

INTERNATIONAL DEVELOPMENT ASSOCIATION  
AND  
INTERNATIONAL MONETARY FUND

CAPE VERDE

**Poverty Reduction Strategy Paper  
Joint Staff Advisory Note**

Prepared by the Staffs of the International Development Association (IDA) and the  
International Monetary Fund (IMF)

Approved by Gobind Nankani and Danny Leipziger (IDA),  
David Nellor and Mark Plant (IMF)

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**I. OVERVIEW**

1. The Poverty Reduction Strategy Paper (PRSP) for Cape Verde builds on the strategy laid out in the Interim PRSP that was presented to the Boards of the International Development Association (IDA) and the International Monetary Fund (IMF) in April 2002. This strategy focuses on five key pillars for public intervention: (i) promoting good governance; (ii) improving competitiveness and private-sector-led growth; (iii) fostering human capital development; (iv) strengthening social security and solidarity; and (v) improving infrastructure and land use management.

2. The PRSP was developed through a broad participatory process (see Chapter 6). A PRSP Steering Committee, involving senior public officials and representatives of civil society, the private sector, and municipalities, effectively managed the process, supported by a technical secretariat. External partners (including the IMF and World Bank) have also participated in technical discussions. The Government intends to provide annual progress reports on the PRSP, and to update and reorient this strategy every three years. In this regard, a “Communication Plan” aims to disseminate the PRSP broadly, mobilize all parties concerned, and manage expectations. The practical details of this plan need to be elaborated, however, and it should then be implemented rapidly.

3. Drawing on the 2002 household survey, the PRSP emphasizes the change in *relative* poverty,<sup>1</sup> which increased from 30 percent of the population in 1988 to about 37 percent in the latest survey, and reflects the rapid growth of the services sector. However, the PRSP underplays

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<sup>1</sup> Relative poverty measures the number of people with incomes under 60 percent of the median income in 1988 and 2002, while absolute poverty measures the number of people in 1988 and 2002 whose income is below the 1988 poverty line, indexed for inflation.

the large decline in *absolute* income poverty which, reflecting robust growth and effective delivery of social services, has fallen from 49 percent in 1988 to 37 percent in 2002. The remaining poor typically live in rural areas, where employment and higher education are scarcer, but they are also closer to the poverty line. Overall, staffs do not believe that the emphasis on inequality compromises the PRSP's policy options.

4. Staffs believe that Cape Verde's main development challenges come across clearly in the five pillars of the PRSP. As discussed in the following sections, these challenges revolve around: (i) maintaining macroeconomic stability, given external vulnerabilities and uncertainties surrounding resource flows; (ii) achieving further improvements in governance, especially in a decentralized context; (iii) reforming social expenditure programs to reflect the changing nature of demand; and (iv) promoting stronger growth and poverty reduction through improvements in the business climate.

## II. MAINTAINING MACROECONOMIC STABILITY WITH EXTERNAL SUPPORT

5. The PRSP presents an appropriately ambitious economic outlook, with real GDP growth projected to rise to 7 percent in 2007. Less clear, however, is whether the sharp increases projected in foreign direct investment and in public investment will be forthcoming<sup>2</sup>. The overall macroeconomic framework of the PRSP is based on a rising primary recurrent surplus and on the buildup of international reserves to back the exchange rate peg. But underlying this framework are assumptions of a containment of contingent liabilities, especially from planned privatizations, and a substantial increase in external support. Donor support is projected at about 15 percent of GDP for each of the next three years, whereas past donor support has been closer to 10 percent of GDP per year. Such increases appear ambitious but feasible, including through Cape Verde's eligibility for financial support from the U.S. Millennium Challenge Account. For short-term planning purposes, however, including in the context of the PRGF-supported program, more conservative assumptions for investment growth and for donor support are currently being applied.

6. In the staffs' view, external financing needs to be met in the form of grants or highly concessional loans, to ensure that debt levels remain sustainable. The PRSP, though, does not elaborate on how the required levels of external support will be mobilized. As external support on highly concessional terms becomes more difficult to obtain with increasing prosperity, more attention should be paid to enhancing domestic resource mobilization in the PRSP macroeconomic framework. The staffs consider that there is substantial scope to strengthen tax revenues, including by implementing the recommendations for improving tax administration and reducing tax exemptions that were provided by two recent missions from the Fund's Fiscal

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<sup>2</sup> See PRSP Annex Tables 15 and 16. The staffs note that the fiscal information in these tables, which is part of the overall macroeconomic framework, appear inconsistent with the detailed fiscal data presented in Annex Table 17.

Affairs Department. Such measures are also needed to help offset revenue losses arising from reductions in customs tariffs (see below).

7. Clearer prioritization among the PRSP's objectives is needed in case efforts to mobilize additional resources fall short. In addition, the PRSP has not yet been fully institutionalized in the budget preparation process. Implementation of a comprehensive Medium-Term Expenditure Framework (MTEF) - which is currently under development—can provide a basis for the necessary prioritization and should be pursued as a matter of urgency.

