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Cape Verde: 2001 Article IV Consultation—Staff Report and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with Cape Verde, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **March 16, 2001,** with the officials of Cape Verde on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on May 11, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its June 15, 2001 discussion** of the staff report that concluded the Article IV consultation.

The document listed below will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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CAPE VERDE

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the 2001 Consultation with Cape Verde

Approved by Anupam Basu and Shigeo Kashiwagi

May 11, 2001

- A staff mission visited Praia during March 3-16, 2001 to conduct discussions for the 2001 Article IV consultation. Cape Verde is on the standard 12-month Article IV consultation cycle. The previous Article IV consultation with Cape Verde was concluded by the Executive Board on May 24, 1999. Discussions for the 2000 Article IV consultation, originally scheduled for April 2000, were postponed twice at the request of the authorities.
- The mission held discussions with Mr. Carlos Burgo, Minister of Finance and Planning, Mr. Olavo Correia, Governor of the Bank of Cape Verde (BCV), and other senior officials. The staff team also met with Mr. José Maria Neves, the newly-elected Prime Minister, as well as with members of the Chamber of Commerce and labor unions, and representatives of the donor community.
- The mission consisted of Mrs. Devaux (head), Messrs. Olters and Zejan, Ms. da Luz (Research Assistant), Ms. Haddi (Administrative Assistant) (all AFR), and collaborated with Mr. van Houtte, the World Bank's country economist for Cape Verde. Mr. Kpetigo from the Executive Director's office participated in the discussions.
- The discussions focused on the recent deterioration of the fiscal situation and on the policies needed to reduce domestic and external imbalances.
- Cape Verde has taken the necessary steps for the formal acceptance of obligations under Article VIII and of the Fourth Amendment to the Fund's Articles of Agreement. Summaries of Cape Verde's relations with the Fund and the World Bank Group are provided in Appendices I and II, respectively. Statistical issues are presented in Appendix III.

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EXECUTIVE SUMMARY

Developments in 2000

- During the period leading up to the legislative and presidential elections (held in early 2001), the structural reform agenda stalled, while the progress made in macroeconomic stabilization in previous years was partly undone. In particular, the fiscal situation deteriorated considerably. The fiscal deficit, including grants, widened by 8 percentage points to 19 percent of GDP in 2000 and was largely financed through recourse to the domestic banking system and the accumulation of arrears. Energy price subsidies, coupled with the good 1999/2000 harvest, resulted in a decrease in consumer prices, while real GDP continued to grow.

- Given the fixed exchange rate system, the fiscally induced expansion of net domestic assets of the banking system resulted in a considerable decline in official reserves. Unlike in 1999, the central bank did not allow the foreign exchange queue to be used as an instrument to control the outflow of foreign exchange. The central bank raised the discount rate by 100 basis points.

Policies for 2001

- Against this background, the mission stressed to the authorities that economic policies in 2001 needed to focus on ways to (i) rapidly redress the fiscal situation; and (ii) reverse the loss of external reserves. In particular, taking into account outlays already incurred during the first three months of the year, the budget for 2001—which is still in the preparatory phase—will need to include both revenue-enhancing and expenditure-restraining measures. In order to safeguard the domestic currency's peg to the euro, the authorities intend to amend the central bank law and the constitution to assure institutionally the central bank's ability to contain inflation.

Points stressed in the staff appraisal

- Both the restoration of fiscal soundness and central bank independence are urgently required to ensure the sustainability of the current exchange rate arrangement.

- The domestic debt-reduction operation should be completed as soon as possible to ensure medium-term fiscal viability.

I. Introduction

1. About two years have lapsed since the last Article IV consultation with Cape Verde because the preparation of the elections led the authorities to request the postponement of a mission twice in 2000. In concluding the last Article IV consultation with Cape Verde, Executive Directors welcomed the elimination of quantitative import restrictions and the liberalization of foreign exchange regulations. They emphasized the need to consolidate the progress made in containing the fiscal imbalances by continuing with prudent expenditure policies and further strengthening the tax system and budgetary procedures. They observed that, with the exchange rate pegged to the euro, it was essential that monetary policy be geared toward both containing inflation and strengthening the level of official reserves.

2. Between February 20, 1998 and March 15, 2000, Cape Verde's macroeconomic stabilization and structural reform efforts were supported by a precautionary Stand-By Arrangement in the amount of SDR 2.5 million (or 26 percent of quota; see EBS/98/18; 02/04/98).[1] The three reviews were completed in September 1998, May 1999, and March 2000, respectively.[2] The program supported by the arrangement aimed at reestablishing a sound macroeconomic framework that would serve as a basis for a comprehensive, donor-supported domestic debt-reduction operation.

3. The year 2000 was marked by strong political activity that intensified after the ruling Movimento para a Democratia (MpD) fared unexpectedly poorly in the municipal elections in February. Internal divisions deepened, weakening the government's popularity in the runoff to the legislative and presidential elections in early 2001. The Partido Africano da Independência de Cabo Verde (PAICV), which had fought for independence and governed the country between 1975 and 1991, won the legislative elections decisively, allowing Mr. José Maria Neves to head the country's new majority government. The transition of power took place peacefully on February 1, 2001. The largely ceremonial position of president, however, was decided only after two rounds of elections and the intervention of the constitutional court, giving the PAICV-supported candidate, former Prime Minister Pedro Pires, a razor-thin advantage of less than 0.01 percent of all votes cast over Carlos Veiga, Prime Minister between 1991 and 2000.

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[1] In February 1998, the Board approved a 14-month Stand-By Arrangement in the amount of SDR 2.1 million (30 percent of quota). In May 1999, the Board extended the arrangement until end-December 1999 and raised the access. In December 1999, the Board granted an additional extension until mid-March 2000. The authorities did not make any purchases under the arrangement.

[2] EBS 98/157 (20/04/98); EBS/99/71 (05/06/99); and EBS/00/34 (02/25/00).

II. Recent Economic Developments

4. **Under the program supported by the precautionary Stand-By Arrangement, Cape Verde made good progress in 1998–99, despite occasional backsliding.** Structural reforms created an environment conducive to private sector activity. Periodic delays notwithstanding, progress was made in the comprehensive privatization program, a key element of the overall domestic debt-reduction operation. Subsequently, real GDP growth accelerated, driven by (i) the development of tourism; (ii) significant foreign investments in the export-oriented manufacturing sector; and (iii) sustained and substantial inflows of workers' remittances, which stimulated construction activities. During 1998–99, real GDP grew by an average of 8 percent. Compared with 1997, inflation was halved to an average level of 4.4 percent in 1998–99.

5. **Fiscal slippages occurred in the second half of 1999** and led to pressures on the balance of payments, mainly because extraordinary public expenditures were undertaken to cushion the social impact of a serious drought that had destroyed much of the 1998/99 harvest. The widening overall fiscal deficit including grants (11 percent of GDP, compared with 4 percent in 1998) was accommodated throughout much of the year by higher-than-programmed credit from the central bank. The government managed to repay some central bank credit at end-December because of substantially higher-than-expected privatization receipts. Given the economy's high degree of openness and the fixed exchange rate regime, the expansionary fiscal and credit policies led to higher imports and a widening of the external current account deficit (including official transfers) to 14 percent of GDP. To some extent, these current account pressures were contained by the Bank of Cape Verde (BCV), which temporarily reintroduced foreign exchange rationing in late 1999. With the significant inflows of foreign direct investment, mainly related to privatization, and large disbursements of bilateral and multilateral credits, the external capital account improved markedly, turning the overall balance into a surplus and thereby allowing a strong year-end accumulation of official reserves to the equivalent of more than two months of imports of goods and services. On balance, these developments led to an acceleration in broad money growth and excess liquidity in the banking system.[3]

6. **In 2000, although real GDP growth slowed down, it still remained strong** (about 7 percent), with exports rising sharply (nearly 30 percent). The import growth rate dropped to less than that of GDP, and there was an improvement in the external current account balance. Reflecting significant energy price subsidies, an improved 1999/2000 harvest, and the fixed exchange rate (limiting increases in import prices), consumer prices declined by almost 2½ percent. With this moderately negative inflation, the effective exchange rate depreciated in real terms (see Figure 1).

[3] Broad money growth rose from 2.7 percent in 1998 to about 15 percent in 1999 (Table 1).

7. In the context of the preparation of the elections and contrary to the commitment made by the government in place in February 2000,[4] **the deterioration in the fiscal stance that started in the second half of 1999 worsened in 2000. Much of the progress made in fiscal consolidation in previous years was reversed, endangering the peg to the euro.**[5] While revenue performance was satisfactory,[6] the overall fiscal deficit, including grants, widened from 11 percent of GDP in 1999 to 19 percent, reflecting the impact of unforeseen restructuring costs in connection with the privatization of commercial banks[7] (7 percent of GDP), the petroleum price subsidies (4 percent), and the newly budgeted student scholarships[8] (1 percent). Moreover, the government did not adjust domestic petroleum prices in line with international prices, leading to subsidies equivalent to 4 percent of GDP. With no net foreign financing available, **the deficit was largely monetized, while domestic and external arrears were accumulated,** equivalent to 5 percent and 2 percent of GDP, respectively (see Box 1 and Figure 2). The sizable recourse to domestic bank credit (8 percent of GDP) increased the stock of domestic debt, including claims on the Trust Fund (theTCMFs),[9] from 30 percent at end-1999 to 40 percent at end-2000; this largely reversed the impact of the donor-supported domestic debt-reduction operation launched in 1998.

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[4] In its memorandum of economic and financial policies of late February 2000, the government had aimed at reversing the drought-induced slippages and limiting the overall fiscal deficit, including grants, to 6.5 percent of GDP (see paragraph 17 of Appendix I in EBS/00/34 of 2/25/00).

[5] Expenditure overruns and temporary episodes of salary arrears during the year prompted the government to present a supplementary budget to parliament in November 2000 in which expenditures were raised by 12.3 percent (see Box 1).

[6] The good performance partly reflects the introduction of antifraud measures by the customs administration and improved collection efforts by the tax administration (taxes can now be directly paid on all islands through commercial bank branches, while penalties for late payments have been increased).

[7] This included the assumption of nonperforming student loans (CVEsc 1.5 billion) and the cost of interest subsidies (CVEsc 1.9 billion) and was financed outside the budget with long-term instruments (10-15 years) at interest rates equal to the London Interbank Offered Rate (LIBOR) plus 1.5 percent.

[8] Prior to the privatization of the commercial banks, scholarships were granted by the government through bank loans. As these, however, were not properly recorded and lacked mechanisms to enforce repayments, they thereby constituted nonperforming loans, which were assumed by the government. Starting with the revised 2000 budget, these scholarships are directly paid out of the budget in the form of grants.

[9] TCMFs are securities issued and serviced by the Trust Fund established to support the domestic debt reduction operation.

8. **With limited statutory independence, the central bank was not able to contain monetary expansion adequately**. Broad money grew by almost twice the rate of nominal GDP, because, in terms of beginning-of-period broad money, credit to government expanded by 21 percent[10] and resulted in an expansion of net domestic assets of the banking system of 16 percent. The central bank' s task of restraining credit expansion was complicated by the delay in passing the supplementary budget until mid-November 2000. In an attempt to limit the large credit expansion during the last quarter of 2000, the BCV raised its rediscount rate by 100 basis points to 9.5 percent in December. Nevertheless, the banking system's net foreign asset position, which was under pressure throughout 2000, declined by 2.7 percent.[11]

9. **Faced with the unsustainable fiscal situation, the central bank accommodated the budget financing needs, partly as a result of its limited independence.**[12] Under the central bank law (Article 26), the BCV's advances to the treasury "should not exceed 5 percent of the previous year's current receipts." This requirement was not observed as the BCV's advances represented more than 20 percent of 1999 tax revenues throughout most of 2000 (see Figure 2). Moreover, the purchase by the central bank of securities (TCMFs) owned by commercial banks contributed to monetary expansion in 2000.

10. **Cape Verde's banking system appears to be sound,**[13] considering the substantial cleanup of the commercial banks' balance sheets during their privatization and the implicitly privileged relationship of these banks with their main shareholders.[14] Nonperforming loans in

[10] Of which 9.3 percent corresponded to the reclassification of privatized banks' balance sheet items (CVEsc 1.5 billion from credit to the private sector on account of nonperforming loans to students and CVEsc 1.9 billion from other items net for interest subsidies) as government debt.

[11] Corresponding to a 37 percent reduction in the central bank's net foreign assets over the year.

[12] The central bank law—Law No. 2/V/96 of June 1, 1996—states that the BCV is to "**collaborate**, in an autonomous fashion, in the definition and execution of monetary policies, having as goal the maintenance of price stability and the support of the overall economic policies by the government" (Article 16). This is repeated in the constitution.

[13] Based on the conclusions of an MAE technical assistance mission that visited Praia during November 11–20, 2000.

[14] All of the commercial banks in Cape Verde are now Portuguese owned. The parent banks back their subsidiaries with credit lines.

the banking system have decreased, both in absolute terms and relative to total credit.[15] This outcome reflects the efforts made in cleaning up the balance sheets of the Banco Comercial do Atlântico (BCA) and the Caixa Econòmica de Cabo Verde (CECV) before their privatization and substantial provisioning in accordance with the prudential requirements defined by the BCV. The central bank's supervision department follows supervision practices that are in broad conformity with the Basel Core Principles. However, greater reliance on short-term capital inflows in the form of deposits held by emigrants might increase the banking system's vulnerability to shocks in the capital account (see Box 2).

11. **Although the external current account deficit narrowed in 2000, despite higher interest payments associated the increased borrowing in 1998–99, the overall balance of payments turned to a deficit as a result of lower inflows of direct foreign investment and external assistance** (Table 5). The suspension of external assistance reflected the deterioration in fiscal performance and the resulting accumulation of external arrears[16] to both multilateral and bilateral creditors. In particular, the failure to repay, by year's end, the credit line with Portugal, as required by the 1998 Exchange Cooperation Accord,[17] blocked access to this facility; this, in turn, raised concerns about the sustainability of the exchange rate peg. The overall balance of payment deficit was financed by a drawdown of official reserves, which fell from US$63 million at end-1999 to US$35 million at end-2000, thereby reducing the import coverage from 2.2 months of goods and services to 1.3 months. In contrast to 1999, the central bank did not allow the foreign exchange queue to be used as an instrument to control the outflow of foreign exchange.

12. **Over the last three years, external debt has been rising continuously as a share of GDP, from 44 percent at end-1998 to 57 percent at end-2000.** Almost all of the additional external debt has been incurred vis-à-vis the World Bank and the African Development Bank, to which 56 percent of the total outstanding debt at end-2000 is owed. Bilateral debt represents only 27 percent thereof. As a result, external debt service increased

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[15] Nonperforming loans decreased from CVEsc 3,116 million in 1997 to CVEsc 1,484 million in 1999. In terms of total credits, the ratio decreased from 31 percent to 10 percent during the same period. Provisions also rose from 35 percent of nonperforming loans in 1997 to 105 percent in 1999.

[16] These arrears relate to government debt and were incurred for lack of adequate government revenue. Thus they do not evidence foreign exchange restrictions.

[17] According to this July 1998 accord, Portugal extended a precautionary credit line of up to CVEsc 4.95 billion, which was to be repaid each year by year's end. This credit line was granted to finance imports and external debt service, and to ensure free convertibility between the currencies of the two countries (Article 1). However, the government actually used the credit line to support the budget and drew thrice in 2000, for a total of CVEsc 1.65 billion (or 2.6 percent of GDP).

from 7 percent of exports (of goods and nonfactor services) and private transfers in 1998 to 17 percent in 2000.

