

**Cape Verde: 2002 Article IV Consultation, First Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criteria—Staff Report; Staff Statement; Public Information Notice and News Brief on the Executive Board Discussion; and Statement by the Executive Director for Cape Verde**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2002 Article IV consultation with Cape Verde, First Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criteria, the following documents have been released and are included in this package:

- the staff report for the combined 2002 Article IV consultation, first review under the Poverty Reduction and Growth Facility, and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **October 27, 2002**, 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 December 6, 2002.** 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 staff statement of **December 16, 2002** updating information on recent economic developments.
- a Public Information Notice (PIN) and a News Brief, **summarizing the views of the Executive Board as expressed during its December 16, 2002 discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the Executive Director of Cape Verde.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Cape Verde\*  
Memorandum of Economic and Financial Policies by the authorities of Cape Verde\*  
Statistical Appendix

\*May also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to [publicationpolicy@imf.org](mailto:publicationpolicy@imf.org).

Copies of this report are available to the public from  
International Monetary Fund • Publication Services  
700 19<sup>th</sup> Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623-7430 • Telefax: (202) 623-7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) • Internet: <http://www.imf.org>

Price: \$15.00 a copy

**International Monetary Fund  
Washington, D.C.**

INTERNATIONAL MONETARY FUND

CAPE VERDE

**Staff Report for the 2002 Article IV Consultation, First Review Under  
the Poverty Reduction and Growth Facility Arrangement, and  
Request for Waiver of Performance Criteria**

Prepared by the African Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, Policy  
Development and Review, Statistics and Treasurer's Departments)

Approved by Donal Donovan and Shigeo Kashiwagi

December 6, 2002

- Discussions for the 2002 Article IV consultation and the first review under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Praia during October 13-27, 2002. The staff team consisted of Mr. Rogers (Head), Messrs. Krichene, Roy, and Floerkemeier (EP), Ms. Denis (Research Assistant), and Ms. Kanyabutembo (Staff Assistant) (all AFR). Messrs. McIntire and van Houtte from the World Bank also participated in the discussions.
- The mission met with Finance Minister Carlos Burgo, the Governor of the Bank of Cape Verde Olavo Correia, and other senior officials. The staff also met with representatives from the private sector, trade unions, the donor community, and the chamber of commerce.
- In concluding the most recent Article IV consultation on June 15, 2001, Executive Directors stressed the need for early action to restore macroeconomic stability. They urged the authorities to quickly implement an automatic and transparent petroleum pricing mechanism and to press ahead with the privatization of public enterprises. They also welcomed the monetary authorities' commitment to use interest rate policy to defend the exchange rate peg.

Contents	Page
Executive Summary.....	4
I. Introduction.....	5
II. Recent Economic Developments .....	6
III. Report on the Discussions.....	9
A. Background.....	9
B. Macroeconomic Framework for 2003.....	10
C. Fiscal Policy.....	11
Policies for 2002 .....	11
Policies for 2003 .....	12
D. Monetary and Financial Sector Policies.....	15
E. External Sector Policies .....	17
F. Structural Reforms .....	18
G. Social Sector Issues and the PRSP.....	18
H. Medium-Term Growth and Balance of Payments Prospects .....	19
I. Statistical Issues .....	22
J. Program Monitoring.....	22
IV. Staff Appraisal .....	22-24
 Figures	
1. Selected Economic Indicators, 1995-2005.....	25
2. Real and Nominal Effective Exchange Rates, January 1997-August 2002 .....	26
3. Monetary Indicators, January 1999-September 2002.....	27
 Tables	
1. Selected Economic and Financial Indicators, 1999-2005.....	28
2. Fiscal Operations of the Central Government, 1999-2005 .....	29
3. Monetary Survey, 1999-2003.....	31
4. Balance of Payments, 1999-2005.....	34
5. External Debt Arrears by Creditors, 1999-2002 .....	36
6. External Public Debt, 1999-2001.....	37
7. Alternative Macroeconomic Scenarios, 1992-2005.....	38
8. Vulnerability Indicators, 1997-2001 .....	39
 Appendices	
I. Letter of Intent.....	40
Attachment I: Supplementary Memorandum of Economic and Financial Policies for September 2002-June 2003 .....	42
II. Relations with the Fund .....	51
III. Fund-Bank Relations .....	53

