

INTERNATIONAL DEVELOPMENT ASSOCIATION

AND

INTERNATIONAL MONETARY FUND

CAPE VERDE

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

Prepared by the Staffs of the International Monetary Fund
and the International Development Association

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

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I. OVERVIEW

1. **Cape Verde's Poverty Reduction Strategy Paper (PRSP) was completed in November 2004 and discussed by the Boards of the International Development Association (IDA) and International Monetary Fund in January 2005.** The PRSP sets out the Government's development strategy for 2004–07, based on five key pillars: (i) promoting good governance, reinforcing effectiveness and guaranteeing equity; (ii) promoting competitiveness to support private-sector-led growth; (iii) fostering human capital development; (iv) strengthening social security and solidarity; and, (v) improving infrastructure and land use management. This is the first Annual Progress Report (APR) of Cape Verde's PRSP.

2. **The preparation and monitoring of the PRSP and the APRs were done in a participatory and consultative manner.** The entire process is coordinated by the Directorate General for Planning (DGP) under the Ministry of Finance and Public Administration. The staffs recommend that the APRs be produced in a more timely manner: this would help to strengthen the monitoring of the PRSP by domestic and external stakeholders, and enable the PRSP process to be better integrated with the government's budget preparation and policy making process. One possible option is to incorporate an analysis of poverty-related expenditures in the annual budget reports.

3. **The recommendations presented in this Joint Staff Advisory Note (JSAN) are part of a broad policy discussion that both the Bank and the IMF are engaged in with the Cape Verde authorities.** In the case of the Bank, the PRSC3 and the PER will follow up on the recommendations on three of five pillars of the PRSP—good governance, development of human capital, and strengthening social security and solidarity. As for the IMF, the government program proposed for support under the PSI

will focus on maintenance of sound macroeconomic policies, supported by further structural reforms in such areas as public sector management and the financial sector.

II. MACROECONOMIC POLICIES AND RISKS

4. The APR notes that the macroeconomic projections agreed recently with the IMF form the basis for the PRSP and medium-term expenditure planning. While the APR would have benefited from a brief discussion of the overall macroeconomic framework that underpins these policy decisions, the concordance between the framework underpinning the PRSP and that in the proposed PSI program with the Fund is fully appropriate. Under the PSI, medium-term macroeconomic policies would be anchored by the further build-up of international reserves to support the exchange rate peg, and by the creation of fiscal space to meet potential future pressures on spending, revenues, and financing. In support of these goals, particular attention is given to reducing domestic debt as a share of GDP, improving expenditure prioritization, and rationalizing tax exemptions.

5. **Fiscal restraint together with further structural reforms will also be needed to address a number of contingent liabilities that could add to fiscal pressures.** There is little discussion in the APR of fiscal risks, or macroeconomic risks more generally, although they have been considered to some degree in other documents issued recently by the authorities, the Bank, and the Fund.¹ There are several areas of concern:

- The INPS pension system is projected to move into a cash-flow deficit by the 2030s; early efforts to reduce these future imbalances would lower the eventual burden of adjustment.
- The long-standing difficulties in the authorities' relations with Electra (the electricity and water company) creates concerns both about fiscal risks and about provision of adequate supplies of electricity and water. Improvements are needed in the regulatory framework for this sector, including full implementation of a tariff structure that provides adequate incentives for investment.
- The national airline (TACV) has recently incurred substantial operating losses, highlighting the need for rapid progress in restructuring the airline to improve performance, reduce fiscal risks, and prepare for its privatization.
- Inflation has increased sharply in 2006 as a result of increases in food and regulated prices. In this context, wage growth in the public sector and the economy as a whole needs to be kept in line with underlying inflation and productivity growth to ensure that budget limits are respected and to prevent short-term price pressures spreading into more generalized inflation.
- Cape Verde's move to middle income status may lead to a decline in the availability of highly concessional external support. Hence, the need to create

¹ These include the Government Program for 2006–11, the PSI, PER and PRSC3.

fiscal space and to improve domestic resource mobilization will become all the more important.

- Other potential risks to the outlook—such as international security concerns or outflows of emigrant deposits—also emphasize the need for adequate safety margins against shocks, including a further build-up in international reserves.