13. **Progress was limited on the structural front.** The preparation for the introduction of a value-added tax (VAT) and the tariff reform was delayed, as well as the reform of the budget management and monitoring system. Privatization efforts slowed (the status of the comprehensive privatization program is summarized in Box 3). The domestic debt-reduction operation under the Trust Fund (see Box 4) was also delayed on account of shortfalls in both external assistance and foreign exchange receipts from privatization.

III. Report on Policy Discussions

14. The authorities concurred with the mission on the seriousness of the deteriorating economic situation and reaffirmed their commitment to macroeconomic stability and the present exchange rate regime. **Against this background, the discussions focused on ways to (i) rapidly redress the fiscal situation and address the resulting problem of an unsustainable debt burden and increasing arrears; (ii) strengthen the relatively low level of official external reserves; and (iii) implement reforms to achieve a sustainable rate of economic growth.** The authorities expressed a strong interest in the preliminary macroeconomic framework, which had been developed with the help of the mission, and indicated that they intended to use it in the preparation of the budget for 2001, which is scheduled to be presented to parliament soon. They also plan to approach the donor community to obtain support for their macroeconomic framework. Portugal, the European Union and the World Bank have already expressed their willingness to support Cape Verde once the authorities adopt a program with the Fund.

A. The Macroeconomic Framework for 2001

15. Economic growth is expected to slow further to 3–4 percent in 2001, due to a number of factors. First, activity is not expected to increase in the agriculture and fishing sectors, which represent 11 percent of GDP. Second, construction activity (8.4 percent of GDP) is projected to contract, reflecting lower public investment and a stagnation in workers' remittances (resulting from a slower growth in the host countries). Finally, despite some dynamism in the private sector, investors are still gauging the policies of the new government, and, hence private investment is likely to drop as a share of GDP. At the same time, inflation is likely to increase to about 5 percent, mainly on account of the significant expansion of money in 2000 and the impact of the recent increase in domestic prices of petroleum products. With exports projected to grow more rapidly than imports (12.8 percent and 2.3 percent, respectively), the external current account deficit (excluding official transfers) is likely to decline by about 1 percentage point of GDP. Consistent with these targets, the authorities plan to limit the overall fiscal deficit (including grants) to about 6–7 percent of GDP; although this deficit was 19 percent of GDP in 2000, the underlying

permanent part of it was 8 percent after excluding the one-time exceptional outlays related to restructuring (7 percent of GDP) and petroleum price subsidies (4 percent).

16. **In contrast to the very short-term outlook, the authorities' medium-term objectives are to achieve real GDP growth rates of at least 6 percent, reduce the inflation rate to the euro zone rates, and continue to narrow the external current account deficit to about 7 percent of GDP by 2003.** The planned fiscal adjustment is expected to be accompanied by a restrained monetary policy.

B. Fiscal Policy

17. **The authorities concurred with the need to tighten the fiscal stance for 2001** in order to curtail the recourse to monetary financing and the growth of the domestic public debt and start to eliminate arrears to both domestic and external creditors. However, given the modest fiscal adjustment planned for 2001, the total financing required to cover the targeted overall deficit (including grants), the scheduled amortization, and the planned reduction of domestic and external arrears would be large (CVEsc 14.3 billion or 21 percent of GDP). After accounting for the expected privatization receipts (CVEsc 2.2 billion), the planned recourse to domestic bank credit (CVEsc 1.0 billion), and the likely foreign loan disbursements for projects (CVEsc 2.5 billion), the financing gap remains sizable (CVEsc 8.6 billion or 12.5 percent of GDP). The authorities plan to contact donors for assistance in rescheduling external arrears and current debt service (5 percent and 8 percent of GDP, respectively) and for budget support. In early 2001, progress has been made in rescheduling bilateral arrears; however, most of the debt service is due to multilateral development banks. To service this debt,[18] the government will need additional external aid. If such an assistance is not forthcoming, the authorities will not be able to eliminate existing arrears and may have to postpone payment of some external amortization obligations.

18. **Taking into account outlays already incurred in the first three months of the year,[19] the authorities agreed that, in order to achieve the deficit target noted above, the budget for 2001 will have to include both revenue-enhancing and expenditure-restraining measures.** Quick-yielding revenue measures could include the introduction of an airport tax, increases in the excise tax on alcohol, and a rise in the tourism tax. The mission emphasized that the reform of the tax system, launched with technical assistance from FAD in 1998, needed to be pursued vigorously. The introduction of the VAT, along with the new tariff, should be implemented in the context of the 2002 budget. The authorities agreed to take the necessary steps to present the draft VAT legislation to parliament in the coming months. In addition, the mission emphasized that the generous system of tax holidays and

[18] In 2001, debt service represents almost 36 percent of government revenue.

[19] In particular, these outlays include petroleum price subsidies for the period up to the price increase in March and expenditures for the elections, which together amount to approximately 2 percent of GDP.

exemptions from customs duties, which had been granted as an incentive to new enterprises (or for extensions of existing ones), needed to be reviewed. On the expenditure side, the recent increase in petroleum product prices of 20–25 percent is expected to reduce subsidies by almost 3 percent of GDP. The authorities indicated that they would be ready to consider further increases in petroleum prices, if needed, while awaiting the results of a World Bank-financed study aimed at introducing an automatic and transparent pricing mechanism. Wage increases will also be strictly resisted, so as to contain the wage bill.[20] The authorities informed the mission that they had started discussions with labor unions on this matter. Finally, transfers and current outlays for goods and services will not increase in nominal terms, and student stipends will be reviewed.

19. **To restore fiscal discipline without delay, the authorities agreed to** (i) implement, in coordination with the BCV, weekly cashflow plans and prepare monthly public finance statements consistent with the monetary program; (ii) eliminate all extrabudgetary outlays and prepare, with World Bank assistance, a public expenditure review; and (iii) promptly adopt the necessary decisions to relaunch the reform of budget management and monitoring, with the objective of starting implementation by January 1, 2002. In addition, the authorities intend to adopt an organic budget law and the new public accounting plan, and to strengthen the budget department.

C. Monetary and External Reserve Policies

20. The authorities recognized that **the large expansion in credit in 2000** that had resulted from expansionary fiscal policies **raised concerns about (i) the central bank's independence; (ii) its ability to maintain sufficient reserve cover; and (iii) the long-run viability of Cape Verde's pegged exchange rate.** The authorities agreed that, in addition to a restrained fiscal stance, central bank independence was an essential element of the policies needed to support the exchange rate peg. They recognized that the central bank law and the constitution should be amended to ensure that it was institutionally empowered to maintain price stability. A draft revision of the above law, which clearly defines the 5 percent limit on central bank financing of the budget, is ready for the government to approve and present to parliament. The staff recommended a complete ban on central bank cash advances.

21. **The authorities also concurred with the mission that a tight monetary stance would help to contain pressures on the exchange rate and stem the further loss of foreign reserves.** The central bank explained that while its instruments to control liquidity (interest rates, reserve requirements, TCMFs, and the newly created liquidity absorption

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[20] An agreement with labor unions reached in 1999 provides for the real purchasing power of public sector salaries to be protected by limiting increases to the expected inflation rate, adjusted to compensate for the difference between actual and projected inflation in the previous year. As a result of the latter adjustment, nominal wages would be constant in 2001.

facility[21]) were adequate, its ability to control credit expansion had been limited by the lack of adequate information to assess economic activity accurately. The mission was assured that

the central bank would use available indirect instruments of monetary control more actively[22] and would soon start to work, in coordination with the National Institute of Statistics (INE), on developing economic activity indicators.

22. **The current level of the Cape Verde's escudo appears to be broadly adequate,** as evidenced by the strong growth in receipts from tourism and exports and the sizable inflows of private investment and foreign remittances since 1998 (the date when the escudo was last adjusted). The recent loss of reserves is closely linked to the fiscal slippages and could be reversed, provided a strong fiscal adjustment is implemented, supported by a tight monetary stance.

D. External Policy

23. **The authorities indicated that they were committed to maintaining the liberalized exchange and trade system**. Except for one outstanding exchange restriction regarding payments for the rendering of financial services related to authorized capital transactions, Cape Verde has eliminated all previously identified exchange restrictions on the making of payments and transfers for current international transactions. The authorities have prepared a draft decree to eliminate the outstanding restriction. Staff are monitoring progress in this regard. In addition, the authorities have indicated that they do not intend to reintroduce the foreign exchange queue in the future to protect official reserves. As regards the trade regime, following the elimination of all remaining quantitative import restrictions and their replacement with revised customs duties, effective January 1, 1999 (EBS/99/71, paragraph 18), it has remained unchanged during 1999–2000. The mission noted that progress should be made to reduce the external tariffs, which have remained high, with maximum and simple average tariff rates of 50 percent and 25 percent,[23] respectively. The authorities indicated that they intend to reduce these rates at the time of the introduction of the VAT, so as to limit the revenue impact on the budget.

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[21] This facility, created in 2000, allows banks to deposit their excess liquidity at the central bank and earn an interest rate of 3½ percent on such deposits.

[22] At end-April 2000, the central bank raised its rediscount rate further by two full percentage points to 11.5 percent in order to protect the exchange rate peg.

[23] Under the current regime, the ten import-duty rates—1,5,10,15, 20, 25, 30, 35, 40, and 50 percent—are complemented by a consumption tax, with rates ranging from 3 percent to 10 percent, and a customs service fee of 7 percent.

E. Structural Reform and Social Policy

24. **Privatization and the related debt-reduction operation are among the key structural reforms being implemented with World Bank assistance.**[24] As summarized in Box 3, several enterprises remain to be privatized, mainly the ports (ENAPOR), the airline (TACV), the ship repair facility (CABNAVE/CABMAR), and the food import and distribution company (EMPA). However, the authorities indicated that, except for the privatization of the TACV, they did not expect much progress in 2001, as the financial resources for the retrenchment of enterprises' staff were lacking (particularly for EMPA). The staff stressed the importance of accelerating at least the privatization of other public enterprises, as the related receipts could be used to cover both retrenchment benefits and domestic debt reduction. The authorities noted that the distribution of pharmaceutical products had now been privatized, and that a regulatory agency would be created soon to oversee the provision of medicine. Finally, they emphasized that food imports had been liberalized with the end of EMPA's monopoly.

25. **The donor-supported domestic debt-reduction operation was delayed** (Box 4). At end-2000, the Trust Fund, which had been established in 1998 to retire domestic public debt, had accumulated resources amounting to US$100 million (or 56 percent of the outstanding debt at end-1997), compared with an objective of US$180 million. Multilateral and international donors contributed up to US$63 million (or 63 percent of their programmed share in Trust Fund resources). However, foreign exchange receipts from privatization[25] amounted only to US$37 million (or 47 percent of the programmed amount). This leaves an amount of about US$80 million to be financed to reach the initially programmed amount. In the meantime, the domestic debt has increased to about US$220 million. The mission noted that these developments highlight the urgent need to correct the deficits in the public sector and press ahead with the privatization process.

26. **The National Poverty Alleviation Plan (NPAP)**, which was adopted in 1997 as an integral part of the 1997-2000 National Development Plan (NDP), aims at achieving sustained poverty reduction by promoting the integration of poor communities and social groups into Cape Verde's economic development efforts (Box 5). A broad-based participatory process involving municipal and nongovernmental organizations has been developed. The authorities indicated that the NPAP, which effectively started in 2000, would focus in the next three years on the preparation of the administrative decentralization. The authorities intend to continue to enhance expenditure tracking through a decentralized and computerized accounting system. The NDP, together with the NPAP, will need to be updated

[24] Under the Economic Reforms Support Operation II, and the Privatization and Regulatory Capacity Building Project.

[25] The sale of the banking group BCA in January 2000 accounted for US$22 million.

soon. In this regard, the authorities will be using the forthcoming household survey to update information on poverty in Cape Verde.

F. Statistics

27. **The mission emphasized the need to improve the quality of data and their timeliness, mainly in the real and external sectors.** The concerns about the national accounts, described in the staff report for the third review under the Stand-By Arrangement,[26] remain to be addressed as the INE's work is constrained by the lack of resources. Nevertheless, in 2001, the INE's staff expects to (i) finalize the national accounts for 1996-97 by end-July (including accounts in constant prices and of final uses); (ii) collect data for 1998-2000 by end-September and issue provisional national accounts by October; and (iii) launch annual surveys of public sector investment, enterprises' financial data, and agricultural sector activity. As already mentioned, work is also progressing on an household survey, to be carried out in July, and the preparation of the new consumer price index (CPI). Finally, the authorities noted that the balance of payments statistics were weak because of the lack of information on private capital flows, particularly foreign direct investment and commercial credits.

G. Prospects for the Medium Term

28. **The policies of structural adjustment implemented during the 1990s had helped to improve Cape Verde's balance of payment viability.** A more dynamic private sector has emerged and the export base has become larger and more diversified, driven by important investments in recent years in the tourism, transport, and manufacturing sectors. In 2000, these improvements were reflected, for instance, in the accumulation of foreign reserves by the commercial banks: for the first time they have been able to sell foreign currencies to—rather than being obliged to buy them from—the central bank.

29. **Nevertheless, Cape Verde's external vulnerability remains high, largely due to fiscal slippages** (Table 6) The trend decline in official foreign reserves and the increasing burden of servicing the external debt, as well as the recent unavailability of the Portuguese credit line, pose great risks to the sustainability of the fixed exchange rate regime. The staff has, therefore, advised the authorities to adopt appropriate policies to correct the weak macroeconomic situation and support the promising developments in the export-oriented private sector. The country could benefit from (i) the expected real economic growth in Portugal,[27] which buys 80–90 percent of Cape Verde's exports; and (ii) the recent improvements in external competitiveness as evidenced by the depreciation in the real exchange rate and, compared with Portugal, lower labor cost increases.

[26] See EBS/00/34 (2/25/00).

[27] For 2001–2003, Portugal's real GDP growth is projected to average about 2.8 percent.

30. The staff prepared a medium-term scenario on the assumptions of continued fiscal consolidation, appropriately tight monetary policy and progress in structural reforms (Tables 1 and 2). Real GDP growth is projected to increase after 2001 and to reach at least 6 percent by 2003. Inflation would average 3 percent per year, consistent with the exchange rate peg. The scenario relies heavily on the authorities' implementation of a coherent set of macroeconomic policies, which would increase private sector confidence and facilitate the resumption of external assistance. It also assumes a sustained growth in exports of goods and tourism,[28] expected to be the main engines of Cape Verde's economic development. Given the heavy import dependency of the country and the low reserve cover of imports, the scenario envisages a halt to the decline of international reserves and their eventual buildup.

31. With the fiscal deficit (including grants) projected to decline from 19 percent of GDP in 2000 to about 3½ percent by 2003 and the projected net inflows of foreign financing, the government is expected to repay the domestic banking system and thus free up resources for private sector activity. This outcome would be mainly achieved through a reduction of public expenditure from 34 percent of GDP in 2000 (net of exceptional bank restructuring costs and petroleum price subsidies, which accounted for about 11 percent) to 30½ percent by 2003. At the same time, government revenue is projected to grow by about 1 percentage point of GDP to about 27 percent of GDP, as a result of the strengthening of the tax system. Total domestic consumption would fall from 114 percent of GDP in 2000 to about 107 percent in 2003.

32. The external current account deficit (including official transfers) would narrow from 12 percent of GDP in 2000 to just above 7 percent by 2003. Export earnings would grow by an average of 9 percent per year, reflecting private investments in tourism and manufacturing. Assuming adequately restrained demand-management policies, import growth would be kept at a yearly average of around 4½ percent. Strong direct investment and private capital inflows, spurred by a strengthening of private sector confidence, would maintain a strongly positive capital account. Reflecting these developments, foreign reserves are forecast to rise from a low of 1 month of imports at end-2000 to about 2½ months by 2003.