IV. Statistical Issues .....	57
V. Selected Social and Demographic Indicators .....	61
VI. Tentative Work Program, December 2002-November 2003 .....	62

## EXECUTIVE SUMMARY

**A substantial tightening of fiscal and monetary policies since early 2001 has contributed to redressing the macroeconomic imbalances that emerged in 2000.** Performance under the first-year PRGF arrangement has been good; real economic growth and international reserves are higher, the inflation rate is lower, and the fiscal deficit is smaller than programmed. However, real interest rates were kept high and private investment in key sectors stagnated. Against this background, the Bank of Cape Verde reduced its refinance rate in May 2002, leading to a decline in commercial bank interest rates. **On the structural side,** a new central bank law was passed by parliament, and the government has started liquidation of two public enterprises. However, the introduction of an adjustment mechanism for domestic petroleum prices has been delayed for technical reasons, and the implementation of the VAT has been postponed until June 2003.

**All but three of the quantitative and structural performance criteria for the period end-December 2001 through end-June 2002 were met.** The authorities have requested waivers for the nonobservance of the performance criteria on the ceiling on the accumulation of new domestic payments arrears and the ceiling on the contracting of nonconcessional external debt. They also request a waiver for the failure to implement an automatic and transparent pricing mechanism for retail petroleum products by end-June 2002.

**The discussions included a review and assessment of the economic strategy and policies implemented by the government since early 2001,** which focus on fiscal restraint, appropriately tight monetary policy, a rebuilding of international reserves, the reorientation of public expenditures towards human development and social services, and the promotion of private sector growth. The authorities indicated that the strategy was, and remains, appropriate. However, the view was expressed that, while monetary policy should be geared toward rebuilding international reserves, more emphasis could have been placed on maintaining favorable conditions for private investment, and that, in this regard, interest rate policy could have been more balanced.

**The authorities reaffirmed their commitment to reduce the fiscal deficit to free up financial resources for the private sector and reduce pressure on the external current account, while gradually reducing interest rates in the context of a continued increase in international reserves.** It also expressed the view that growth rates in the range of 5–6 percent will be necessary to achieve significant progress in increasing employment and reducing poverty. While the staff agreed that higher growth rates than previously expected are possible in the medium-term, the authorities and the staff also concurred that such growth rates could be sustained only with continued fiscal restraint and the steadfast implementation of structural reforms, which will be necessary to maintain external competitiveness.

**The main risks to the medium-term outlook are the possibility of fiscal slippages as Cape Verde approaches municipal elections in early 2004, and a slowdown in economic activity in the advanced economies,** which are the main sources of worker remittances and tourism receipts.

## I. INTRODUCTION

1. The last Article IV consultation was concluded on June 15, 2001 (SM/01/145; 5/11/01). Directors stressed the need for early action to restore macroeconomic stability following the fiscal slippages in 2000. They recommended strong fiscal adjustment and the early implementation of an automatic and transparent petroleum pricing mechanism. They also urged the authorities to push forward with the privatization of public enterprises and welcomed the monetary authorities' commitment to use interest rate policy to defend the exchange rate peg. The authorities' actions since the last Article IV consultation have been broadly consistent with Directors' recommendations. They have achieved more success than anticipated with regard to restoring macroeconomic stability and rebuilding international reserves; however, structural reforms are being implemented more slowly than hoped.
2. On April 4, 2002, Directors approved Cape Verde's request for a Poverty Reduction and Growth Facility (PRGF) arrangement in the amount of SDR 8.64 million (90 percent of quota), in support of the authorities' economic program covering the period January 1, 2002–December 31, 2004. As of October 31, 2002, total Fund credit and loans outstanding to Cape Verde amounted to SDR 1.23 million (12.8 percent of quota). Upon completion of the first review, the second disbursement of SDR 1.23 million would become available. Cape Verde is an Article XIV country but has indicated its intention to accept the obligations under Article VIII.
3. In the attached letter (Appendix I) dated December 6, 2002, together with the supplementary memorandum of economic and financial policies (MEFP) (Appendix I, Attachment I), the government of Cape Verde requests the completion of the first PRGF review, and waivers for the nonobservance of two quantitative and one structural performance criteria for end-June 2002. In support of these requests, the supplementary MEFP reviews progress through September 2002 under the first-year PRGF program and sets forth the policies to be implemented through June 2003, including the establishment of quantitative performance criteria for end-2002. The second disbursement (SDR 1.23 million ) is conditional on the completion of the first review. Cape Verde's reform effort is also being financed by structural adjustment support from the World Bank, the African Development Bank (AfDB), and the European Union (EU).
4. Information on core statistical indicators is provided in Tables 1–8. Summaries of Cape Verde's relations with the Fund and the World Bank Group are provided in Appendices II and III, respectively. Statistical issues are discussed in Appendix IV, and Cape Verde's social and demographic indicators are summarized in Appendix V.

