Date PID Prepared	*10/20/2016*
Estimated Date of Appraisal Completion	*04/14/2016*
Estimated Date of Board Approval	*06/22/2016*
Concept Review Decision	Following the review of the concept, the decision was taken to proceed with the preparation of the operation.
Other Decision *{Optional}*	The team will request the government to prepare an SOE Reform Program by December, with clear objectives, activities and costs. This program will form the basis for the P4R support.

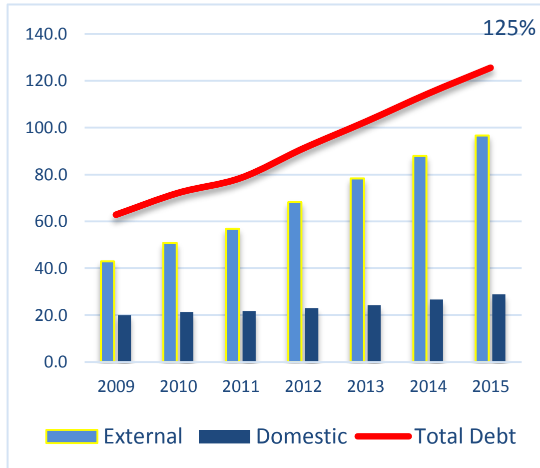
I. Introduction and Context

A. Country Context

1. **Cabo Verde has made impressive progress on economic and social development indicators, including poverty reduction.** Cabo Verde's economy recorded average growth of 6.6 percent between 2000 and 2008, which helped to pull thousands out of poverty and accommodated the country's modestly growing population. With an open economic model anchored by a stable democracy and strong foreign direct investments (FDI) flows, the country was able to transition from low income to middle income country (MIC) status. It is one of the few countries to have achieved all the Millennium Development Goals. In 2007 (year of the last household survey), 18.1 percent of the population lived below the international poverty line of US$ 1.9 per person per day down from 28.7 percent in 2001. The reduction in poverty was also accompanied by an improvement in the distribution of income, with the Gini coefficient declining from 52.6 in 2001 to 47.2 in 2007. The share of income of the bottom 40 percent increased from 12.4 percent to 15.3 percent over the same period. The country also made considerable progress on increasing basic services, including health and water and sanitation. Cabo Verde has the highest CPIA (Country Policy and Institutional Assessment) score (3.9) among IDA countries which shows the strength of its institutions.

2. **Cabo Verde has experienced a significant slowdown in growth and a rapid build-up in debt since the global financial crisis in 2008.** The economy has struggled to reach average growth of 2 percent per annum between 2009 and 2015, in spite of a sizable fiscal stimulus which replaced the falloff in FDI (from a peak of 13 percent of Gross Domestic Product in 2007 to 2 percent in 2013). Taking advantage of available concessional financing, public investment rose sharply as the government decided to utilize remaining concessional resources to address infrastructure bottlenecks to lay the foundations for future growth[1]. In this context, government debt increased from 60 percent of GDP to 125 percent of GDP between 2009 and 2015, among the highest in Sub-Saharan Africa. Cabo Verde is now categorized as having a high level of debt distress, which if not addressed could lead to crisis conditions, given sharply elevated and building pressures on public sector finances, which are being compounded by a deteriorating external environment. Huge annual operating cost of financially strained and likely insolvent state-owned entities —equivalent to an estimated 3 percent of GDP (in 2016) for the two largest SOEs—further underline the fragility of the government fiscal position.

Figure 1: Public Debt (Percent of GDP 2009-15)



3. **Adjusting the country's development model to its current economic circumstances while jumpstarting sustainable growth require urgent actions to address public sector balances, as well as resolving multiple public financial issues which impairs government decision making and creating space for greater private sector participation**. The development model that enabled the country to graduate to MIC status and the global circumstances which enabled Cabo Verde's impressive growth performance are now much less favorable and subject to increasing downside risks. The evolution of public sector balances is intimately tied to urgent reforms in the SOEs sector, in particular the operations of key loss-making public enterprises. A new administration took office in June 2016, tabled an expansionary budget but recognizing the need for corrective actions, have since begun implementing a number of measures with a focus on containing current expenditures, improving the public investment management and strengthening the SOE sector.