IV. Staff Appraisal

33. **The recent progress made in macroeconomic stabilization was partly undone by the fiscal derailment observed in 2000**, with the consequence that, in 2001, the government

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[28] The tourism industry is nascent in Cape Verde; its share in total exports of goods and services has grown from 11 percent in 1998 to 31 percent in 2000. In the scenario, they are conservatively projected to grow by 20 percent per year during 2001–2003 (less than one half the rate observed during 1997–2000), driven by the ongoing construction of hotels. Exports of goods are expected to double in 2001 (from a very low base and as a result of the expansion of productive capacity by several major export-oriented enterprises in 1999 and 2000) and by an annual average of 6 percentage points in 2002–03.

is faced with the challenges of (i) substantial fiscal adjustment; (ii) bolstering central bank independence through appropriate changes in related laws; and (iii) the regularization of relations with its creditors. These tasks will have to be completed with urgency given the large imbalances in the public sector, the delays in the preparation of the 2001 budget, a slowing economy, and rising prices. The staff regrets that there were no discussions with the authorities during 2000, nor regular communication of information, which prevented an early warning of the deterioration that took place during the year.

34. **The sharp decline in official reserves, the unsustainable debt burden, and the suspension of the Portuguese credit line pose risks to the sustainability of the fixed exchange rate between the Cape Verde's escudo and the euro.** While welcoming the authorities' commitment to the current exchange rate arrangement, the staff urges them to implement promptly appropriate macroeconomic policies to ensure the viability of the exchange rate peg.

35. **A strong fiscal adjustment is needed to reduce domestic and external imbalances.** The staff welcomes the authorities' intention to rely on both revenue-raising and expenditure-restraining measures to ensure an appropriately tight budget for 2001 that is strictly consistent with the need to reduce domestic bank financing. It commends the authorities for their decision to increase petroleum prices without delay and recommends the urgent implementation of an automatic and transparent pricing mechanism. The authorities are also strongly advised to resist wage increases, so as to contain the wage bill. In addition, the staff urges them to resume preparations for introducing the VAT with the 2002 budget.

36. **To avert future fiscal slippages, fiscal discipline needs to be restored.** In this regard, the staff considers it important to establish weekly cashflow plans in coordination with the central bank, and monthly public finance statements that are consistent with the monetary program. In addition, to ensure a close and reliable control of expenditure, the staff urges the government to take the decisions needed to resume preparation of the new budget management and monitoring system.

37. **The independence of the central bank is crucial to its ability to control inflation and protect the exchange rate peg.** The staff welcomes the authorities' intention to constitutionally enshrine the central bank's statutory independence. The monetary authorities should be commended for their decision to raise the discount rate and refrain from resorting to foreign exchange rationing mechanisms to stem the loss of reserves. The BCV should actively use all its indirect instruments to control inflation.

38. **Strong efforts to reduce the domestic debt remain key to achieving medium-term fiscal sustainability.** This is all the more important, given the significant increase in the domestic public debt in 2000. The staff urges the authorities to push forward with the privatization of the remaining public enterprises and to work with the principal donors to ensure that the debt conversion process can be completed as soon as possible.

39. **Despite recent progress, there is an urgent need for further improvements in the statistical system.** The staff welcomes the INE's work program for the coming months and strongly supports its efforts in updating the base of the national accounts and the CPI, especially in view of the substantial changes in the economy in recent years. Moreover, the household survey, scheduled for July 2001, is critical for updating Cape Verde's poverty profile and as a foundation for future reform of the CPI. The staff also urges the central bank to improve the compilation of balance of payments data by focusing on direct foreign investment and private financial flows—the weakest elements of the balance of payments. Government expenditure recording and public accounting also need improvement; and implementation of the new budget management and control system should make an important contribution in this area.

40. It is proposed that the next Article IV consultation with Cape Verde be held on the standard 12-month cycle.

Box 1. The Supplementary Budget in 2000

The supplementary budget—approved by parliament in mid-November 2000—represents the central factor behind the rapid deterioration in Cape Verde's fiscal stance in 2000. It allowed for additional expenditures based on (i) an expected 8 percent improvement on the revenue side, (ii) considerably higher domestic financing, and (iii) a projection of lower interest payments. However, by year's end, it became evident that expenditure needs had exceeded the budget projections, while revenue projections had proven to be overly optimistic. Notwithstanding considerably lower public investments (and excluding the unbudgeted bank restructuring costs), the ultimate fiscal gap exceeded projections by CVEsc 3.4 billion (or 5.3 percent of GDP), which mainly stemmed from underestimated projections for petrol price subsidies (CVEsc 1.7 billion) and interest payments (CVEsc 1 billion). In the absence of foreign financing, the developing gap (CVEsc 8 billion) was closed by using domestic resources, including arrears (CVEsc 1.5 billion).

	Original Budget	Supplementary Budget	Budget Execution
		(In billions of Cape Verde escudos)	
Total revenue, grants and capital participation	**20.6**	**22.3**	**16.9**
Total revenue	13.4	13.7	13.2
External grants	5.8	6.3	3.6
Domestic capital participation	1.4	2.3	0.0
Total expenditure	**23.8**	**26.7**	**24.7**
Recurrent expenditure	12.5	14.0	17.6
Primary current expenditure	11.5	13.3	15.8
Wage bill	6.8	7.2	6.4
Goods and services	0.9	1.0	0.5
Transfers and subsidies	3.0	4.1	6.8
Of which: petrol price subsidies	0.0	1.1	2.8
Other expenditures	0.9	1.1	2.1
Interest accrual	1.0	0.7	1.7
Capital expenditure	11.3	12.7	7.2
Overall balance, incl. grants	**–3.2**	**–4.5**	**–7.9**
Financing	**3.2**	**4.5**	**7.4**
External	3.3	2.7	3.0
Of which: arrears	0.0	0.0	3.0
Domestic	–0.1	1.8	4.4
Of which: arrears	0.0	0.0	1.5
Gap	**0.0**	**0.0**	**0.5**
Memorandum items:			
Bank restructuring costs	0.0	0.0	4.4
Associated domestic bank financing	0.0	0.0	4.4
		(In percent of GDP)	
Total receipts	31.8	34.5	26.1
Total expenditure	36.8	41.3	38.2
Overall balance, incl. grants	–4.9	–7.0	–12.1

Sources: Cape Verdean authorities; and staff estimates.

Box 2. The Banking System

There are currently four banks[1] with 30 branches operating in Cape Verde. Branches are mainly concentrated in the islands of Santiago and São Vicente. In addition to the banks, there are three nonbank financial institutions and two insurance companies. The nonbank financial institutions consist of a risk capital company (Promotora), a foreign exchange agency (Câmbios 24 Horas), and a company issuing credit cards (Sociedade Interbancaria e Sistemas de Pagamentos).

The commercial banking system is largely privatized, although the state retains a substantial minority interest. Control is now vested in Portuguese banks and insurance companies, although the banks are all incorporated in Cape Verde and there is no explicit obligation on the part of the majority shareholders. The BCA and the CECV together account for 88 percent of the banking system's deposits. With the privatization of state-owned banks largely completed and the opening of the banking system to foreign banks, the role of the state has been redefined to become one of regulating the financial system.

Banking supervision is the responsibility of the BCV under the terms of Article 21(2) of the Organic Law of the Bank of Cape Verde, approved pursuant to Law 2/V/96 of July 1, 1996. The Department of Supervision of the BCV is subdivided into two sections—one for insurance companies, the other for credit and parabanking institutions. Besides the commercial banks, the latter section is also responsible for the supervision of the future stock market and any offshore banks.

The banking supervision department has followed the Basel Core Principles. The department conducts both off- and on-site inspections of the banks and informs the board of the BCV on a monthly basis on the situation of the individual banks and their compliance with prudential regulations. It also advises the Minister of Finance on the granting of new banking licenses.

The following regulations govern the activities of financial institutions:

- The purchase of real estate is limited to what is necessary for their operations, and the market value of real estate holdings may not exceed the bank's capital.
- Equity stakes in firms not supervised by the BCV may not exceed certain maximum limits; an institution may not invest in any single firm more than 15 percent of its capital, nor may this particular equity stake represent more than 25 percent of voting rights. These equity stakes count toward the risk exposure limits.
- Equity and loans exceeding 10 percent of the bank's capital are considered to be of high risk. Exposure to one client may not exceed 25 percent of the institution's capital, and the total amount of high risks cannot exceed eight times the amount of the institution's capital.
- The minimum capital of a bank is CVEsc 300 million, and the risk-weighted capital adequacy ratio is 10 percent. The definition of the various components of own capital and the criteria for weighting off-balance-sheet assets and accounts follow closely the rules adopted by the European Union.
- The institutions are obliged to establish provisions for overdue loans, general credit risks, retirement pensions, survivors' benefits, and capital losses on securities and other investments. Nonperforming loans are divided into five groups (up to 3, 6, 12, 36, and more months), with nonperforming loans secured by collateral requiring lower provisioning.
- Banks have to keep unremunerated legal reserves of 18 percent at the BCV, with a minimum of 5 percent of deposits invested in government bonds (2 percent for nonbank financial institutions).
- Banks need to have adequate internal risk management and audit procedures. External audits have to be conducted by one of the large international audit firms.

So far, the BCV has not imposed sanctions, and all banks have complied with the regulations.

[1] Banco Comercial do Atlântico (BCA), Caixa Económica de Cabo Verde (CECV), the subsidiary of Banco Totta & Açores (BTA), and Banco Interatlântico (BIA), formerly Caixa Geral de Depósitos.

Box 3. Cape Verde's Privatization Program, 1998-2002

Enterprise	Sector	Revenues Received in: Foreign exchange	Cape Verde escudos	Total Privatization Receipts	Revenues Used for: Trust Fund	Retrench-ment	Budget support
		(In millions of U.S. dollars; unless otherwise indicated)					
Companies fully privatized in 1998							
Fama	Pasta	0.0	0.1	0.1	0.0	0.0	0.1
Moave	Flour	0.0	0.6	0.6	0.0	0.0	0.6
Sonacor	Maintenance	0.0	0.5	0.5	0.0	0.0	0.5
Total		*0.0*	*1.2*	*1.2*	***0.0***	*0.0*	*1.2*
Total (in billions of Cape Verde escudos)		*0.000*	*0.118*	*0.118*	*0.000*	*0.000*	***0.118***
Companies fully or partially privatized in 1999							
CECV	Bank	6.3	0.0	6.3	3.9	0.0	2.4
CVTelecom	Telecommunications	0.0	0.7	0.7	0.0	0.0	0.7
Electra	Electricity and water	45.0	0.0	45.0	11.1	0.0	33.9
Enacol	Petrol products	0.0	0.4	0.4	0.0	0.0	0.4
Interbetão	Construction	0.0	>0.1	>0.1	0.0	0.0	>0.1
Oficinas	Repair shop	0.0	>0.1	>0.1	0.0	0.0	>0.1
Total		*51.3*	*1.3*	*52.6*	***15.0***	*0.0*	*37.6*
Total (in billions of Cape Verde escudos)		*5.269*	*0.129*	*5.398*	*1.541*	*0.000*	***3.857***
Companies fully or partially privatized in 2000							
BCA	Bank	19.5	5.2	24.7	13.2	0.0	11.5
CECV	Bank	0.0	2.0	2.0	0.0	2.0	0.0
CVC	Construction	0.0	0.2	0.2	0.0	0.0	0.2
CVTelecom	Telecommunications	0.0	3.5	3.5	0.0	0.7	2.8
Garantia	Insurance	7.5	0.0	7.5	7.5	0.0	0.0
Promotora	Venture capital	1.5	0.0	1.5	1.5	0.0	0.0
Total		*28.5*	*10.9*	*39.4*	***22.2***	*2.7*	*14.5*
Total (in billions of Cape Verde escudos)		*3.302*	*1.266*	*4.568*	*2.572*	*0.313*	***1.683***
Companies to be privatized in 2001-02							
Arca Verde	Maritime	...	...	...	...	...	...
Cabnave/Cabmar	Shipyard	...	...	...	...	...	...
Ceris	Beverage	...	...	...	...	...	...
CSLine	Shipping	...	...	...	...	...	...
CVTelecom	Telecommunications	...	...	...	...	...	...
Electra	Electricity and water	...	...	...	...	...	...
EMPA	Procurement	...	...	...	...	...	...
Emprofac	Pharmaceutical	...	...	...	...	...	...
Enacol	Petrol products	...	...	...	...	...	...
Enapor	Port administration	...	...	...	...	...	...
Interbase	Fish marketing	...	...	...	...	...	...
Promotora	Venture capital	...	...	...	...	...	...
Sea Invest	Shipping	...	...	...	...	...	...
TACV	Airline	...	...	...	...	...	...
Expected total		...	...	*64.9*	*42.8*	...	...

Sources: Cape Verdean authorities; and staff estimates and projections.

Box 4. Domestic Debt Reduction and the Trust Fund

Design. At end-1997, after years of running large bank-financed fiscal deficits, the stock of domestic debt stood at CVEsc 17.7 billion, equivalent to US$180 million or 40 percent of GDP. The elimination of the debt overhang through a privatization-cum-domestic debt-reduction operation (DDRO) represented a key element in the fiscal consolidation program supported by the 1998–99 Stand-By Arrangement. During the program period, donors were to contribute US$100 million in grants and loans, while the government was to earmark all foreign-currency denominated privatization receipts (net of retrenchment costs)—up to an amount of US$80 million—to an offshore Trust Fund. The CVEsc 17.7 billion in domestic debt was to be swapped for securities issued and serviced by the Trust Fund (the TCMFs), thus helping to consolidate the budget. As the fiscal and monetary situation would allow, the government was to buy back the TCMFs over a 20-year period, thereby permitting it to fully retire the debt overhang without injecting inflationary pressures into the economy.

Implementation. Delays in the comprehensive privatization program (Box 3) and shortfalls in donor assistance led to a deferment in the establishment of the Trust Fund. By end-February 2001, the domestic contributions represented less than one-half of the envisaged amount, and foreign ones about two-thirds. These shortfalls necessitated the government's requesting two foreign "bridge" loans (US$15 million) in 1998 and 1999 to finance domestic debt-service payments in those years. These had originally been programmed to be paid with Trust Fund resources. As of mid-February 2001, one of the bridge loans was in arrears, with the other one due in July. In addition, the fiscal expansion in 2000 has increased domestic debt by another CVEsc 7.9 billion, thereby reversing much of the progress made during the program period in reducing the budgetary impact of the domestic debt overhang (Figure 2).

Trust Fund Contributions
(In millions of U.S. dollars, unless otherwise indicated)

	12/31/98	12/31/99	12/31/00	2/28/01	Target
Total donor and domestic resources	**29.1**	**66.7**	**99.7**	**101.1**	**180.0**
Donor contributions	**29.1**	**51.7**	**62.5**	**63.9**	**100.0**
World Bank	14.1	29.1	29.1	29.1	...
European Union	10.0	10.0	10.0	10.0	...
African Development Bank	0.0	2.7	2.7	4.0	...
Portugal	5.0	5.0	10.0	10.0	...
Switzerland	0.0	3.8	3.8	3.8	...
Austria	0.0	0.0	2.0	2.0	...
Netherlands	0.0	0.0	2.3	2.3	...
Sweden	0.0	0.0	1.5	1.5	...
Reinvested interest	0.0	1.1	1.1	1.2	...
Domestic resources	**0.0**	**15.0**	**37.2**	**37.2**	**80.0**
BCA/Promotora/Garantia	0.0	0.0	22.2	22.2	...
CECV	0.0	3.9	3.9	3.9	...
Electra	0.0	11.1	11.1	11.1	...
Domestic debt converted into TCMFs	**0.0**	**63.2**	**89.3**	**88.9**	**180.0**
(in billions of Cape Verde escudos)	0.0	6.8	10.6	10.6	...
Held by central bank	0.0	0.0	35.1	35.0	...
Held by rest of the economy	0.0	63.2	54.2	54.0	...
Domestic debt in TCMF-equivalent terms 1/	**0.0**	**51.4**	**32.4**	**32.2**	**0.0**

1/ Under the Stand-By Arrangement, the authorities were temporarily allowed to reschedule the government's debt to the central bank under terms similar to that of the TCMF's (low-interest claims on the Trust Fund), but without placing resources in the Trust Fund.