## II. RECENT ECONOMIC DEVELOPMENTS

5. **Cape Verde is recovering from the macroeconomic imbalances that emerged in 2000 during the run-up to parliamentary and presidential elections in early 2001.** The fiscal deficit (including grants) nearly doubled to 20 percent of GDP in 2000 (Table 1)<sup>1</sup>. Excluding grants, the deficit increased from 20 percent to 27 percent of GDP (Table 2 and Figure 1). The government began accumulating external and domestic arrears. International capital flows, including donor support, fell sharply, and international reserves declined to about one month of import coverage. The maintenance of the exchange rate peg, albeit with a loss of reserves, helped to contain inflationary pressures, but real economic growth slowed.

6. **The new government, after taking office in early 2001, focused on reducing the fiscal deficit, restoring order to public finances, regularizing domestic and external arrears, maintaining a tight monetary policy to rebuild international reserves, and implementing structural reforms to achieve a high rate of economic growth.** While the authorities have had notable success in reducing the fiscal deficit and rebuilding international reserves, structural reforms have progressed more slowly than expected, and achieving high rates of economic growth has proved elusive. However, there are indications that economic growth is reviving, setting the stage for more rapid progress in reducing poverty in the coming years.

7. **Performance under the first-year PRGF arrangement has been positive; real economic growth and international reserves are higher, inflation is lower, and the fiscal deficit is smaller than programmed.** All performance criteria for end-June 2002 were met except for those pertaining to nonconcessional debt, the accumulation of domestic arrears, and the implementation of an automatic pricing mechanism for retail petroleum products. The government signed a US\$2.5 million nonconcessional loan agreement in January 2002, to finance a road construction project that had been contracted in 2000, before financing had been secured.<sup>2</sup> The Portuguese government is paying the interest on the loan, thereby bringing the grant element of the loan to about 18 percent.

---

<sup>1</sup> Balance of payments and national accounts data have been revised back to 1999 in line with data published by the Bank of Cape Verde and preliminary estimates from the National Institute of Statistics (INE).

<sup>2</sup> The loan was signed before the PRGF arrangement was approved, but it falls within the period covered by conditionality under the first-year program (December 31, 2001–June 30, 2002).

8. **The authorities have taken actions to redress these slippages.** They have informed the staff that there will be no further borrowing on nonconcessional terms,<sup>3</sup> and they are seeking additional donor assistance to bring the grant element of the aforementioned loan to 35 percent. They have cleared the domestic arrears accumulated this year and intend to pay all future bills when due. The government has been negotiating the new petroleum pricing mechanism with the oil companies and has publicly announced its intention to implement the mechanism on January 1, 2003. This will be a structural performance criterion for the second review of the PRGF arrangement.

9. **Real GDP growth is projected to rise to about 4½ percent in 2002, a more favorable outcome than envisaged earlier.**<sup>4</sup> The impact of the September 11 events was not as severe as anticipated. The higher-than-expected economic growth was fueled by exports of manufactured goods, tourism, and transportation services, all of which performed better than projected in the first half of the year, as did private transfers, which helped support domestic construction. Imports of capital goods also increased briskly, pointing to a recovery in private investment. Consumer prices fell by 0.6 percent during the 12 months ended September 2002, and the inflation rate is projected to average 1.7 percent for the year as a whole.