B. Sectoral (or multi-sectoral) and Institutional Context

4. **There are thirty two SOEs in Cabo Verde, covering services such as electricity, water, transport, postal services and real estate**. The state has as a 50 percent or higher share in twenty two of these and three with a 20-30 percent share. The remaining seven are enterprises where the state has a 10 percent or smaller stake and include two financial companies, the telecommunications firm CV Telecom and the national fuel company.[2] The largest SOEs by assets and turnover are ELECTRA (electricity utility), ASA (airports management), TACV (airline), ENAPOR (port), and IFH (housing). The five largest enterprises, account for 80 percent of state owned capital[3] and hold assets equivalent to 36 percent of GDP as of 2015.

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[1] Most of the concessional funds were channeled to state-owned entities (SOEs) for execution (onlending).
[2] See Annex 3 for the complete list of SOEs and a detailed discussions on the three large SOEs with the highest risk profile.
[3] The state's total capital share of these SOEs was CV12.1bn in 2010 (9 percent of GDP), 70 percent of the enterprises total capital.

5. **The performance of SOEs vary, but on aggregate the SOE portfolio has been loss-making**. Between 2008 and 2014 the average return on assets (ROA) for the 14 SOEs on which figures are available was negative four percent. Only three SOEs had an average positive ROA over the period. The biggest contributors to these losses were TACV, ELECTRA and to some extent IFH, while ASA and EMPROFAC have been profitable on average. TACV made a profit for the first time in 2014 due to a one-off sale to ASA of its ground handling services, but returned to a loss of in USD 32 Million in 2015. The company is technically insolvent and treasury is currently paying its creditors directly. These losses pose a continued drain on the government budget and ultimately stifles the growth potential of the country.

6. **The stock of SOE debt has increased in recent years and many SOEs are in need of government guarantees for their commercial debt.** In 2015 the state provided explicit guarantees for SOE commercial loans equal to 2.7 percent of GDP (ECV 4.3B – USD 43M) a decrease from 5.6 percent in 2014 (ECV 8B – USD 80M). The total debt stock for the three largest SOE reached 30 percent of GDP in 2014 (USD 500M). The largest debts are held by IFH (USD 197M), followed by ELECTRA (USD 188M) and TACV (USD 116M). In 2013-14 the authorities set an annual limit of ECV 7B for government guarantees (just under five percent of GDP), while in 2015 this was lowered to ECV 5B (three percent of GDP). Cabo Verde does not have a history of SOE debt defaults, and SOEs whose debt is guaranteed by the state have not defaulted and called on the guarantees provided by the state. However, in reality some SOEs have 'technically' defaulted since government has stepped in to provide emergency loans or recapitalizations in the past, and they are currently making direct payments on behalf of TACV to its creditors. IFH has also requested direct support from the authorities to deal with its cash flow problems while treasury is directly servicing the credit line which finances the social housing program managed by IFH.

7. **The risk profile of SOE debts has risen, and Government's fiscal space is severely limited**. The government simply does not have the capacity to continue bailing out loss making SOEs, and urgently need to put in place measures to improve their operational and financial performance in order to reduce their fiscal burden. IFH and TACV are the most critical, given that these SOEs pose the largest burden on the budget and are in need to additional financial support from government in 2016. The latest report on contingent liabilities by the treasury classifies debt held by IFH and TACV as high risk debts given the markets in which these companies operate, as well as their operational and financial performance and profitability prospects in the short to medium term.