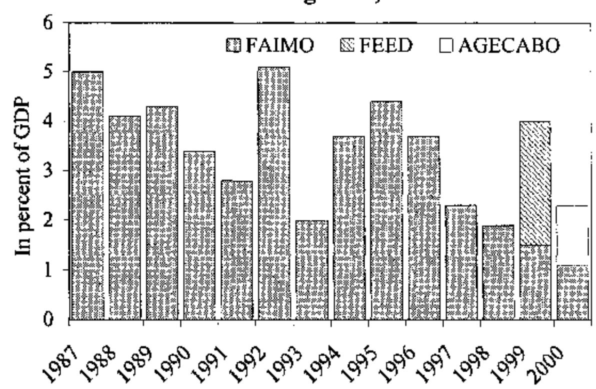
Sources: Cape Verdean authorities; and World Bank and Fund staff estimates and projections.

Box 5. Main Poverty Alleviation Programs

The newly elected government stressed that poverty alleviation would remain high on its agenda. According to the latest available household survey (1988), about one-third (one-fourth) of the population lives in (extreme) poverty. Notwithstanding the considerable economic changes that have taken place since, the survey's findings—according to which poverty was a rural phenomenon and disproportionately affected women (particularly as were heads of household), the unemployed, and young—remain valid. In response to these challenges, the government adopted a relatively comprehensive framework for poverty alleviation in 1997. Based on three pillars (described below), the National Poverty Alleviation Plan (NPAP) consciously targeted rural poverty, while aiming at an improvement of the overall effectiveness of the poverty-alleviation programs. The new administration intends to focus on these experiences.

The FAIMO tradition. Since independence, governments have responded to food insecurity and associated rural poverty with labor-intensive public work programs (Frentes de Alta Intensidade de Mão de Obra, or FAIMO). These were financed by the counterparts of foreign food aid, providing payments in exchange for work. While FAIMO succeeded in securing a minimum degree of food security for the poorest segments of the population and in creating and maintaining some basic infrastructure (especially roads), the program created a considerable degree of "welfare dependency" as it failed to provide incentives for labor productivity increases. At present, about 20,000 households depend on FAIMO support.

Public Work Programs, 1987-2000



Economic integration of the poor. In 1999, the government began reforms aimed at complementing the FAIMO program by (i) developing a participatory and municipality-based mechanism of allocating public works; (ii) enhancing the productive capacity of the poor through the professional development of their marketable skills; and (iii) building capacity within the 17 municipalities to plan, implement, and monitor projects. Requiring the regions to cofinance the projects (with 10 percent of total costs), a mechanism has been found to prioritize public infrastructure investment projects, thereby minimizing inefficient expenditures. In this context, a contract management agency (AGECABO) was created to coordinate small-scale infrastructure projects and assist workers in establishing enterprises for this purpose. The latter would bid for, and carry out, the locally owned public work projects. The program—brought together under the umbrella of the Unidade da Coordenação dos Projetos (UCP)—started to fully operate in 2000, despite some start-up problems stemming from insufficient communication and coordination among the various parties. With a budget of US$7.3 million, largely foreign financed, the UCP looked after 80 projects in 2000. The project-based approach is complemented by social policies designed to (i) improve access to health, water, and nutrition; (ii) enhance primary and professional education; and (iii) reduce the vulnerability of the poor, thereby creating conditions that permit a reduction in FAIMO's food security role.

The social emergency fund. The authorities created a third antipoverty pillar with the establishment, in late 1998, of a special fund for social emergency expenditures—the Fundo Especial de Estabilização e Desenvolvimento (FEED)—from which they could draw in cases of droughts, floods, volcanic eruptions, or epidemics. FEED is to be financed with (domestic currency) privatization revenues and from a 5 percent share of the offshore Trust Fund earnings. In 1999—the only year so far, in which FEED resources have been used—"extraordinary social expenditures," for a total amount of about 2½ percent of GDP, were financed from the budget.

Table 1. Cape Verde: Selected Economic and Financial Indicators, 1997-2003

	1997	1998	1999	2000	2001	2002	2003
				Est.		Projections	
	(Annual percentage change, unless otherwise specified)						
National income and prices							
Real GDP	5.4	7.4	8.6	6.8	3.3	4.0	6.0
Real GDP (per capita)	2.6	4.6	6.4	4.6	1.1	1.8	3.8
Consumer price index (annual average)	8.6	4.4	4.4	-2.4	5.0	3.0	2.0
Consumer price index (end of period)	6.7	8.3	-1.5	-1.1	4.0	2.5	2.0
External sector							
Exports 1/	35.9	-8.0	14.8	29.6	12.8	13.5	16.0
Imports 1/	15.8	11.0	19.1	6.0	2.3	4.3	8.8
Nominal exchange rate (avg., Cape Verde escudos per U.S. dollar)	-12.8	-5.4	-4.6	-11.4	...	...	...
Real effective exchange rate	5.1	2.3	-5.5	-3.7	...	...	...
Government budget							
Total revenue	2.4	15.5	22.4	6.7	10.1	14.6	9.5
Total expenditure and net lending	-3.1	0.8	21.9	24.5	-23.4	5.0	4.4
Recurrent expenditure	13.6	3.2	47.6	37.1	-27.7	3.7	2.7
Capital expenditure and net lending	-18.0	-2.2	-11.7	-2.9	-10.3	8.3	8.3
Money and credit (in percent of opening-period M2)							
Net domestic assets	16.5	2.6	7.4	15.9	5.7	...	...
Net credit to the government	6.2	-0.9	0.0	21.5	2.6	...	...
Credit to the economy	11.0	5.6	8.1	1.2	3.1	...	...
Broad money	14.3	2.7	14.8	13.5	6.0	...	...
Velocity (GDP/M2)	1.52	1.67	1.63	1.63	1.63	...	...
Discount rate 2/	12.1	10.0	8.5	9.5	11.5	...	...
	(In percent of GDP)						
Saving-investment balance							
Gross domestic investment	22.0	19.8	20.9	19.3	17.8	18.2	18.5
Public	9.0	7.9	6.1	5.5	4.7	4.7	4.7
Private	13.0	11.9	14.8	13.8	13.2	13.5	13.8
Gross national savings	13.7	8.0	7.1	7.3	6.9	9.9	11.2
External current account (excl. official transfers)	-8.3	-11.7	-13.8	-12.0	-10.9	-8.3	-7.3
Government budget							
Total revenue	30.4	32.2	27.7	26.1	26.3	27.5	27.2
Total expenditure and net lending	40.4	36.2	38.7	45.0	32.5	31.9	30.5
Overall balance before grants	-20.1	-17.0	-18.2	-24.6	-11.2	-9.1	-7.7
Total grants	10.1	13.0	7.2	5.7	5.1	4.7	4.4
Overall balance after grants	-10.0	-4.0	-11.0	-18.9	-6.1	-4.4	-3.3
Domestic bank financing	4.6	-0.1	1.3	8.1	1.6	0.0	0.0
Domestic public debt, net 3/	38.7	34.8	30.0	40.2	...	...	...
	(In months of imports of goods and services)						
Gross international reserves (end of period)	1.9	1.4	2.2	1.3	1.2	1.8	2.5
	(In millions of U.S. dollars)						
External current account (after grants)	-42.1	-63.3	-80.9	-66.9	-64.3	-52.7	-50.4
Overall balance of payments	16.2	-8.6	54.3	-49.2	-45.7	-4.4	11.9
Total external debt (end of period)	215.8	236.9	285.1	292.8	...	...	...
External arrears (public sector; end of period)	9.9	9.1	3.8	27.8	...	...	...
Gross international reserves (end of period)	60.2	57.5	79.0	61.6	...	...	...
	(In millions of SDRs)						
Use of Fund resources							
Stand-By Arrangement (amount agreed)	0.0	2.1	2.5	0.0	...	...	...
Stand-By Arrangement (undrawn balance)	0.0	2.1	2.5	0.0	...	...	...
Quota	7.0	7.0	9.6	9.6	9.6	9.6	9.6
	(In units specified)						
Nominal GDP (in billions of Cape Verde escudos)	47.2	53.0	60.4	64.7	69.7	73.5	79.5
Nominal GDP (per capita, in U.S. dollars)	1,232	1,278	1,357	1,254	1,306	1,347	1,423
Exchange rate (Cape Verde escudos per U.S. dollar)	93.2	98.2	102.7	115.9	...	...	...

Sources: Cape Verdean authorities; and staff estimates and projections.

1/ Exports and imports of goods and nonfactor services. In 1997, the Cape Verdean authorities began to record sales of fuel to ships in full; previously they had been recorded only partially. The staff has attempted to replicate this new, more accurate presentation for the years 1994-96. The staff has also moved the item to exports, rather than services, to comply with the stipulations of the 5th edition of the *Balance of Payments Manual*.

2/ Lending rate; in percent. The discount rate was increased to 9.5 percent in December 2000 and to 11.5 percent in April 2001.

3/ Including the claims on the offshore Trust Fund.

Table 2. Cape Verde: Sources and Uses of Resources, 1997-2003
(In percent of GDP)

	1997	1998	1999	2000	2001	2002	2003
						Projections	
Gross domestic product (Y)	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Current account (CA)	-8.3	-11.7	-13.8	-12.0	-10.9	-8.3	-7.3
Resource balance $(X - M)$	-30.4	-35.1	-38.4	-33.8	-30.2	-27.3	-25.7
Exports of goods and nonfactor services	25.5	20.2	19.3	23.4	24.8	26.3	28.2
Imports of goods and nonfactor services	-55.9	-55.3	-57.8	-57.1	-55.1	-53.7	-54.0
Net factor income	-1.6	-1.0	-1.4	-2.1	-2.4	-2.3	-2.5
Public sector	-1.2	-0.7	-0.7	-1.4	-1.3	-1.2	-1.1
Private sector	-0.4	-0.4	-0.8	-0.6	-1.1	-1.1	-1.4
Unrequited transfers	23.7	24.4	26.1	23.8	21.7	21.3	20.9
Public sector	9.7	9.1	7.3	3.9	3.5	3.8	3.9
Private sector	14.0	15.3	18.8	20.0	18.2	17.5	17.0
Gross national product	98.4	99.0	98.6	97.9	97.6	97.7	97.5
Gross national income	122.1	123.4	124.7	121.8	119.3	119.0	118.4
Public sector							
Current revenue	18.6	19.1	20.5	20.5	21.2	22.7	23.0
Current expenditure 1/	18.4	16.9	25.3	31.3	20.0	19.0	18.4
Capital expenditure 1/	18.0	15.7	12.2	11.0	9.3	9.4	9.4
Grants	10.1	13.0	7.2	5.6	5.1	4.8	4.4
Loans	3.9	5.6	9.6	6.0	3.6	3.4	3.8
Domestic	8.6	0.7	8.2	13.6	0.9	0.4	0.0
Of which: privatization	4.0	0.2	6.4	2.6	3.2	0.4	0.0
Gross domestic investment (I)	22.0	19.8	20.9	19.3	17.8	18.2	18.5
Fixed capital formation	22.0	19.8	20.9	19.3	17.8	18.2	18.5
Public sector 1/	9.0	7.9	6.1	5.5	4.7	4.7	4.7
Private sector	13.0	11.9	14.8	13.8	13.2	13.5	13.8
Change in stocks	...	...	...	...	...	...	...
Domestic consumption (C)	108.4	115.3	117.6	114.4	112.4	109.1	107.2
Public sector 1/	27.5	24.8	31.3	36.8	24.7	23.7	23.1
Private sector	80.9	90.5	86.2	77.6	87.8	85.4	84.2
Domestic saving (Sd)	-8.4	-15.3	-17.6	-14.4	-12.4	-9.1	-7.2
Public sector	0.2	2.2	-4.7	-10.8	1.2	3.7	4.7
Private sector	-8.6	-17.5	-12.8	-3.6	-13.6	-12.8	-11.9
National saving	13.7	8.0	7.1	7.3	6.9	9.9	11.2

Sources: National Institute of Statistics (INE); and staff estimates and projections.

1/ Assuming that 50 percent of capital expenditure, as classified by the treasury, is indeed current expenditures.

Table 3. Cape Verde: Fiscal Operations of the Central Government, 1997-2001

	1997	1998	1999	2000	2001 Proj.
	(In millions of Cape Verde escudos)				
Total revenue, grants, and capital participation	14,328	17,071	16,747	16,860	18,068
Total revenue (*Rev*)	8,773	10,132	12,397	13,228	14,568
Tax revenue 1/	7,479	8,580	10,507	11,761	12,999
Nontax revenue 2/	1,294	1,552	1,890	1,467	1,569
External grants (*Gr*)	4,750	6,876	4,350	3,632	3,500
Capital grants	4,750	5,241	4,350	3,632	3,000
Budgetary grants	0	1,635	0	0	500
Domestic capital participation (*Dcp*) 3/	805	64	0	0	0
Total expenditure (*Ex*)	19,036	19,184	23,382	29,114	22,285
Recurrent expenditure (*CEx*) 2/	10,529	10,865	16,040	21,986	15,893
Primary current expenditure	8,697	8,972	13,757	15,784	13,752
Wage bill (central government)	4,529	4,894	5,978	6,412	6,848
Goods and services	619	350	655	474	652
Transfers and subsidies	2,893	2,819	3,529	6,837	5,318
Petroleum-price subsidies	...	136	523	2,774	1,000
Paid	...	136	85	1,063	1,000
In arrears	...	0	438	1,711	0
Scholarships for students abroad	...	...	...	801	901
Other transfers and subsidies	...	2,682	3,006	3,262	3,416
Other expenditures	656	910	3,595	2,061	934
Autonomous expenditure	0	200	502	300	300
Reimbursement for foreign exchange advances	0	0	1,755	1,289	0
Elections	0	0	0	38	199
Other current expenditures	656	710	1,338	434	434
Domestic interest accrual (*rdom*) 4/	1,402	1,543	390	824	972
External interest accrual (*rext*)	430	350	393	917	1,169
Extraordinary expenditures (*EEs*)	0	0	1,500	4,461	0
Social emergency measures (FEED)	...	0	1,500	27	0
Restructuring costs	...	0	0	4,434	0
Capital expenditure	8,507	8,319	7,342	7,128	6,392
Foreign financed (*KExf*)	6,594	7,355	6,358	5,864	5,500
Domestically financed (*KExd*)	1,913	964	984	1,264	892
			7,858	5,864	5,500
Current balance, incl. *EEs*: *Rev - CEx*	-1,756	-734	-3,643	-8,758	-1,324
Current balance, excl. *EEs*: *Rev - CEx - EEs*	-1,756	-734	-2,143	-4,297	-1,324
Domestic balance: *Rev + Dcp - (CEx - rext) - KExd*	-2,434	-1,284	-4,234	-9,105	-1,048
External balance: *Gr - rext - KExf*	-2,274	-829	-2,401	-3,150	-3,169
Primary balance: *Rev + Dcp - Ex + rdom + rext*	-7,626	-7,096	-10,202	-14,145	-5,575
Overall balance, incl. grants: *Rev + Dcp + Gr - Ex* 5/	-4,708	-2,113	-6,635	-12,254	-4,217
Overall balance, excl. grants: *Rev + Dcp - Ex* 5/	-9,458	-8,989	-10,985	-15,886	-7,717
Financing	4,708	2,166	6,287	11,768	-4,348
Foreign (net)	649	1,779	1,364	2,958	-4,975
Total drawings 4/ 6/	1,844	2,949	5,826	3,882	2,500
Balance of payment and/or budget support	0	835	2,318	1,650	0
Bridge loan	0	835	668	0	0
Credit facility (FAC)	0	0	1,650	1,650	0
Project loans	1,844	2,114	3,508	2,232	2,500
Amortization 6/	-882	-965	-3,716	-3,920	-4,212
Bridge loans and FAC credits	...	0	-1,650	-1,650	-1,752
Project loans	...	-965	-2,066	-2,270	-2,460
Change in arrears	-1,777	-224	-1,210	2,996	-3,263
Interest arrears	-546	-144	-466	253	-300
Principal arrears	-1,231	-80	-744	2,743	-2,964
Refinancing and rescheduling of arrears 7/	1,464	19	464	0	0
Cancellation	...	19	464	0	...
Rescheduling	...	0	0	0	...
Domestic (net)	4,059	387	4,923	8,810	627
Banking system 8/	2,173	-40	767	5,220	1,086
Nonbanks	1,886	427	3,746	2,086	2,184
Bonds sold to nonbanks	0	309	-111	403	0
Privatization revenues	1,886	118	3,857	1,683	2,184
Domestic arrears (+ acc.)	0	0	410	1,504	-2,643
Financing gap 9/	0	-52	349	486	8,565