10. **Fiscal policy was tighter than programmed during the first nine months of 2002.**<sup>5</sup> The overall fiscal balance (including grants) registered a surplus of 0.4 percent of GDP, compared with a programmed deficit of 0.4 percent, despite a modest shortfall in revenues (Table 2).<sup>6</sup> The outturn reflects a delaying of recurrent expenditures in order to repay domestic arrears more rapidly than programmed. The authorities made cash settlements of domestic arrears amounting to 2.7 percent of GDP during the first nine months of the year (mostly to the oil companies) compared with a programmed total of 0.6 percent for the year as a whole, with a view to reopening credit lines and reestablishing good relations with suppliers. However, the magnitude of the arrears repayments exceeded expenditure cuts, and

---

<sup>3</sup> This commitment has been demonstrated by the recent cancellation of another nonconcessional loan that had been signed before the PRGF program was negotiated.

<sup>4</sup> Analysis of real economic activity has been hampered by the lack of national accounts statistics since 1997. Preliminary estimates for 1998-2002 were discussed with the authorities, but the final accounts are still being compiled.

<sup>5</sup> The actual fiscal deficit for 2001 was smaller than what was set under the staff-monitored program, which, in turn, was smaller than the one set at the time of the 2001 Article IV consultation discussions earlier in the year. Since taking office, the new government has consistently delivered smaller-than-targeted fiscal deficits.

<sup>6</sup> Excluding grants, there was a deficit of 3.7 percent of GDP, against a programmed deficit of 3.5 percent, owing to a higher level of donor-financed capital expenditures.



government borrowing from the banking system was above the program target at end-September.

**11. Broad money increased by 17 percent during the 12 months ended September 2002, against a projected rise of 9 percent, reflecting a stronger overall balance of payments and the excess government borrowing from the banking system (Table 3).** Nearly half of the growth of broad money originated from “emigrant” deposits, financed by private capital inflows in response to relatively high interest rates in Cape Verde. These deposits currently yield 8.0-9.3 percent, including 1 percent paid by the government.<sup>7</sup> Monetary policy remained fairly tight during the past year, as evidenced by the decline in net domestic assets of the Bank of Cape Verde (BCV). **Net international reserves are well above target, having stabilized following a sharp rise through March 2002, and are currently at about 1.7 months of import coverage.** Given the strong balance of payments position and low inflation rate, the BCV lowered its refinance rate from 11.5 percent to 10.0 percent in May. In the face of high levels of excess liquidity, commercial banks reduced lending rates slightly in June from 14.3 percent to 13.7 percent,<sup>8</sup> still a high level in real terms. **The real effective exchange rate has been subject to some volatility since the introduction of the peg in 1998 but has shown no upward or downward trend (Figure 2).** However, its value has risen recently, owing to the appreciation of the euro against the U.S. dollar.

**12. Progress on fiscal reforms has been weaker than hoped for.** The value-added tax (VAT) law and the new customs tariff schedule were unanimously approved by the National Assembly in June 2002, but implementation will be delayed until June 2003, as more time is needed to establish the administrative framework and draft supporting regulations. The authorities have not yet appointed a budget advisor despite the availability of donor financing and the submission of numerous candidates. On the positive side, they have completed three of four planned public expenditure reviews, with technical assistance from the World Bank, the EU, and Luxembourg.<sup>9</sup> A monthly cash-flow plan was implemented and appears to be working well. The government has also completed a preliminary review of customs exemptions.

---

<sup>7</sup> The government began paying this subsidy on emigrant time deposits in 1995 as a way of encouraging private capital inflows. The budgetary costs of the subsidy are about 0.2 percent of GDP per year.

<sup>8</sup> Average lending rate for 6-12-month loans.

<sup>9</sup> The three cover the central government (in general), health and education. The remaining one, covering agriculture and the environment, is expected before the end of this year.