8. **In Cabo Verde, the overall corporate governance environment for SOEs is generally acceptable, even though there are areas for further improvement.** Corporate governance of SOEs refers to the rules and mechanisms under which they operate, including their internal governance structures, their relations with shareholders, the ability of the state to act as an informed owner, and their transparency and disclosure requirements. In particular, there is room for clarifying the objectives of state ownership, strengthening the disclosure and reporting obligations of SOEs and the state, the strengthen state's capacity to act as an informed and proactive owner. In addition, board and management practices could be strengthened to minimize political appointments in favor of bringing in needed technical expertise.

9. **SOEs operate under the commercial code, their own founding legislation and the 2016 framework SOE Law**[4] that consolidates the main SOE governance provisions. It includes rules related to reporting, disclosure, state oversight, and boards of directors. It subjects SOEs to the same rules of competition as all other companies in Cape Verde, and appoints the Minister of Finance as the shareholder representative. The legal framework for SOEs was strengthened in early 2016 with the passing of law 104/VIII/2016 on January 6, 2016, replacing the SOE framework law 47/VII/2009 of 7 December 2009. The new law has been strengthened in several areas, notably (i) it clarifies and broadens

[4] Law 47/VII/2009

its scope of coverage to all categories of state owned corporate entities, including those owned by Municipalities (ii) it includes clearer guidance and limits on SOE debt, including the need for SOEs to outline debt plans as part of their annual budget and business planning process which is subject to approval by the authorities (iii) the new law introduces stronger sanctions for non-compliance with reporting obligations of the SOEs to the state, where failure to comply now provides justification for dismissal of senior management (iv) the new law includes new articles (art. 33 and 34) on the Transformation/Fusion and Liquidation of SOEs. While the reporting responsibilities of SOEs to the state have been slightly expanded to include regular reporting on operational targets and shareholders, the reporting requirements of SOEs to the public remain limited to an annual publication in the official bulletin of the structure and composition of management, board, committees, etc. as well as their qualifications and their remuneration, as in the previous law. The council of ministers can request the publication of additional information.

10. **This legal framework provides a sound basis for SOE governance and oversight, but it suffers from uneven implementation**. For example, the law clearly states that SOEs should be compensated for public service obligations (PSOs) and that the costs of PSOs should be calculated in a clear and transparent manner, yet in practice this has not been done. Further, the reporting obligations of SOEs to government go far beyond standard financial reporting to include detailed information on company corporate governance, including the frequency of board meetings and selection and remuneration of senior management and board. Currently, reporting happens on an irregular basis and is generally limited to audited financial reports. Closing this implementation gap requires stronger monitoring on compliance by the government as owner and regulator. In addition, and in line with evolving international practice, an ownership policy is an important instrument to lay out the rationale for state ownership and the specific objectives of companies, including public service obligations.

11. **The institutional framework for monitoring SOEs is a dual system where the Ministry of Finance and line ministries share technical and financial oversight responsibilities.** Treasury is the owner of SOE shares and is responsible for monitoring SOE debts and general financial performance, while technical ministries and regulatory agencies are involved in monitoring operational performance, including the setting of performance targets. SOE oversight has been weak overall although it is improving. The Unit assigned to the oversight of the SOEs within the Ministry of Finance (DNPE) is staffed by four mid-level and junior technicians and lacks the training, experience and seniority to discharge their responsibilities. Moreover, the SOE Unit lacks essential monitoring instruments, such as updated SOE accounts, strategic plans, budgets and quarterly reports. The unit is currently receiving support through the World Bank transport project to improve its monitoring system. But in order to support the state as an owner, the unit also needs senior in-house technical expertise to provide independent and authoritative analytical advice on SOE business plans and performance. Currently, the SOEs have stronger technical and business knowledge than the ministry of finance, meaning that the authorities are unable to independently assess SOE proposals and reports and challenge SOE views and proposals when necessary. In addition to DNPE, the authorities have established a unit in charge of public private partnerships and privatization (PPPP). This unit is in charge of the privatization of eleven SOEs. It has relatively more capacity than DNPE and is better resourced. Government is planning to merge the two units.