Table 3. Cape Verde: Fiscal Operations of the Central Government, 1997-2001 (concluded)

	1997	1998	1999	2000	2001 Proj.
			(In percent of GDP)		
Total revenue, grants, and capital participation	30.4	32.2	27.7	26.1	26.3
Total revenue (*Rev*)	18.6	19.1	20.5	20.5	21.2
Tax revenue 1/	15.9	16.2	17.4	18.2	18.9
Nontax revenue 2/	2.7	2.9	3.1	2.3	2.3
External grants (*Gr*)	10.1	13.0	7.2	5.6	5.1
Capital grants	10.1	9.9	7.2	5.6	4.4
Budgetary grants	0.0	3.1	0.0	0.0	0.7
Domestic capital participation (*Dcp*) 3/	1.7	0.1	0.0	0.0	0.0
Total expenditure (*Ex*)	40.4	36.2	38.7	45.0	32.5
Recurrent expenditure (*CEx*) 2/	22.3	20.5	26.6	34.0	23.1
Primary current expenditure	18.4	16.9	22.8	24.4	20.0
Wage bill (central government)	9.6	9.2	9.9	9.9	10.0
Goods and services	1.3	0.7	1.1	0.7	1.0
Transfers and subsidies	6.1	5.3	5.8	10.6	7.7
Petroleum-price subsidies	...	0.3	0.9	4.3	1.5
Paid	...	0.3	0.1	1.6	1.5
In arrears	...	0.0	0.7	2.6	0.0
Scholarships for students abroad	...	...	...	1.2	1.3
Other transfers and subsidies	...	5.1	5.0	5.0	5.0
Other expenditures	1.4	1.7	6.0	3.2	1.4
Autonomous expenditure	0.0	0.4	0.8	0.5	0.4
Reimbursement for foreign exchange advances	0.0	0.0	2.9	2.0	0.0
Elections	0.0	0.0	0.0	0.1	0.3
Other current expenditures	1.4	1.3	2.2	0.7	0.6
Domestic interest accrual (*rdom*) 4/	3.0	2.9	0.6	1.3	1.4
External interest accrual (*rext*)	0.9	0.7	0.7	1.4	1.7
Extraordinary expenditures (*EEs*)	0.0	0.0	2.5	6.9	0.0
Social emergency measures (FEED)	...	0.0	2.5	0.0	0.0
Restructuring costs	...	0.0	0.0	6.9	0.0
Capital expenditure	18.0	15.7	12.2	11.0	9.3
Foreign financed (*KExf*)	14.0	13.9	10.5	9.1	8.0
Domestically financed (*KExd*)	4.1	1.8	1.6	2.0	1.3
Current balance, incl. *EEs*: *Rev - CEx*	-3.7	-1.4	-6.0	-13.5	-1.9
Current balance, excl. *EEs*: *Rev - CEx - EEs*	-3.7	-1.4	-3.5	-6.6	-1.9
Domestic balance: *Rev + Dcp - (CEx - rext) - KExd*	-5.2	-2.4	-7.0	-14.1	-1.5
External balance: *Gr - rext - KExf*	-4.8	-1.6	-4.0	-4.9	-4.6
Primary balance: *Rev + Dcp - Ex + rdom + rext*	-16.2	-13.4	-16.9	-21.9	-8.1
Overall balance, incl. grants: *Rev + Dcp + Gr - Ex* 5/	-10.0	-4.0	-11.0	-18.9	-6.1
Overall balance, excl. grants: *Rev + Dcp - Ex* 5/	-20.1	-17.0	-18.2	-24.6	-11.2
Financing	10.0	4.1	10.4	18.2	-6.3
Foreign (net)	1.4	3.4	2.3	4.6	-7.2
Total drawings 4/ 6/	3.9	5.6	9.6	6.0	3.6
Balance of payment and/or budget support	0.0	1.6	3.8	2.6	0.0
Bridge loan	0.0	1.6	1.1	0.0	0.0
Credit facility (FAC)	0.0	0.0	2.7	2.6	0.0
Project loans	3.9	4.0	5.8	3.5	3.6
Amortization 6/	-1.9	-1.8	-6.2	-6.1	-6.1
Bridge loans and FAC credits	...	0.0	-2.7	-2.6	-2.6
Project loans	...	-1.8	-3.4	-3.5	-3.6
Change in arrears	-3.8	-0.4	-2.0	4.6	-4.8
Interest arrears	-1.2	-0.3	-0.8	0.4	-0.4
Principal arrears	-2.6	-0.2	-1.2	4.2	-4.3
Refinancing and rescheduling of arrears 7/	3.1	0.0	0.8	0.0	0.0
Cancellation	...	0.0	0.8	0.0	...
Rescheduling	...	0.0	0.0	0.0	...
Domestic (net)	8.6	0.7	8.2	13.6	0.9
Banking system 8/	4.6	-0.1	1.3	8.1	1.6
Nonbanks	4.0	0.8	6.2	3.2	3.2
Bonds sold to nonbanks	0.0	0.6	-0.2	0.6	0.0
Privatization revenues	4.0	0.2	6.4	2.6	3.2
Domestic arrears (+ acc.)	0.0	0.0	0.7	2.3	-3.8
Financing gap 9/	0.0	-0.1	0.6	0.8	12.5

Sources: Ministry of Finance; Bank of Cape Verde; and staff estimates and projections.

1/ Since 1998, tax revenue excludes taxes collected on behalf of the municipalities and the TPC (Economic Community of West African States).

2/ Includes the so-called *contas de ordem*, which are budgeted revenues from direct provision of services by government agencies offset by the same amounts under current expenditure for each of these agencies. Recurrent expenditure excludes extraordinary social outlays.

3/ These are enterprises' shares of government investment costs, usually in infrastructure directly related to the activity of these enterprises.

4/ For 1998, include the drawings expected from the concessional line of credit to cover domestic interest payments.

5/ On a commitment basis.

6/ For December 1999, amortization includes repayment of US$15 million drawn on the Portuguese credit line (FAC).

7/ In 1999, Cape Verde was trying to reschedule its US$6.49 million arrears with Spain and managed to find an agreement with Brazil on its bilateral US$7.29 million obligations. While negotiations with Spain are still ongoing, Brazil cancelled 60 percent of Cape Verde's debt and arranged a ten-year repayment schedule with the Cape Verdian authorities.

8/ Net of current amortization.

9/ Includes discrepancy vis-à-vis the monetary accounts; the financing gap in 2000 reflects ongoing negotiations regarding a settlement of a foreign loan.

Table 4. Cape Verde: Monetary Survey, 1997-2001

	1997	1998	1999				2000				2001
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Proj.
				(In millions of Cape Verde escudos, unless otherwise indicated)							
Net foreign assets (NFA)	5,613	5,646	5,644	6,312	5,486	8,110	6,684	5,661	5,945	7,139	7,294
(in millions of U.S. dollars)	58.3	59.9	55.1	60.0	53.0	75.4	59.8	49.6	50.5	60.1	67.8
(in millions of euros) 1/	53.3	51.2	51.2	57.2	49.8	73.6	60.6	51.3	53.9	64.7	66.1
Central bank	4,272	3,496	3,537	4,518	4,099	6,476	5,049	3,749	3,629	4,053	4,053
(in millions of U.S. dollars)	44.4	37.1	34.5	42.9	39.6	60.2	45.2	32.9	30.9	34.1	37.7
(in millions of euros) 1/	40.6	31.7	32.1	41.0	37.2	58.7	45.8	34.0	32.9	36.7	36.7
Commercial banks	1,341	2,150	2,108	1,795	1,387	1,634	1,635	1,912	2,316	3,086	3,241
(in millions of U.S. dollars)	13.9	22.8	20.6	17.1	13.4	15.2	14.6	16.8	19.7	26.0	30.1
(in millions of euros) 1/	12.7	19.5	19.1	16.3	12.6	14.8	14.8	17.3	21.0	28.0	29.4
Net domestic assets (NDA)	25,362	26,173	27,220	27,668	29,964	28,515	30,550	32,282	32,394	34,324	36,683
Domestic credit	27,712	29,416	32,311	31,670	33,984	32,763	34,374	36,596	38,823	40,888	43,248
Net claims on the government	13,126	13,092	15,405	14,085	15,925	13,875	15,030	16,860	20,175	21,572	22,658
Net claims on central government	12,851	12,811	15,079	10,458	11,970	6,775	7,048	7,220	10,534	10,684	22,370
Of which: Claims on the central government	15,846	15,583	17,829	16,846	18,741	15,710	16,997	18,663	22,580	23,573	24,659
Regular claims	15,846	15,583	17,829	13,606	15,122	8,906	9,300	9,286	13,203	12,973	14,059
Of which: project deposits	1,036	623	819	1,338	1,115	835	835	835	835	0	500
Claims on Trust Fund (TCMFs)	0	0	0	3,240	3,619	6,803	7,697	9,377	9,377	10,600	10,600
Claims on local government	120	130	176	186	189	237	225	263	264	288	288
Claims on other government agencies	155	151	151	201	147	60	60	0	0	0	0
Deposits	-2,995	-2,772	-2,750	-3,148	-3,152	-2,132	-2,252	-2,066	-2,669	-2,289	-2,289
Deposits to the Trust Fund	0	-2,755	-3,417	0	0	-1,608	-2	-6	-3	-10	0
Credit to the economy	14,587	16,325	16,906	17,585	18,058	18,888	19,343	19,736	18,648	19,317	20,591
Public enterprises	370	440	234	206	158	512	444	404	413	115	0
Private enterprises	14,217	15,885	16,672	17,379	17,900	18,377	18,899	19,333	18,235	19,202	20,591
Other items (net)	-2,351	-3,244	-5,091	-4,002	-4,020	-4,248	-3,823	-4,314	-6,428	-6,565	-6,565
Check	0	0	0	0	0	86	-17	-28	-106	-25	0
Broad money	30,975	31,819	32,864	33,980	35,450	36,539	37,252	37,971	38,446	41,488	43,977
Currency in circulation	4,854	5,073	4,871	5,046	5,113	6,026	5,260	5,536	5,388	6,458	6,846
Demand deposits	10,666	10,396	11,450	11,412	12,187	12,191	12,576	12,541	12,340	13,672	14,492
Time deposits	13,965	14,632	15,049	15,518	16,113	16,352	17,316	17,712	18,657	19,162	20,311
Foreign exchange deposits (residents)	526	575	698	1,406	1,541	1,075	1,050	1,101	980	1,107	1,174
Banking orders payable to residents	289	278	332	309	291	5	20	0	12	14	15
Minimum reserve requirements	309	610	164	240	121	260	355	282	265	516	547
Repurchase agreements	366	256	301	50	84	631	676	798	804	559	593
				(Changes in percent of beginning-of-period money stock)							
Net foreign assets	-4.4	0.1	0.0	2.1	-0.5	7.7	-3.9	-6.7	-5.9	-2.7	0.4
Net domestic assets	18.8	2.6	3.3	4.7	11.9	7.4	5.6	10.3	10.6	15.9	5.7
Domestic credit	17.2	5.5	9.1	7.1	14.4	10.5	4.4	10.5	16.6	22.2	5.7
Claims on the general government	6.2	-0.1	7.3	3.1	8.9	2.5	3.2	8.2	17.2	21.1	2.6
Claims on the central government	58.5	-0.9	7.1	4.0	9.9	0.0	3.5	8.1	18.8	21.5	2.6
Credit to the economy	11.0	5.6	1.8	4.0	5.4	8.1	1.2	2.3	-0.7	1.2	3.1
Broad money	14.3	2.7	3.3	6.8	11.4	14.8	1.9	3.9	5.2	13.5	6.0
				(In units as indicated)							
Selected monetary indicators											
Net claims on the government, excl. project deposits (in millions of CVEsc)	14,810	14,960	17,009	15,508	17,626	14,874	14,195	17,828	21,745	23,573	24,159
Broad money (in percent of beginning-of-period money stock)	14.3	2.7	3.3	6.8	11.4	14.8	1.9	3.9	5.2	13.5	6.0
NFA (in percent of beginning-of-period money stock)	-4.4	0.1	0.0	2.1	-0.5	7.7	-3.9	-6.7	-5.9	-2.7	0.4
Change in NFA of the banking system (in millions of U.S. dollars)	...	1.6	-4.8	0.1	-6.9	15.5	-15.6	-25.7	-24.8	-15.3	7.7
Central bank	...	-2.1	-2.6	5.8	2.5	23.1	-15.0	-27.3	-29.3	-26.1	3.6
Commercial banks	...	3.7	-2.2	-5.8	-9.4	-7.6	-0.6	1.6	4.5	10.8	4.2
Income velocity of broad money (GDP/M2)	1.52	1.66	1.68	1.68	1.68	1.63	1.67	1.67	1.67	1.56	1.56
Money multiplier (M2 as a fraction of base money)	3.1	2.9	3.1	2.9	3.0	3.1	...	...	...	...	...
Gross official reserves (in percent of base money)	43.5	32.7	34.3	39.1	35.8	55.3	...	...	...	...	...
Gross official reserves (in percent of M2)	14.1	11.3	11.0	14.1	11.8	18.1	...	...	...	...	...
Central bank reserves (in months of GNFS imports)	1.9	1.4	1.3	1.6	1.4	2.2	1.6	1.2	1.2	1.3	1.2
Cape Verde escudos per U.S. dollar (end of period)	96.2	94.3	102.4	105.2	103.6	107.6	111.8	114.0	117.6	118.8	107.5
Cape Verde escudos per ("synthetic") euro 1/	105.2	110.3	110.3	110.3	110.3	110.3	110.3	110.3	110.3	110.3	110.3
TCMF conversions (in billions of Cape Verde escudos) 2/	0.0	0.0	0.0	3.2	3.6	7.2	...	...	...	...	...
Nominal (annualized) GDP (in millions of Cape Verde escudos)	47,158	52,958	55,344	57,223	59,698	59,631	62,210	63,412	64,204	64,680	69,532
(Annualized) GNFS imports (in millions of Cape Verde escudos)	26,373	29,277	32,818	33,550	34,271	34,883	36,959	36,959	36,959	36,959	40,470

Sources: Bank of Cape Verde; and staff estimates and projections.