13. **Progress on other structural reforms has been relatively positive.** The new central bank law was approved by the National Assembly, thereby enabling the authorities to meet one of the two structural performance criteria under the program. The new law prohibits central bank financing of budgetary operations, except for a temporary overdraft facility that must be cleared at the end of each year. The government liquidated one of two large loss-making public enterprises, TRANSCOR (the municipal transportation company), and has announced its intention to liquidate EMPA (the commodity import and distribution company) before the end of this year. The government estimates the total retrenchment costs at about 2.3 percent of GDP, of which 1.5 percent of GDP is expected to be paid in 2002.<sup>10</sup> The World Bank structural adjustment credit (SAC) envisages US\$5 million (0.8 percent of GDP) in support of the retrenchment costs, and the World Bank staff is preparing a request for an additional US\$3-4 million under a SAC supplemental credit, with disbursement tentatively scheduled for the end of this year. The status of other structural reforms is summarized in Tables 2 and 3 of the MEFP (Appendix I, Attachment 1).

### III. REPORT ON THE DISCUSSIONS

#### A. Background

14. Cape Verde is a highly open, small-island economy with a per capita income of about US\$1,400 (2002). While about 46 percent of the population is rural, less than 10 percent of GDP derives from agriculture, reflecting the scarcity of arable land and the country's susceptibility to drought. Chronic unemployment pressures have induced much of the population to emigrate over the years, and workers' remittances are the largest source of foreign exchange earnings. After gaining independence in 1975, Cape Verde put in place a one-party political system with a largely state-planned economy.

15. In 1992, following the country's first multiparty elections, the new government launched a far-reaching economic reform program aimed at reducing the size of the public sector and promoting growth led by private sector exports. The reform agenda focused on privatization, trade and exchange liberalization, financial sector restructuring, tax reform, and price liberalization. Real GDP growth averaged about 7 percent a year in the period 1992-2000, but recurrent fiscal slippages undermined macroeconomic stability, first during 1992-96 and subsequently in 2000, resulting in the loss of international reserves, the accumulation of domestic and external payment arrears, and a rapid increase in domestic debt. The current government was elected in early 2001 and is implementing a strategy to restore fiscal discipline, rebuild international reserves, and complete the structural reform agenda.

---

<sup>10</sup> This estimate is subject to some uncertainty. As of the drafting of this report, the government was still negotiating the severance package with the workers and unions.

16. **Against this background, the 2002 Article IV consultation discussions focused on the appropriateness of the economic strategy implemented by the new government since it took office, the policies for the remainder of 2002, and the medium-term growth and balance of payments prospects and risks.** Key elements of the government's economic strategy are to (i) reduce the fiscal deficit in order to free up financial resources for the private sector and reduce pressure on the external current account; (ii) reorient public expenditures toward health, education, and development of infrastructure; (iii) maintain an appropriately tight monetary policy to rebuild international reserves; and (iv) implement structural reforms to enhance private sector competitiveness and promote economic growth, in order to reduce unemployment and poverty.

17. **The authorities expressed the view that this strategy had been, and remained, appropriate.** However, there was a general feeling, both among the authorities and the representatives of the private sector, that the use of monetary policy to rebuild international reserves has kept real interest rates high and has inhibited private investment and economic growth.<sup>11</sup> While all parties agreed that monetary policy should be geared toward rebuilding reserves, and that the economic situation in 2002 was far better than in 2000, some expressed the view that more emphasis could have been placed on maintaining favorable conditions for private investment, and that interest rate policy could have been more balanced in this respect. The mission agreed that real interest rates had been unsustainably high and that it would be desirable to bring them down gradually, so as not to undermine the sustainability of the balance of payments. It also noted that economic growth during 2001 and 2002 did not fall as sharply as previously thought, based on revised estimates, and that the stage had been set for sustaining a somewhat higher rate of growth. These issues are revisited in the discussions on monetary policy and alternative medium-term growth scenarios described below.

#### **B. Macroeconomic Framework for 2003**

18. **The authorities expressed the view that the GDP growth projections underpinning the PRGF arrangement for 2003 and 2004 (3.5 percent and 4.5 percent, respectively) were not sufficiently ambitious, and that significant progress in increasing employment and reducing poverty would not be realized without economic growth in the range of 5-6 percent.** The staff agreed that higher rates of growth than had been experienced since 2000 were desirable and possible. Based on a joint assessment of the implications of alternative growth scenarios on the external balance (see below), the staff and authorities concluded that the key elements of the macroeconomic framework for 2003 should be real GDP growth of about 5 percent, an inflation rate in the range of

---

<sup>11</sup> Credit to the economy has been expanding at a rate of about 13 percent a year, but most of it has been for housing construction and personal loans. There has been little commercial bank lending for manufacturing, commercial real estate, or fishing.