12. **Performance contracts are key instrument in the authorities' efforts to improve SOE monitoring.** All but TACV and IFH have signed such performance agreements. The ones signed with ENAPOR, ELECTRA and EMPROFAC are all of good quality, prepared with the technical support of independent consulting companies with sector specific expertise. The challenges has been in ensuring timely reporting and evaluation of the agreements, and the lack of application of sanctions for non-performance. Despite an explicit requirement for companies to report regularly on their commitments and targets, such monitoring is sporadic.

13. **Limited capacity in government has meant that many SOEs have been able to continue to**

operate with continued losses and increasing their debt levels and their dependence on state support. The situation reached a critical level in 2016, with two large SOEs becoming technically insolvent and dependent on direct state support for their survival (TACV, IFH). The challenge for the government is to gain some control of the situation and take urgent decisions on difficult but necessary SOE reforms in order to minimize the fiscal impact. For this to happen, the government needs to become a more active owner, with the capacity to form its own opinion of SOE performance and necessary reforms based on high quality technical analysis on SOE performance and on this basis exercise its ownership in a more proactive manner in SOE boards and as ultimate shareholder of these companies. Currently, the SOEs themselves are stronger technically and are therefore able to set the agenda for technical and financial discussions with Government and Treasury.

C. Relationship to the CAS/CPF and Rationale for Use of Instrument

14. The Country Partnership Strategy (CPS) for the period 2015-17 is structured around two complementary pillars: (a) enhancing macro-fiscal stability, setting the foundations for renewed growth; and (b) improving competitiveness and private sector development. The proposed operation supports the objectives of Pillar 1 which includes specific targets on reducing GoCV lending to SOEs (from 8.8 percent of GDP in 2013 to 6.7 percent in 2017) and increasing accountability for results through the expansion of performance agreements to 5 SOEs. It would partly support Pillar 2 which has a sub-objective target on reduced electricity losses.

D. Rationale for Bank Engagement and Choice of Financing Instrument

15. **The bank has a long history of support to SOE reform in Cabo Verde through numerous operations**. The recently concluded PRSC series supported a number of SOE reforms including TACV, ELECTRA and ENAPOR as well as overall risk management of contingent liabilities by the treasury. The ongoing Transport Project is providing technical assistance to strengthen transport sector SOEs as well as the preparation of a monitoring system for the SOE unit. Building on this past support, the proposed P4R operation will consolidate many of the reforms and take them further. It will also lay the ground for future budget support by the bank and other donors who are currently unable to move ahead due to concerns over macro fiscal management related to SOE reforms.

16. **The choice of the P4R instrument for the proposed operation can be justified by the following expected benefits**: (i) providing a meaningful incentive to undertake structural reforms by disbursing against agreed results, (ii) building on and reinforcing existing capacities in government to undertake politically sensitive reforms, and (iii) strengthened coordination with other development partners in supporting similar yet complementary programs and reforms in an area of recognized Bank comparative advantage. The choice of P4R is also appropriate for a country which is lacking a well defined results framework for its own SOE reform program, as it would help government establish clear targets and monitor these.

II. Program Development Objective(s)

A. Program Development Objective/s (PDO) and key results

17. The Project Development Objective is to: Strengthen the legal and policy framework and institutional capacity for SOE oversight, monitoring and reporting, and to support the privatization of the national airline (TACV) and the restructuring of the social housing program (IFH/CPT).