1/ For pre-1999 dates, rate is calculated with the Portuguese escudo (Esc) multiplied by the fixed Esc-Euro rate established on Jan 1, 1999.
2/ The end-December 1999 figure includes CVEsc 5,524.4 million in central bank "rescheduling" and the CVEsc 0.4 billion conversion with the social-security agency (INPS).

Table 5. Cape Verde: Balance of Payments, 1997-2003

(In millions of Cape Verde escudos, unless otherwise indicated)

	1997	1998	1999	2000	2001	2002	2003
				Est.	Projections		
Current account 1/	-3,921	-6,220	-8,306	-7,757	-7,543	-6,060	-5,659
Excluding official current transfers	-8,503	-11,052	-12,744	-10,249	-9,963	-8,860	-8,759
Trade balance	-16,160	-18,191	-22,096	-22,438	-22,280	-22,884	-25,032
Exports, f.o.b.	3,513	2,217	807	2,774	3,184	3,343	3,577
Merchandise exports	1,294	396	327	297	600	630	660
Reexports of fuel	2,219	1,569	607	2,500	2,550	2,677	2,878
Intermediate goods (net)	...	51	-36	71	29	30	32
Repairs (net)	...	201	-91	-93	6	6	7
Imports, f.o.b.	-19,673	-20,408	-22,903	-25,212	-25,464	-26,228	-28,609
Services (net)	1,808	-402	-1,117	603	1,511	2,778	4,569
Credit	8,508	8,467	10,862	12,350	13,870	16,016	18,882
Of which: tourism	1,399	1,988	2,961	4,727	5,672	6,807	8,168
Debit	-6,700	-8,869	-11,979	-11,747	-12,358	-13,238	-14,313
Factor income (net)	-755	-543	-868	-1,337	-1,657	-1,653	-1,801
Of which: scheduled interest payments	-565	-350	-393	-917	-1,169	-1,023	-1,009
Technical assistance	-346	0	0	0	0	0	0
Trust fund interest receipts	0	...	...	100	412	412	412
Current transfers (net)	11,185	12,915	15,775	15,415	14,882	15,700	16,605
Official	4,581	4,832	4,438	2,492	2,419	2,800	3,100
Of which: food aid	1,080	1,009	875	709	864	900	1,000
Private	6,603	8,084	11,337	12,923	12,463	12,900	13,505
Of which: workers' remittances	6,500	7,050	8,071	9,601	9,611	10,000	10,600
Capital and financial account	2,065	4,220	12,618	5,431	2,210	5,548	7,035
Direct investment	1,074	860	6,832	3,637	3,594	2,900	3,700
Of which: privatization	...	...	5,432	2,437	1,729	...	...
Capital transfers	587	2,499	2,934	3,177	968	1,400	1,500
Project grants	587	530	591	566	568	700	800
Trust fund (grants)	...	1,568	1,891	1,269	...	...	...
Other	...	401	452	1,342	400	700	700
Disbursements	1,844	4,423	7,975	5,532	2,500	2,500	3,000
Central government	1,844	2,949	5,826	3,882	2,500	2,500	3,000
Of which: bridge loans	...	0	1,650	1,650	0	0	0
Public enterprises	0	0	0	0	0	0	0
Trust fund (loans)	0	1,474	499	0	0	0	0
Amortizations due	-882	-965	-3,716	-3,920	-4,212	-2,672	-2,885
Central government	-882	-965	-3,716	-3,920	-4,212	-2,672	-2,885
Public enterprises	0	0	0	0	0	0	0
Trust fund investments	...	-3,042	-3,991	-3,708	-1,729	...	...
Privatizations	...	0	-1,600	-2,438	-1,729	...	...
Loans	...	-1,474	-499	0	...	...	...
Grants	...	-1,568	-1,891	-1,269	...	...	...
Private capital flows	-558	755	3,166	713	1,089	1,420	1,720
Portfolio flows	0	0	293	13	13	20	20
Banking system	-931	...	...	...	...	...	...
Commercial credits	0	41	1,441	-773	236	500	700
Other	373	714	1,433	1,472	840	900	1,000
Central bank	0	-309	-583	0	0	0	0
Net errors and omissions	3,366	1,159	1,262	-3,374	0	0	0
Overall balance	1,509	-841	5,574	-5,700	-5,333	-512	1,376
Financing	-1,509	841	-5,574	5,700	5,306	512	-1,376
Change in central bank reserves	268	776	-2,980	2,423	0	-1,867	-3,022
Arrears (+=increase)	-1,777	65	-1,670	3,277	-3,263	0	0
Agreed rescheduling/cancellation of arrears	0	0	-924	0	0	0	0
Financing gap	0	0	0	0	8,569	2,379	1,646
Memorandum items:							
Central bank reserves	4,272	3,496	6,476	4,053	4,053	5,920	8,942
In months of imports of goods and services	1.9	1.4	2.2	1.3	1.3	1.8	2.5
Export of goods and services	12,021	10,685	11,669	15,124	17,053	19,359	22,459
Imports of goods and services	-26,373	-29,277	-34,883	-36,959	-37,822	-39,466	-42,922
Export of goods and services, and private transfers	18,938	19,090	23,775	28,967	30,896	33,709	37,559
Imports of goods and services, and private transfers	-26,687	-29,599	-35,651	-37,878	-39,202	-40,916	-44,517
Current account, incl. transfers (percent of GDP)	-8.3	-11.7	-13.8	-12.0	-11.0	-8.2	-7.1
Current account, excl. transfers (percent of GDP)	-18.0	-20.9	-21.1	-15.8	-14.5	-12.0	-11.0
Overall balance (percent of GDP)	3.2	-1.6	9.2	-8.8	-7.8	-0.7	1.7
Cape Verde escudos per U.S. dollar (period average)	93.2	98.2	102.7	115.9	...	...	...

Table 5. Cape Verde: Balance of Payments, 1997-2003 (concluded)

(In millions of U.S. dollars)

	1997	1998	1999	2000 Est.	2001	2002	2003
					Projections		
Current account 1/	-42.1	-63.3	-80.9	-66.9	-64.6	-52.1	-48.8
Excluding official current transfers	-91.3	-112.5	-124.1	-88.4	-85.3	-76.2	-75.5
Trade balance	-173.4	-185.2	-215.2	-193.6	-190.7	-196.7	-215.9
Exports, f.o.b.	37.7	22.6	7.9	23.9	27.3	28.7	30.8
Merchandise exports	13.9	4.0	3.2	2.6	5.1	5.4	5.7
Reexports of fuel	23.8	16.0	5.9	21.6	21.8	23.0	24.8
Intermediate goods (net)	...	0.5	-0.4	0.6	0.2	0.3	0.3
Repairs (net)	...	2.1	-0.9	-0.8	0.1	0.1	0.1
Imports, f.o.b.	-211.1	-207.8	-223.0	-217.6	-218.0	-225.5	-246.7
Services (net)	19.4	-4.1	-10.9	5.2	12.9	23.9	39.4
Credit	91.3	86.2	105.8	106.6	118.7	137.7	162.9
Of which: tourism	15.0	20.2	28.8	40.8	48.6	58.5	70.4
Debit	-71.9	-90.3	-116.6	-101.4	-105.8	-113.8	-123.4
Factor income (net)	-8.1	-5.5	-8.4	-11.5	-14.2	-14.2	-15.5
Of which: scheduled interest payments	-6.1	-3.6	-3.8	-7.9	-10.0	-8.8	-8.7
Technical assistance	-3.7	0.0	0.0	0.0	0.0	0.0	0.0
Trust fund interest receipts	0.0	...	...	0.9	3.5	3.5	3.6
Current transfers (net)	120.0	131.5	153.6	133.0	127.4	135.0	143.2
Official	49.2	49.2	43.2	21.5	20.7	24.1	26.7
Of which: food aid	11.6	10.3	8.5	6.1	7.4	7.7	8.6
Private	70.9	82.3	110.4	111.5	106.7	110.9	116.5
Of which: workers' remittances	69.8	71.8	78.6	82.9	82.3	86.0	91.4
Capital and financial account	22.2	43.0	122.9	46.9	18.9	47.7	60.7
Direct investment	11.5	8.8	66.5	31.4	30.8	24.9	31.9
Of which: privatization	...	...	52.9	21.0	14.8	...	...
Capital transfers	6.3	25.4	28.6	27.4	8.3	12.0	12.9
Project grants	6.3	5.4	5.8	4.9	4.9	6.0	6.9
Trust fund (grants)	...	16.0	18.4	11.0	...	...	...
Other	...	4.1	4.4	11.6	3.4	6.0	6.0
Disbursements	19.8	45.0	77.6	47.7	21.4	21.5	25.9
Central government	19.8	30.0	56.7	33.5	21.4	21.5	25.9
Of which: bridge loans		0.0	16.1	14.2	0.0	0.0	0.0
Public enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Trust fund (loans)	0.0	15.0	4.9	0.0	0.0	0.0	0.0
Amortizations due	-9.5	-9.8	-36.2	-33.8	-36.1	-23.0	-24.9
Central government	-9.5	-9.8	-36.2	-33.8	-36.1	-23.0	-24.9
Public enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Trust fund investments	...	-31.0	-38.9	-32.0	-14.8	...	...
Privatizations	...	0.0	-15.6	-21.0	-14.8	...	...
Loans	...	-15.0	-4.9	0.0	...	...	...
Grants	...	-16.0	-18.4	-11.0	...	...	...
Private capital flows	-6.0	7.7	30.8	6.1	9.3	12.2	14.8
Portfolio flows	0.0	0.0	2.9	0.1	0.1	0.2	0.2
Banking system	-10.0	...	...	...	...	...	...
Commercial credits	0.0	0.4	14.0	-6.7	2.0	4.3	6.0
Other	4.0	7.3	14.0	12.7	7.2	7.7	8.6
Central bank	0.0	-3.2	-5.7	0.0	0.0	0.0	0.0
Net errors and omissions	36.1	11.8	12.3	-29.1	0.0	0.0	0.0
Overall balance	16.2	-8.6	54.3	-49.2	-45.7	-4.4	11.9
Financing	-16.2	8.6	-54.3	49.2	45.4	4.4	-11.9
Change in central bank reserves	2.9	7.9	-29.0	20.9	0.0	-16.1	-26.1
Arrears (+=increase)	-19.1	0.7	-16.3	28.3	-27.9	0.0	0.0
Agreed rescheduling/cancellation of arrears	0.0	0.0	-9.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	73.4	20.5	14.2

Source: Bank of Cape Verde; and staff estimates.

1/ This series is presented differently from the previous staff reports in order to have it conform with the *Balance of Payments Manual* (5th edition).

Table 6. Cape Verde: Vulnerability Indicators, 1997-2001

	1997	1998	1999	2000 Est.	2001 Proj.
	(In units as indicated)				
Real effective exchange rate (annual percentage change) 1/	5.1	2.3	-5.5	-3.7	...
Nominal effective exchange rate (annual percentage change) 1/	-0.5	-3.3	-1.8	1.1	...
Nominal CVEsc/US$ rate (annual percentage change) 1/	-12.8	-5.4	-4.6	-11.4	...
Domestic credit growth (annual percentage change)	20.3	6.1	11.4	24.8	5.8
Overall fiscal balance, including grants (in percent of GDP)	-10.0	-4.0	-11.0	-18.9	-6.1
Public debt (in percent of GDP)	55.0	53.0	51.5	67.2	64.9
Domestic debt, incl. TCMFs (in percent of GDP)	38.7	34.8	30.0	40.2	39.4
Domestic debt, excl. TCMFs (in percent of GDP)	38.7	34.8	18.7	23.8	23.0
External debt (in percent of GDP)	16.3	18.2	21.6	27.0	25.5
Scheduled external debt service relative to official reserves (in percent)	30.7	37.6	63.4	119.3	132.8
Official reserves (in months of imports of goods and NFS)	1.9	1.4	2.2	1.3	1.2
Broad money relative to official reserves (in percent)	725.0	910.1	564.2	1,023.6	1,085.1
Broad money relative to net foreign assets (in percent)	551.8	563.5	450.5	581.1	602.9
Discount rate (in percent) 2/	12.1	10.0	8.5	9.5	11.5
Private transfers (in percent of GDP)	14.0	15.3	18.8	20.0	18.2
	-18.0	-20.9	-21.1	-15.8	-14.5
Exports of goods and NFS relative to imports of goods and NFS (in percent)	45.6	36.5	33.5	40.9	45.1
Tourism receipts and foreign direct investment (in percent of GDP)	5.2	5.4	16.2	12.9	13.5
Tourism receipts (annual percentage change)	50.9	42.1	48.9	59.7	20.0

Sources: Cape Verde authorities; and staff estimates.

1/ A minus sign symbolizes a depreciation.
2/ Lending rate. The discount rate has been increased to 9.5 percent in December 2000 and to 11.5 percent in April 2001.

Figure 1. Cape Verde: Real and Nominal Effective Exchange Rates, January 1997-January 2001

(Index, July 1998 = 100)