III. MONITORING AND EVALUATION

6. **The staffs recommend that the timeliness and reliability of data for the monitoring and evaluation of the PRSP be improved.** Staffs agree with the APR that such monitoring is critical to measure progress and define priorities. The APR notes that little progress has been achieved because of lack of financing. Given the core function of monitoring and evaluation to successful implementation of the PRSP, including the ability to report on results linked to donor budget support, the Government should ensure funding for its core elements and place a high priority on finding financing resources to push ahead the Statistical Agenda, including the finalization of the QUIBB² which will provide data for the next APR. Furthermore, the staffs urge that APRs be produced in a more timely manner, be better integrated into the budget process, and be more fully utilized to update the PRSP. The PRSP quantitative targets and indicators should be further developed and prioritized, particularly for outcomes.

IV. PRSP POLICIES AND PROGRAMS

A. Promoting Good Governance

7. **In addressing the first of the main PRSP pillars—that of promoting good governance—the APR focuses on recent steps and reform priorities to strengthen public financial management and budget processes.** The report draws in particular on reforms shaped by the CFAA action plan, and is in line with recent discussions on the government program to be supported by the IMF under the PSI.

8. **The report gives particular emphasis to measures undertaken and planned to strengthen audit processes, budget prioritization, procurement practices, and revenue collection.** It notes that improvements in some of these areas draw on the recently developed SIGOF system, which promises to be a highly effective tool for control of budget execution and monitoring. Furthermore, some specific issues raised in the report, including implementation of the medium-term expenditure framework (MTEF) and the streamlining of tax exemptions, reflect policy recommendations that were included in the previous JSAN and are addressed in government commitments under the PSI program.

9. **The staffs urge the authorities to develop and implement the MTEF as a top-down instrument rather than viewing this tool just from a bottom-up perspective.** The APR tends to take the latter viewpoint—indicating, for example, that the global

² QUIBB refers to a questionnaire on basic social indicators.

MTEF should reflect sectoral plans. Such an approach, however, would imply that trade-offs between sectors and ministries are not adequately faced, and would risk undermining overall budget discipline. Instead, sectoral plans need to be coordinated with and contained within a top-down envelope established under the MTEF: this envelope would establish hard budget constraints that define line ministries' spending plans, ensure that allocations to sectors and ministries reflect political priorities, and allow projects and programs to be adequately and reliably funded through the budget.

10. **The staffs recommend that high priority should be placed on closing the government accounts and strengthening auditing systems.** As the APR indicates, the State general accounts are not yet sent yearly to the Court of Auditors (TdC), although progress has been made in clearing backlogs, and the newly designed public accounting system has not yet been implemented. As stated in the Law, accounts for each year should be submitted to the TdC before the end of the following year to improve the effectiveness of the TdC assessment; indeed, more rapid submission should be possible given the capacities of the SIGOF system. Staffs agree with the APR that, to fulfill its mandate, TdC will need increased and long term technical assistance. Furthermore, the staffs recommend that the legislative reforms to the organization and competences of the TdC, which were planned to be submitted to the National Assembly in October 2004, be submitted as soon as possible. With regard to internal auditing, the staffs urge that a work program be developed to identify and address high risk areas of public finance management.

11. **Debt management practices also need to be strengthened.** Improvements are needed in the reliability and timeliness of debt data, both domestic and external; in reporting on the evolution of debt; and in assessing how debt developments relate to achieving the MDGs. Project appraisal capacities also need to be built, especially if Cape Verde makes use of external funding on less concessional terms.

12. **Staffs encourage the authorities to push ahead with reforms to improve human resource management and capacities in the public sector.** As the APR notes, important progress has been made under the PRSP in finalizing and validating the human resources database. Revision of career plans (PCSS) is long overdue, however, and is now planned for 2006. Staffs recommend that reforms in this area proceed rapidly in order to improve public sector performance, attract qualified professionals, and rationalize current staffing and compensation practices.

B. Promote Competitiveness to Foster Private-Sector-led Growth

13. **The APR describes briefly a number of measures the authorities are pursuing to improve competitiveness and the business climate.** These include important reforms that are underway or planned to reduce the administrative cost of doing business, improve labor market flexibility, strengthen regulatory frameworks in such areas as energy and telecommunications, and support tourism development.

14. **In considering the development of financial services, the APR notes the recent rapid growth in the offshore financial center.** The staffs fully agree with the

authorities, as stated in the APR and addressed in the PSI program, that the framework for regulation and supervision of the financial sector needs to be reviewed to ensure it conforms with best international practice.