### **III. STRENGTHENING GOVERNANCE ARRANGEMENTS**

8. While the PRSP's discussion of expenditure management and tax policy is well-founded on existing documents and action plans, the assessment of public administration is constrained by insufficient analysis of possible reform options and their associated costs. Further work in this area will be needed if the objectives of public administration reform are to be reached. The PRSP emphasizes decentralization as a critical element to improve service delivery. To this end, the document details the devolution of competences and resource allocation mechanisms, but insufficiently treats the associated issues of human resource and financial management in municipalities. Moving forward, staffs support the Government's efforts to address these matters, with Bank support in the context of a proposed PRSC.

### **IV. MANAGING THE TRANSITION TO A HIGHER DEVELOPMENT PLANE**

9. The country's transition to "middle income" status reflects the success of the Government's programs to increase access to education, health, and other social services. As basic social needs are addressed, demand for social services has expanded in scope, with substantial increases in associated fiscal costs. Increasing the efficiency and effectiveness of core social spending programs has therefore become a pressing issue.

10. The topic of education is well developed in the PRSP. However, the quasi universal enrollment in primary education has led to a rapid increase in demand for secondary education, for which costs are more than 2.5 times that of primary education per pupil. New sources of financing along with policy reforms are needed to avoid compromising the quality of, and access to, both primary and secondary education.

11. The discussion of the health sector covers primary, secondary and tertiary health care, but little is said on the sustainability of the existing rules of access for health care (full gratuity and easy access). While public health care has eradicated nearly all contagious diseases prevalent in Africa, non-communicable diseases have become gradually more important and claim an increasing share of the health budget. Staffs recommend that policy reforms focus on preventive care, and therefore invite the authorities to improve health service utilization data.

12. Existing social protection schemes require reforms to ensure sustainability and broaden coverage. In this regard, the Government's reform strategy is appropriately placing increased

attention on risk mitigation and prevention measures. Staffs encourage the Government to act on the recommendations of several important analyses, including one on the targeting and financial sustainability of the non-contributory pension system.

## **V. FOSTERING PRIVATE SECTOR-LED GROWTH**

13. While the PRSP focuses mainly on enhancing sectors where most of the poor are active (agriculture and fisheries), more poverty alleviation could come from improving the business climate for tourism and other promising growth sectors. Such growth would require clear strategies to facilitate labor transition from lower to higher productivity sectors, and to mitigate the adverse side-effects of rapid tourism development. Also important are measures to further integrate Cape Verde into the global economy. While reductions in customs tariffs in January 2004 represent a significant step forward in this regard, the PRSP appropriately notes that further trade liberalization would be desirable in the context of the country's accession to the WTO.

14. Infrastructure will play a critical role in attracting investors. The principles underpinning transport sector development include user fees, accessibility of poor areas, and public/private partnerships to expand services. As set out in Chapter 4 of the PRSP, these principles are translated into a sound "roads" policy, but they are also associated with ambitious development plans for maritime and air transportation. These plans remain vague regarding the involvement of private partners, and thus risk entailing significant contingent liabilities for the Government if they are not implemented cautiously. Conversely, the monopoly operator in the electricity and water sector urgently needs to be put on a financially sustainable footing by the introduction of tariff-setting regulation, so that it is able to support business growth and provide publicly-mandated connections for the poor.

15. The PRSP is also vague regarding the completion of remaining privatizations (e.g. of the national airline and the ports operator), while explicitly acknowledging the risks that state-owned enterprises pose to public finances. Because of this, the staffs urge the Government to accelerate the pace of privatizations to minimize labor retrenchment costs and to ensure that basic infrastructure services are available for private sector development.

## **VI. CONCLUSIONS AND ISSUES FOR DISCUSSIONS**

16. Cape Verde has made major strides in the last several years in improving the well-being of its citizens. Income inequality has increased, however, and Cape Verde's small open economy remains vulnerable to external shocks. Successes in improving access to social services has only broadened expectations of public interventions under current rules of access. Their sustainability will need to be supported by better targeting of beneficiaries and enhanced cost recovery to contain future spending requirements.

17. To address the challenges ahead, some additional information and application of existing analytic work are needed to guide policy formulation. These include studies on the contributory pensions schemes, and better information on health service utilization. In several cases, staffs

advise that the authorities develop the practical policy implications of the PRSP: specific guidelines are needed in the prioritization of expenditure, with a MTEF rooted in the budget preparation process, in rules of access to education and health, and in concession / privatization frameworks for infrastructure development. Moreover, staffs recommend that statements of intent regarding privatization and economic regulation be supported by a clear plan of action and its timetable. The absence of such practical measures may lead to the accumulation of contingent liabilities, undermine the investment growth, and jeopardize macroeconomic stability.

18. Do the Executive Directors concur with:
  - (i) the broad direction of the proposed strategy as outlined in the five pillars; and
  - (ii) priority areas staffs have identified as key for strengthening the PRS and its implementation over the coming year?