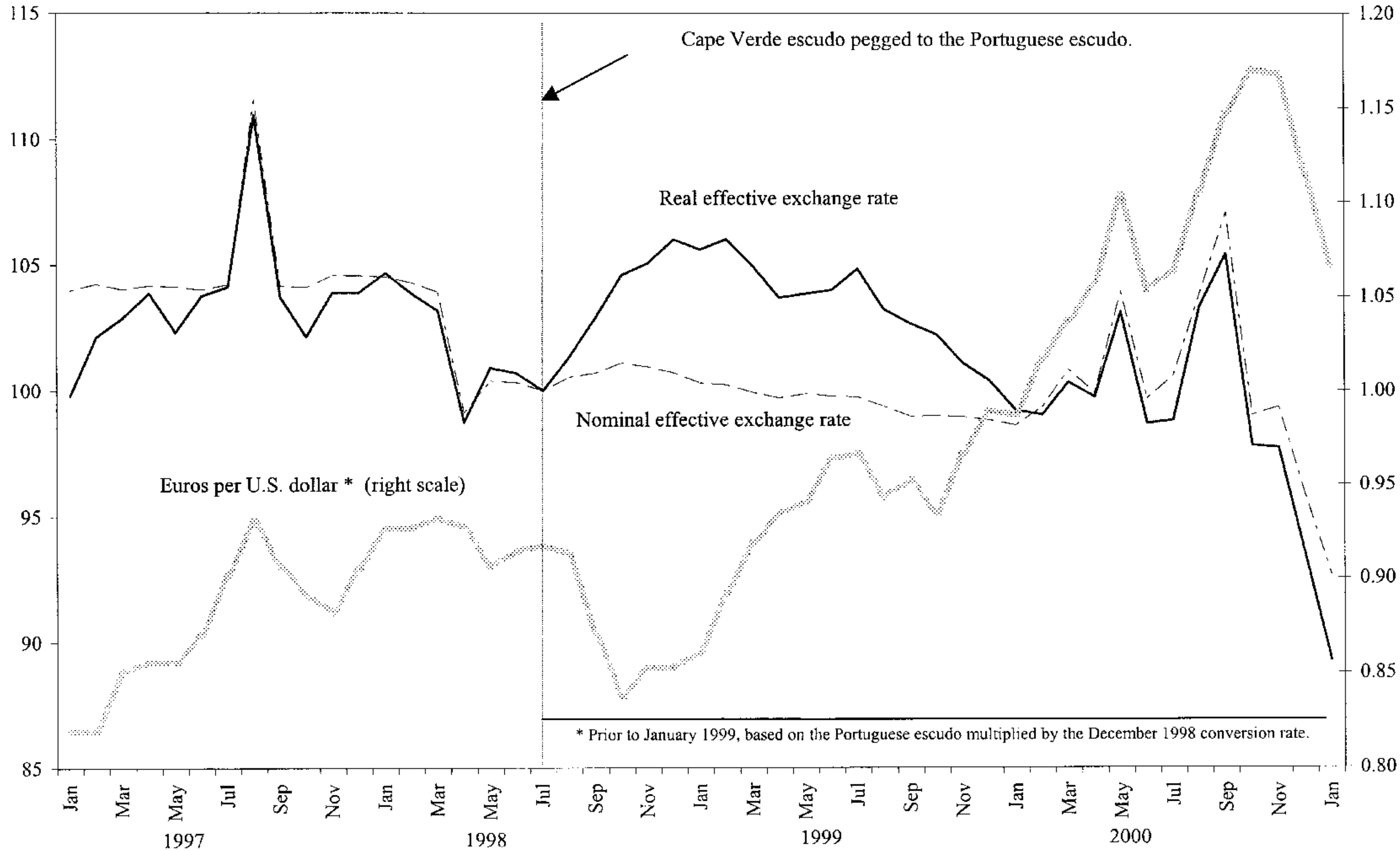
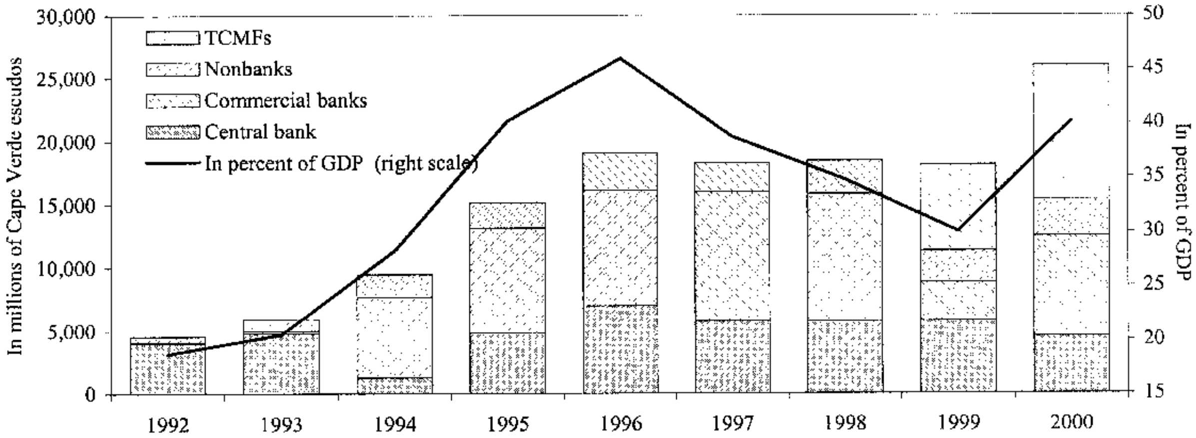
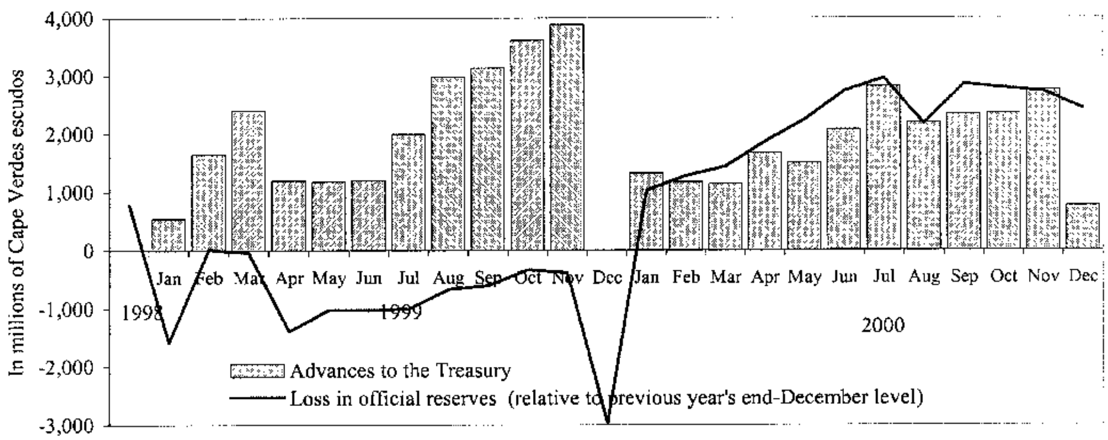


Figure 2. Cape Verde: Selected Economic Indicators

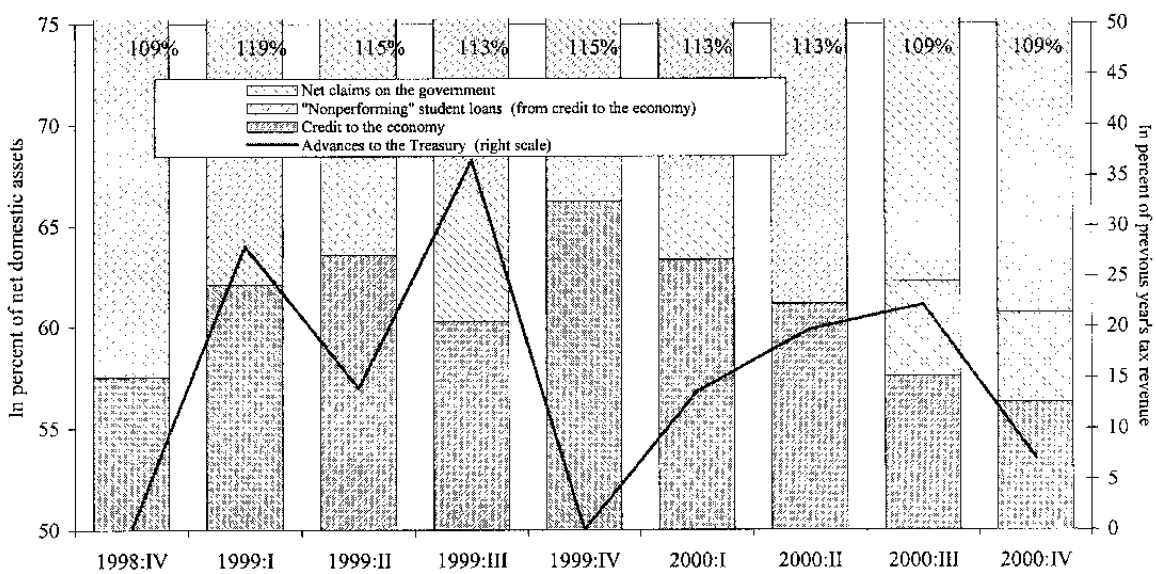
Stock of Domestic Debt, 1992-2000



Treasury Advances and Foreign Reserves, December 1998-December 2000



Composition of Net Domestic Assets, 1998:Q4-2000:Q4



Cape Verde: Relations with the Fund

(As of December 31, 2000)

Membership Status

Joined November 20, 1978; Article XIV.

General Resources Account	**SDR million**	**Percent of quota**
Quota	9.60	100.00
Fund holdings of currency	9.60	100.00
Reserve position in Fund	0.00	0.00

SDR Department	**SDR million**	**Percent of allocation**
Net cumulative allocation	0.62	100.0
Holdings	0.01	2.2

Outstanding purchases and loans

None.

Financial arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By Arrangement	02/20/98	3/15/2000	2.50	0.00

Projected Obligations to the Fund
(based on existing use of resources and present holdings of SDRs):

None.

Exchange rate arrangement

The currency of Cape Verde, the Cape Verde escudo, was pegged to the Portuguese escudo, from mid-1998 to end-1998, and from January 4, 1999 it has been pegged to the euro, at a rate of CVEsc 110 per euro. There are no taxes or subsidies on purchases or sales of foreign exchange. There are no arrangements for forward cover against exchange rate risk operating in the official or the commercial banking sector.

Article IV consultation

The 1999 Article IV consultation discussions were held in Praia during the period February 15-March 3, 1999. The staff report (EBS/99/71; 5/6/99) and recent economic developments (SM/99/107; 5/10/99) were issued to the Executive Board on May 6, 1999, and May 10, 1999, respectively, and the decision concluding the 1999 Article IV consultation was approved on May 24, 1999. The decision adopted was as follows:

1. The Fund takes this decision relating to Cape Verde's exchange rate measures subject to Article VIII, Section 2 (*a*), in the light of the 1998 Article IV consultation with Cape Verde conducted under Decision No. 5392-(77/63) adopted on April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. As described in EBS/99/71, Cape Verde maintains exchange rate restrictions in the form of limits on travel allowances that are subject to approval under Article VIII, Section 2 (*a*). In the circumstances of Cape Verde, the Fund grants approval for the retention of the above exchange restrictions until June 30, 1999.

Technical assistance

Since 1985, the Fund has provided technical assistance to both the Bank of Cape Verde and the Ministry of Finance in several areas: (i) for the Bank of Cape Verde, in organization and methods, management of external debt, monetary and banking statistics, accounting, credit, and foreign exchange operations, public debt, and the separation of the functions of the Bank of Cape Verde; and (ii) for the Ministry of Finance, in organization and budgetary procedures, budgeting, tax policy, and tax administration.

An MAE accounting expert has been providing advice to the Bank of Cape Verde since 1989 during periodic visits. Two MAE technical assistance missions (April 1991 and March 1992) advised the authorities on financial sector reform. MAE also arranged for the placement of a long-term expert in banking supervision (September 1993-March 1994) and for short-term assistance in the areas of public debt operations (April-May 1994), refinance facilities (March-May 1994), and foreign exchange operations (March-April 1994). An inspection visit by MAE took place during April 1994. In 1995, an MAE expert advised the authorities on banking reform and establishment of indirect instruments of monitoring control. During November 1997, the authorities were also advised by MAE experts on modalities to establish an offshore Trust Fund in the context of the retirement of domestic debt. In May 1998, a mission visited to advise on changes to the exchange system necessary for Cape Verde's acceptance of the obligations of Article VIII. The Cape Verdean authorities also benefited from the expertise of several STA missions in the context of a pilot project to improve the country's statistical systems, (with three statistical advisors assigned between April 1998 and June 1999; in August-September 1996 (multisector); in January-February 1998 and April 1999 (follow-up and money and banking statistics); in the periods of April-July 1998 and April-June 1999 (balance of payments); in June-December 1998 and March 1999 (national accounts and general statistics); and in June-July 1999 (follow-up and pilot project assessment). During February 1997, an FAD mission consulted on matters of public expenditure management. A resident expert from FAD has been assisting the Ministry of Finance to streamline budgetary procedures since late 1998. An FAD mission, in June–July 1999, and a resident advisor, during March 2000–June 2001, have been advising the authorities on the rationalization of the import tariff and the overhaul of the domestic indirect tax system, including the introduction of a value-added tax (VAT). In November 2000, an MAE TA mission advised the authorities on the desirability of a strongly anchored exchange rate regime.

Resident Representative

None.

Cape Verde: Relations with the World Bank Group
(As of December 31, 2000)

Statement of IDA Operations
(In millions of U.S. dollars)

Credit #	Projects	Principal Amount	Cancel-lation	Disbursed	Undisbur-sed	Approved Date	Closing Date
	6 credits closed	**54.3**	**3.1**	**52.9**	**0.00**		
2466	Transport Infrastructure	12.5	0.0	11.3	1.1	4-Mar-93	30-Jun-00
3566	Public Sector Reform & Cap. Bldg.	8.1	0.0	7.0	1.1	8-Feb-94	30-Jun-00
2675	Basic Education and Training	11.5	0.0	10.9	0.0	19-Jan-95	31-Dec-00
2864	Private/Financial Sector	11.4	0.0	7.8	3.0	21-May-96	31-Dec-00
3121	Privatization TA	9.0	0.0	2.2	7.2	21-Jul-98	31-Dec-00
3205	Energy/Water	17.5	0.0	0.0	17.2	11-May-99	30-Jun-00
3223	Education & Training Consolidation	6.0	0.0	0.0	6.2	25-May-99	20-Jun-00
3224	Social Sector Development	16.1	0.0	0.5	15.8	25-May-99	31-Aug-00
3294	Public Sect. Reform & Cap Bldg. Supp.	3.0	0.0	0.0	3.2	11-May-99	30-Jun-00
	Total active projects	**95.1**	**0.0**	**39.7**	**54.8**		
	Active and closed projects	**149.4**	**3.1**	**92.6**	**54.8**		
	Repayments	1.0					

Note: Disbursed amount may be higher than commitment (approved amount) due to exchange rate vis-à-vis SDR.

Statement of IFC Investments
(In millions of U.S. dollars)

			Original Gross Commitments				
Fiscal Year Approved	**Company**	**Type of Business**	**IFC Loan**	**IFC Equity**	**Partici-pation**	**Total**	**Disbursed**
1992	AEF Growela 1/	Shoe manufacturing	0.15	0.00	0.00	0.15	0.15
1993	AEF Hotel Tropico	Hotel/tourism	0.52	0.00	0.00	0.52	0.52
1999	SEF Britagem 2/	Construction materials	1.25	0.00	0.00	1.25	1.25
Total portfolio:			1.92	0.00	0.00	0.67	1.92
Total pending commitments			0.00	0.00	0.00	0.00	

1/ AEF Growela = African Enterprise Fund for shoe manufacturing.
2/ SEF Britagem = Small Enterprise Fund for cement and construction materials.

Cape Verde - Relations with the World Bank Group

1. As of December 31, 1999, the International Development Association (IDA) had extended fifteen credits to Cape Verde, amounting to about US$149.4 million equivalent, of which about US$92.6 million equivalent had been disbursed. **Six** operations had been closed, leaving the current portfolio with **nine** projects. These nine ongoing projects represent a total of about US$95.1 million equivalent in commitments, with an undisbursed balance of about US$54.8 million.

2. The current portfolio gives a high priority to capacity building, particularly through the Public Sector Reform and Capacity Building (PSRCB) Project. Complemented by the Privatization and Regulatory Capacity Building Project approved in July 1998, the Privatization Technical Assistance Project has developed local capacity to design and implement reforms in the public enterprise sector, monitor performance, and build private sector capacity through training. National capacity building has also been strengthened under the Transport and Infrastructure Project (TIP) through large-scale contracting of road works to local construction enterprises. The Capacity Building Project for Private Sector Promotion (CBPSP) also focuses on capacity building—it supports legislative, institutional, and financial sector reforms to facilitate private sector development.

3. The Bank's strategy for Cape Verde for fiscal year 1998-2000 has been formulated to support: (i) macroeconomic management and domestic debt reduction; (ii) consolidation of policy reforms in support of private sector development, underpinned by a more prominent involvement of the IFC and MIGA; and (iii) human resource development and poverty reduction. Instruments to support the strategy include: an economic reforms support operation (ERSO), which was approved on December 23, 1997; a privatization and regulatory capacity building project approved on July 21, 1998, three credits approved in FY 1999 (an energy/water project, an education and training consolidation project, and a social sector development operation), and a follow-up public sector reform and capacity building project approved in November 1999 (FY 2000).

4. A Country Portfolio Performance Review (CPPR) took place in May 1999. This allowed the government and the Bank to review progress on all projects in the portfolio, identify weaknesses and strengths of projects, and agree on a plan of action to further improve project implementation. The government has been implementing agreed actions with vigor, including positive changes in the management of the privatization operations. The Second Tranche of ERSO was released in December 1999. The IDA portfolio in Cape Verde is rated a satisfactory.

5. As of December 1999, the International Finance Corporation (IFC) had **three** ongoing investments in Cape Verde totaling about US$1.92 million. IFC's investments in Cape Verde cover activities in shoe manufacturing, hotel/tourism, and cement and construction materials. IFC will continue to focus on the development of small and medium-scale enterprises through the African Enterprise Fund. Cape Verde became a member of MIGA in May 1993.