Key Program Results

18. **In order to achieve the PDO, the P4R operation aims to achieve the following results**:

- Improved institutional capacity for oversight, monitoring and advice on the SOE portfolio by the SOE unit in Treasury
- Strengthened legal and policy framework for SOEs
- Restructuring of the national social housing project (Casa Para Todos) and the SOE which manages it (IFH)
- Restructuring and privatization of the national airlines (TACV)

PDO Level Indicators:

	Indicator
PDO Level Indicator 1	Monitoring reports on the SOE portfolio
PDO Level Indicator 2	Strengthened legal and policy framework for SOEs
PDO Level Indicator 3	Casa Para Todos and IFH restructured
PDO Level Indicator 4	TACV restructured and privatized

III. Program Description

B. P4R Program Scope

19. The P4R operation will support a subset of the government program, with a focus on activities that have the most direct and immediate impact on reducing the medium term net fiscal burden of SOEs on the budget. The following indicative output targets and activities will be supported:

Results Area 1: Strengthened legal and policy framework and institutional capacity for monitoring, oversight and analysis on the SOE portfolio:

20. **This results area will focus on strengthening the ministry of finance's role as an active owner of SOEs**, including their ability to independently analyze and assess SOE activities, operational and financial performance, business plans, audits, and to prepare comprehensive and in-depth analytical reports on the SOE portfolio under their purview. This set of actions is an essential element of the state's ability to better manage the fiscal risk posed by SOEs through repeated ad-hoc requests for guarantees, recapitalizations and loans. It will also strengthen the state's capacity to take strategic and timely decisions on their SOE portfolio, such as whether to restructure, privatize or liquidate persistently under-performing companies. Tentative results would include:

- Improved corporate governance legal framework – through drafting of complementary regulations to the framework SOE legislation (law 47/2009);
- The preparation of an SOE reform program with clear objectives, results, activities and associated costs
- Clear objectives for government ownership and medium term performance objectives for each SOE, outlined in a government SOE Policy;
- Improve the technical capacity of the ownership unit for assessing the realism/quality of proposals and reports presented by SOEs (including business plans, performance agreements, HR restructuring plans), and to carry out SOE performance benchmarking with the objective to inform government decisions regarding approvals of restructuring, recapitalizations, divestiture, liquidation, etc.;
- Increased transparency of SOEs and performance monitoring through a new reporting

platform in treasury that will provide timely information on SOE finances and progress on performance contract targets;

- Preparation of comprehensive annual reports on the entire SOE portfolio;
- Regular publication of audited financial statements for all SOEs on their websites;
- All performance agreements evaluation and findings published in line with performance agreements;
- All SOEs submit timely financial statements to ownership unit in line with national legislation and/or specific requirements.

Results Area 2: Privatization of TACV and Restructuring of IFH/Casa Para Todos

21. **This results area will support a series of targeted reforms in the two SOEs with the largest claims on the state budget and the riskiest debt profile**, with a view to improve their operational performance and reduce their medium term needs for fiscal transfers in the form of (i) subsidies, (ii) government guarantees for commercial credit, (iii) capital contributions, or (iv) direct loans. Currently, these are CPT/IFH (Housing) and TACV (Airline). Tentative results and activities would include :

- Improve the financial sustainability and reduce the financing gap from the social housing program (*Casa Para Todos*), through a review of the financial and business model and the implementation of reforms aimed at improved institutional/management arrangements and greater financial sustainability. This will include (i) a financial review of CPT, (ii) a housing market study, (iii) a review of institutional arrangements for the management of CPT, (iv) the design of a new financing and management model for the program, and (v) legal reforms to support a more flexible pricing mechanism and institutional arrangements.
- Restructuring and privatization of TACV. Government is making a last attempt at privatization of TACV. This process will involve a short term restructuring and cost cutting plan, the preparation of an investor deck and possible roadshow/visits to potential investors. Privatization may also involve the sale of some of TACVs assets while other parts of the airline could be liquidated or wound down. A privatization team in the ministry of finance is preparing a series of technical assessments, including an evaluation of the airlines' assets and costs associated with staff retrenchment. Contacts are also being made with creditors and with other airlines who might be interested in some of TACVs asses, including taking over some routes.