C. Fostering Human Capital Development

15. **In considering PRSP priorities for education going forward, the staffs recommend that particular attention be given to improving the quality and efficiency of primary education.** APR notes that activities were focused on training teachers but provides only limited quantification of the results achieved. While some indicators are presented of increases in education coverage and in the proportion of teachers with professional qualifications (see annex tables), the staffs recommend that the authorities develop a wider array of indicators of education quality to ensure that reform efforts are results oriented. Staffs agree that focus should be given to improve the quality of primary education, directed in part at reducing the high repetition rate. In addition to improving teacher training, initiatives that could be envisioned include lengthening the school day (right now students attend school four hours per day); providing additional learning and teaching materials; developing teacher resource centers in order to facilitate exchanges between teaching staff; developing school and student report cards; and finally allowing for greater community and parental participation. Furthermore, as noted in the previous JSAN, the quasi-universal enrollment in primary education will lead to higher demand for secondary education; this will imply increasing cost pressures that will need to be accommodated.

16. **The APR notes the importance of improving access to health care services by the poor.** A few indicators of increased access are provided but, as in the case of education, future APRs should aim to draw on a larger number of measures of both the quality and volume of health services that are provided. Staffs agree with the APR on the need to further increase access to health care. Inequities in health outcomes and access to health services persist. Access is limited primarily by geographic factors, while costly medical evacuations remain numerous. This is aggravated by the insufficient number of doctors and poor distribution of staff. To improve access, the staffs recommend expansion of health infrastructure, particularly in remote rural areas; training and deploying health personnel to these areas; and prioritizing the financing and provision of services for those diseases that have the most impact on the poor. The staffs recommend that not only physical access but also financial access should be enhanced. Introduction of user fees is a possibility, assuming a system of exemptions is put in place and expansion of the existing social insurance program, INPS, can free up public resources and improve the social targeting of health services. Again, the report does not provide results or indicators.

D. Strengthening Social Security and Solidarity

17. **The staffs recommend further decentralization and rationalization in the delivery of social services.** There has been little progress in this area, because this needs to be coordinated with the new Organic Law on decentralization which has not yet been approved. Staffs urge the approval and implementation of revised protocols of agreement

for decentralized social services in all municipalities once the Organic Law on decentralization is approved. The APR makes no reference to this even though this is an agreed trigger for the PRSC3. Staffs recommend that the next APR should address performance in this area. As discussed in the previous JSAN, attention also needs to be paid to developing human resource and financial management capacities in municipalities.

E. Improving Infrastructure

18. The staffs urge that the capacities of the economic regulatory agency (ARE) be strengthened and that tariff adjustment mechanisms be fully implemented.

Although the APR mentions the energy sector only briefly, significant weaknesses persist in this area. The staffs recommend that ARE, which has full authority and responsibility over tariff setting, ensure that tariffs for water and electricity fully compensate for the elimination of subsidies on electricity and water production. As emphasized in the previous JSAN, the staffs urge the full implementation of the automatic adjustment mechanism for utility tariffs and the effective application of the adjustment mechanism for petroleum products.

V. CONCLUSIONS

19. The APR provides an update on implementation of several aspects of the PRSP, although with substantial variation in the details of progress across the main PRSP pillars. For example, there is a relatively detailed account of developments in public financial management, but much less information on measures to foster private sector development and address infrastructure weaknesses. As noted above, the APR gives little or no attention to some of the issues identified in the PRSP and is weakened by the limited quantification of progress in key areas such as education, health and social protection. Future assessments of progress in implementing the PRSP would be helped significantly by the development of specific targets and indicators against which progress can be measured. Nevertheless, the necessary directions of reform to meet PRSP objectives are well understood in most cases. In this regard, the emphasis now—as reflected in most of the recommendations of this JSAN—is for the authorities to push ahead with implementation of these reforms. This will require in many cases further growth in domestic capacities, accompanied by ongoing external assistance.

20. **Overall implementation of the PRSP is progressing well.** Staffs recommend that Government maintain its commitment to pursue reforms consistent with the PRSP pillars. Implementation of the program proposed under the PSI will contribute to create fiscal space to meet future fiscal pressures and to help address contingent liabilities. To meet the PRSP goals the staffs recommend that the authorities focus on (i) progressing further with the implementation of the MTEF; (ii) strengthening auditing systems; (iii) pushing ahead with reforms to improve human capital; (iv) further enhancing human resource management and capacities in the public sector; (v) fully implementing the tariff adjustment mechanism; and (vi) improving monitoring and evaluation of progress toward the PRSP objectives.