6. IDA and IFC will continue to coordinate their respective roles to support development activities in Cape Verde. Their involvement is being further enhanced by the IFC's office in Dakar, which also oversees the IFC's activities in Cape Verde.

Cape Verde: Statistical Issues

The data compilation and reporting system in Cape Verde is weak and suffers from a shortage of financial and human resources. Cape Verde's transition to a market-oriented economy has not been accompanied by the development of an integrated macroeconomic database capable of supporting economic and financial analysis within a broad macroeconomic framework. STA fielded a multisector mission to Cape Verde in August 1996 and several follow-up missions, including in money and banking statistics, government finance statistics, balance of payments statistics, and national accounts. An "Assessment of Technical Assistance Project" mission took place in June–July 1999 to evaluate the pilot project from more comprehensive technical assistance, which started in 1996 and aimed at improving macroeconomic statistical systems for more comprehensive technical assistance that was started in 1996 to improve macroeconomic statistical systems. The mission found that great improvements had been made in all aspects of Cape Verde's statistical systems.

Three statistical advisors were stationed in Praia during 1998: (i) an expert on balance of payments statistics; (ii) a national accounts and price statistics expert; and (iii) an advisor on general statistics legislation and policy. In addition, the World Bank has agreed to provide partial funding for the development of new data sources for an agricultural census in 1999, a population and housing census in 2000, and a household income and expenditure survey in 2001.

Real sector

With assistance from the World Bank, national accounts estimates are being prepared through 1996. Preliminary national accounts estimates through 1997 were prepared with the assistance of the STA statistical advisor and the French government. The 1999 mission has reported that notable progress has been made in reforming the institutional structure and the legal framework for the production of real sector statistics, most importantly through the establishment of the National Statistical Institute as an autonomous institution to replace the former General Directorate of Statistics. However, much remains to be done to improve the quality and timeliness of data, including (i) the introduction of phased improvements to the present system of calculations of final estimates until they can be replaced by the updated series utilizing the new base year; (ii) the extension of the preliminary accounts to include estimates at constant prices and of final uses; (iii) the establishment of institutional arrangements to improve the collection of basic data, mainly those related to the expenditures on the public sector investment program and the financial data of enterprises; and (iv) the establishment of an inter-institutional system for calculating quarterly indicators of GDP.

The official consumer price index (CPI) is obsolete, as the weights date back to 1989, four years before the import liberalization that considerably changed the composition of consumption. The National Statistics Institute has improved the timeliness of its CPI, so that an alternative CPI reported monthly by the Bank of Cape Verde (BCV) has been discontinued, as recommended by the 1996 multisectoral statistical mission.

Government finance

Fiscal data cover the budgetary central government transactions, municipal taxes, and that part of the budgetary execution of semiautonomous public institutions that is financed through those institutions' own revenues (e.g., fees and so-called *contas de ordem*, which are added to both revenue and expenditure on the basis of the amounts budgeted by the respective agencies). These data do not include the transactions of the social security agency and other extrabudgetary agencies. Some of the main deficiencies in government finance statistics were partially addressed in 1997 and in the context of the 1998 budget preparation with the implementation of some of the recommendations made by a FAD technical assistance mission on expenditure control that took place in 1996.[1] The management of government expenditures has been improved with the consolidation of most accounts previously held with commercial banks at the central bank level. In addition, government agencies' reporting, as well as the coordination among the treasury, the budget directorates, and the central bank has also been improved, with the Ministry of Economic Coordination being the single point of commitment, execution, and monitoring of public expenditure. In the context of the 1998 budget, the central government's and autonomous agencies' accounts have been centralized and compiled at the Ministry of Economic Coordination. With progressive decentralization and the granting to municipalities of access to bank credit, this action will help promote a broader consolidation of general government operations. However, improvement is still needed in recording various government operations—in particular, regarding data on foreign grants and loans—that have been the source of expenditure overruns in the past and led to the accumulation of a large stock of domestic debt. Reporting to AFR has usually coincided with official meetings. No government finance data are reported for publication in *International Financial Statistics (IFS)* or *Government Finance Statistics (GFS) Yearbooks.*

Money and banking

The central bank compiles and transmits monthly monetary statistics. Balance sheet data for the central bank and two commercial banks (Caixa Económica de Cabo Verde and Banco Comercial do Atlântico) are provided with a lag of approximately six weeks.

The April 1999 money and banking statistics mission ascertained that substantial progress had been made in implementing the recommendations of the 1998 mission, leading to a more timely reporting of monetary accounts to the IMF. The mission provided several recommendations regarding the statistical treatment of a number of accounts to improve the quality of the banking survey. These included (i) the treatment of the repurchase agreements;

[1] Abdelali Tazi and others, "Cape Verde: Consolidation of Public Expenditure" (Praia, Cape Verde: IMF, Fiscal Affairs Department, 1997).

(ii) the treatment of trust accounts; (iii) the issuance of BCV's short term securities; and (iv) the harmonization of international reserves data between balance of payments and monetary statistics.

The "Assessment of Technical Assistance Project" mission of June–July 1999 found that, since 1996, significant progress has been made in the area of money and banking statistics, both in terms of the analytical quality and timeliness of the data. The methodology used by the Money and Banking Division (MBD) for the compilation of the monetary aggregates follows closely the preliminary version of the *Manual on Monetary and Financial Statistics*; monthly consolidated accounts for the banking system are compiled within 2–3 weeks of the end of the reference month; the MBD verifies regularly the consistency of the foreign accounts of the banking system with the data compiled by the BPD; and the data reported by the depository corporations strictly follow the BCV's guidelines and are submitted on a timely basis.

As a result of extensive "hands-on" training and courses provided by STA to the staff of the MBD and to commercial banks, the institutional capacity of the BCV to compile monetary statistics has improved considerably. The MBD maintains close links with STA to update and further strengthen the system developed in 1996 for the compilation of the analytical accounts of the BCV and the banking sector.

Balance of payments

The quality and timeliness of balance of payments statistics have shown a dramatic improvement since the last two missions in that area. The BCV currently compiles quarterly statistics with a lag of about ten weeks from the reference period. Greater use of surveys has permitted a significant expansion of data sources and statistical coverage, which, to a large extent, follows the recommendations of the fifth edition of the *Balance of Payments Manual. BPM5.* Balance of payments statistics are provided to AFR on the occasion of official contacts.

The balance of payments mission that visited Cape Verde in 1999 evaluated the implementation of a new international transactions reporting system (ITRS), which provides information as specified in *BPM5*, and it revised the operation and preliminary results of the new system of quarterly enterprise surveys, which will supplement and cross-check the information available through the ITRS. The mission also assisted the BCV in its endeavor to initiate the compilation of data on direct investment, commercial credits, and financial loans to expand the coverage of external debt.

The last published data in the 1999 edition of the *Balance of Payments Statistics Yearbook* and in *IFS* refer to 1998. The Cape Verdean authorities provided STA with technical notes describing the methodologies and compilation procedures used for balance of payments statistics, which were published in Part III of the 1999 *Balance of Payments Statistics Yearbook.*

External debt and arrears

An adequate database seems to be in place. The Treasury Department of the Ministry of Economic Coordination is able to provide a breakdown by creditors for debt and arrears.

Cape Verde: Core Statistical Indicators
(As of January 31, 2000)

	Exchange Rates	Interna-tional Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance	GDP/ GNP	External Debt/ Debt Service
Date of latest observation	12/31/99	11/30/99	11/30/99	11/30/99	11/30/99	11/30/99	12/31/99	6/30/99	6/30/90	9/30/99	1995	12/31/98
Date received	01/00	01/00	01/00	01/00	01/00	01/00	01/00	12/99	12/99	12/99	12/99	03/99
Frequency of data	M	M	M	M	M	M	M	Q	Q	Q	A	A
Frequency of reporting	M	M	M	M	Q	M	V	V	V	V	V	V
Source of update	CB	CB	CB	CB	CB	CB	MEC	CB	CB	MEC	MEC	CB
Mode of reporting	C	C	C	C	C	C	C	M	M	M	M	M
Confidentiality	C	B	B	B	B	C	C	C	C	B	C	B
Frequency of publication	M	M	M	M	M	M	M	SA	A	A	V	V

Notes: Frequency of data: D = daily; M = monthly; Q = quarterly; SA = semiannual; and A = annual.
Frequency of reporting and frequency of publication: M = monthly; SA = semiannual; A = annual; and V = irregular.
Source of update: CB = Bank of Cape Verde; and MEC = Ministry of Economic Coordination.
Mode of reporting: C = cable or facsimile; and M = mission/staff visit.
Confidentiality: B = for use by the staff and the Executive Board; and C = for unrestricted use.

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International Monetary Fund
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Washington, D. C. 20431 USA

IMF Concludes 2001 Article IV Consultation with Cape Verde

On June 15, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Cape Verde.[1]

Background

Since 1992, Cape Verde has pursued an economic reform program aimed at transforming its command economy into one organized on the principle of free markets and private ownership. Until 1997, however, as the liberalization of the economy had been conducted with insufficiently restrained fiscal policies, large macroeconomic imbalances emerged that resulted in the accumulation of substantial domestic public debt and the virtual depletion of foreign exchange reserves. Initial attempts at fiscal consolidation were frustrated by the domestic debt burden, and exchange controls were introduced to protect reserves.

In 1998, the authorities adopted an economic and financial program aimed at restoring financial stability. The program, which was supported by a Stand-By Arrangement with the Fund, included the implementation of a large domestic debt-reduction operation, supported by the donor community.

Under this program, Cape Verde made good progress in 1998-99, despite occasional backsliding. Structural reforms created an environment conducive to private sector activity. Progress was made in the comprehensive privatization program, a key element of the domestic debt-reduction operation. During 1998-99, real GDP growth accelerated from 4¼ percent during 1996-97 to 8 percent on average, driven by the development of tourism,

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the June 15, 2001 Executive Board discussion based on the staff report.

significant foreign investment in the export-oriented manufacturing sector, and sustained inflows of workers' remittances, which stimulated construction activities. Inflation was halved to an average level of 4.4 percent in both years, compared with 1997.

However, partly as a result of extraordinary public expenditures aimed at cushioning the social impact of a serious drought that had destroyed much of the 1998/99 harvest, fiscal slippages occurred in the second half of 1999, leading to pressures in the balance of payments.

In 2000, Cape Verde's fiscal situation deteriorated considerably and economic activity slowed down. Real GDP grew by about 7 percent, compared with 8½ percent in 1999, while average consumer prices declined by 2½ percent, owing to significant energy price subsidies, a good 199/2000 harvest and the fixed exchange rate peg. The deterioration in the fiscal stance that started in the second half of 1999 worsened, undoing much of the progress made in previous years. The overall fiscal deficit, including grants, widened to 19 percent of GDP—compared with 11 percent in 1999—and was largely monetized, while domestic and external arrears were accumulated. The sizable recourse to bank credit increased the stock of domestic debt, largely reversing the impact of the domestic debt-reduction operation launched in 1998.

Given the fixed exchange rate regime, the fiscally induced expansion of net domestic assets of the banking system resulted in a decline of official reserves from the equivalent of 2.2 months of imports at end-1999 to 1.3 months at end-2000. The central bank raised the discount rate by 100 basis points. However, unlike in 1999, the central bank did not use the foreign exchange queue as an instrument to control the outflow of foreign exchange.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They regretted that the progress made in macroeconomic stabilization in recent years was partly undermined by fiscal slippages in 2000 and that structural reforms have mostly stalled. In this connection, they expressed concern at the interruptions in the flow of information to the Fund, and the postponement of regular surveillance dialogue in 2000. Directors noted the continued strong growth and the emergence of a more dynamic private sector and a more diversified export base, but stressed the need for early action to restore macroeconomic stability. They, therefore, welcomed the development of a preliminary medium-term macroeconomic policy framework with emphasis on fiscal consolidation and the willingness expressed by some donors to support the authorities' reform efforts.

Directors underscored the importance of supporting the fixed exchange rate with prudent macroeconomic policies to bolster the official reserves, and of tackling the unsustainable debt burden of the public sector. They welcomed the authorities' commitment to the current exchange system and urged them to implement a strong fiscal adjustment, the necessary structural reforms in the public enterprise sector, and a tight monetary policy.

In this regard, Directors welcomed the authorities' commitment to reduce fiscal imbalances. They commended the decision to increase domestic petroleum prices without delay, and recommended the early implementation of an automatic and transparent petroleum pricing mechanism. They urged the authorities to prepare a realistic budget, including both revenue-enhancing and expenditure-restraining measures. In particular, they supported the implementation of quick-yielding revenue measures, the containment of the wage bill, and the elimination of off-budget transactions. They also stressed the importance of the new budget management and monitoring system being prepared for effective control of expenditure. Directors encouraged the authorities to resume preparations for introducing the VAT and the new tariff schedule in the 2002 budget.

Directors stressed that a reduction in the domestic debt remains the key to achieving medium-term fiscal sustainability. They urged the authorities to push forward with the privatization of the remaining public enterprises and to work with the principal donors to ensure that the debt conversion process can be completed as soon as possible.

Directors observed that the independence of the central bank is crucial to curb inflation and protect the exchange rate peg. They welcomed the authorities' intention to amend the central bank law and the constitution in order to assure the central bank's statutory independence and limit central bank financing of the budget. Directors also commended the monetary authorities for not rationing foreign exchange to stem the loss of reserves and for having instead raised the discount rate twice in the last four months.

Noting that data weaknesses limit the government's financial management capacity, Directors urged the authorities to take steps to improve the quality and timeliness of economic and financial statistics.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article IV Consultation with Cape Verde is also available.

Table 1. Cape Verde: Selected Economic Indicators

	1993	1994	1995	1996	1997	1998	1999	2000
Domestic economy	(Annual percentage change)							
Real GDP	7.3	6.9	7.5	3.5	5.4	7.4	8.6	6.8
Real GDP (per capita)	4.2	4.1	4.7	0.8	2.6	4.6	6.4	4.6
Consumer price index (annual average)	5.8	3.4	8.4	6.0	8.6	4.4	4.4	-2.4
	(In percent of GDP)							
Gross domestic investment					22.0	19.8	20.9	19.3
Gross national savings					13.7	8.0	7.1	7.3
External economy	(In units indicated)							
Exports, f.o.b. (in local currency, annual percentage change)	...	...	16.4	27.6	35.9	-8.0	14.8	29.6
Imports, f.o.b. (in local currency, annual percentage change)	7.0	31.1	12.4	1.1	15.8	11.0	19.1	6.0
Current account balance, excl. grants (in millions of U.S. dollars)					-91.3	-112.5	-124.1	-88.4
Current account balance, excl. grants (in percent of GDP)					-18.0	-20.9	-21.1	-15.8
Capital and financial account (in millions of U.S. dollars)					22.2	43.0	122.9	46.9
Debt service (in percent of exports of goods and NFS)					12.3	11.0	30.9	31.0
External debt (in percent of GDP)	42.7	36.5	37.3	41.4	44.0	42.2	50.8	53.8
Real effective exchange rate (end of period, percentage change)					5.1	2.3	-5.5	-3.7
Financial variables	(In percent of GDP)							
Government revenues	18.2	1.8	-6.2	7.5	30.4	32.2	27.7	26.1
Total grants					10.1	13.0	7.2	5.6
Current expenditures	...	-2.8	1.9	-0.7	22.3	20.5	26.6	34.0
Overall fiscal deficit (incl. grants, commitment basis)					-10.0	-4.0	-11.0	-18.9
Change in broad money	16.7	14.7	12.6	-3.1	14.3	2.7	14.8	13.5

Sources: Cape Verdean authorities; and IMF staff estimates.