IV. Initial Environmental and Social Screening

22. **The country has a comprehensive institutional and regulatory framework to sustain acceptable implementation of safeguards.** The initial environmental and social assessment concludes that the Program's Environmental and Social Management System is adequate for P4R financing. In addition, the Directorate General of the Environment (DGA) is fairly familiar with the Bank safeguard policies requirements. The planned Environmental and Social Systems Assessment (ESSA) will determine the social and environmental risks associated with the activities to be funded under the program.

23. **In accordance with the requirements of OP 9:00, *Program-for-Results Financing*, a comprehensive technical assessment (Environmental and Social Systems Assessment – ESSA) will be conducted** to identify the strengths, weaknesses, and shortcomings of the Program's Environmental and Social Management System (ESMS) with a view to assessing the adequacy of the ESMS for P4R financing and identifying key actions to improve the environmental and social management performance of the Program. The final ESSA will be validated in consultation with all of the Program stakeholders. The final ESSA will (i) verify that the potential environmental and social risks and impacts of the Program are subject to an adequate initial screening; (ii) ensure that environmental and social mitigation measures to avoid, minimize, offset, and/or compensate any adverse impacts and promote environmental,

and social sustainability will be applied to activities that will have potential environmental and social negative impacts; and (iii) identify suitable measures to strengthen the ESMS for inclusion in the Program Action Plan.

24. **The initial environmental and social assessment suggests that as a natural disaster high risk country Cabo Verde has disaster risk management plans in place** and when natural disasters materialize the government receives strong support from humanitarian agencies, led by the United Nations. In addition, the World Bank Group has systems in place to support recovery assessments and longer-term recovery efforts, thus moderating the impact of natural disasters. This has most recently been evidenced against the backdrop of the volcanic eruption in Fogo.

25. **In addition, the initial assessment identified three key social risks:**

(i) *Involuntary land acquisition:* The activities related to IFH/CPT might include some building construction and rehabilitation. Though the Government plans to mobilize and use only public land, the ESSA will consider potential impacts in terms of loss of revenues, habitats and sources of revenues, in particular in rural areas where land titling is not systematic and customary laws are still practiced and in situations where public land is occupied or used informally;

(ii) *Gender and inclusion*: The Program will be gender informed and there will be no major gender and inclusion risks deriving directly from the implementation of the Program activities. However, the ESSA will consider a few potential indirect impacts due to inherent system weaknesses, including: (i) increasing access of female beneficiaries to social housing; (ii) potential negative impact of CPT/IFH measures on female headed households in poor areas; and (iii) limited physical accessibility of buildings for handicapped persons;

(iii) *Retrenchment of TACV staff*: Restructuring and privatization of TACV could lead to the retrenchment of up to 500 staff. This will have an impact on a significant number of families and households throughout Cabo Verde. The negative impact will be partially offset by the relatively generous retrenchment packages provided under Cabo Verdean law, as well as continued pension and insurance benefits for retrenched staff. In addition, the very significant public resources that will be freed up can be used to strengthen social programs. The ESSA will examine the impact of staff retrenchment.

26. **The ESSA will determine whether national systems provide adequate mitigation measures for these social risks and risks posed by minor infrastructure and rehabilitation activities**. The ESSA will put particular emphasis on the issues identified below:

(i) Processes and tools (screening sheets, compensation mechanisms and other relevant documentation included in the ESSA);

(ii) Institutional mechanisms to enforce safeguard policies (focal person at central and local levels in charge of monitoring social related impacts and mitigation measures);

(iii) Reinforce coordination and harmonization between relevant administrative stakeholders in rural areas in terms of land administration and procedures;

(iv) Avoid and/or minimize resettlement of people;

(v) Take into account informal occupants/squatters;

(vi) Include monitoring and evaluation processes in case of resettlement.

V. Tentative financing

Source:	($m.)
Borrower/Recipient	

IBRD		
IDA:	16 Million USD	
Others (specify)		
Total		16 Million USD

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