2.0-2.5 percent, and an increase in gross international reserves to 1.8-2.0 months of import coverage. The external current account deficit (excluding grants) would narrow modestly to 13.8 percent of GDP (Table 4).

**19. There are a number of reasons to be more optimistic about the growth and balance of payments prospects for 2003:**

- Continued fiscal restraint will reduce the government's domestic borrowing needs and strengthen investor confidence.
- A gradual lowering of domestic interest rates, consistent with further increases in international reserves, will help support private sector investment.
- Continued improvements in basic infrastructure, including utilities, roads, transportation, and port facilities through the completion of the privatization and utility regulation agenda, will enhance productivity, as will reorienting public expenditures toward health and education, including professional training.
- The World Economic Outlook (WEO) outlook for world economic growth in 2003 is somewhat more robust.
- New tourist destinations are being opened up to foreign investors.
- Cape Verde has been granted access to U.S. textile markets under the African Growth and Opportunity Act (AGOA).
- The EU embargo on Cape Verde's seafood products is expected to be lifted soon.
- The recent implementation of an "open skies" policy by the United States and the expected qualification for "category one" status will expand the potential growth of Cape Verde's air transport industry.

**C. Fiscal Policy**

**Policies for 2002**

**20. The staff commended the authorities for their success in substantially reducing the fiscal deficit since 2000.** Revenues (including domestic capital participation and net lending) continue to perform well and are projected to rise to 23½ percent of GDP for 2002, reflecting better performance across all categories, but especially international trade taxes.<sup>12</sup>

---

<sup>12</sup> Revenues are projected to perform better than programmed for the year as a whole, despite the shortfall during the first three quarters, because of a reassessment of the seasonal pattern of revenues. The program assumed that 80 percent of revenue would be collected in the first

(continued...)

However, most of the fiscal adjustment since 2000 has come from expenditure cuts, including a wage freeze in 2001 and the elimination of the petroleum product subsidy through two increases in product prices. **The authorities reaffirmed their commitment to fiscal discipline and the overall fiscal strategy, but indicated that the stance of fiscal policy so far in 2002 could not be sustained for the remainder of the year.** The cuts in discretionary expenditures during the first three quarters were compromising the government's ability to implement key policies, such as the hiring of additional teachers and police. In addition, retrenchment costs associated with the liquidation of public enterprises will amount to 1.5 percent of GDP in 2002, against a programmed level of 0.5 percent of GDP.<sup>13</sup> The government indicated it will attempt to limit the need for additional bank borrowing in the fourth quarter to pay domestic arrears by offsetting them against tax arrears accumulated by suppliers.<sup>14</sup>

21. **The staff agreed that there was room to loosen fiscal policy in the fourth quarter of 2002** but urged the authorities to contain the deficit as much as possible in light of the liquidity impact of domestic arrears payments. The World Bank SAC supplement in support of higher retrenchment costs will help limit the need for additional bank borrowing. Against this background, total expenditure in 2002 will still fall moderately to about 31½ percent of GDP (from 31.8 percent in 2001), notwithstanding higher outlays for retrenchment costs; recurrent expenditure would continue to fall relative to GDP. **Thus, the overall fiscal deficit (including grants) is projected to shrink to 2 percent of GDP in 2002 from 4.6 percent in 2001.**<sup>15</sup>

### **Policies for 2003**

22. **Total revenue (including domestic capital participation and net lending) is projected to stabilize at about 23½ percent of GDP in 2003.** Tax revenue would fall slightly, based on a projected easing of import demand and a cautious estimate of the yield of

---

three quarters. The revised projection assumes that revenue collection will be fairly evenly distributed throughout the year, as it has been in previous years.

<sup>13</sup> The minimum severance package is determined by law, based on the years of experience and salary of each employee. These details, which have only recently been worked out in the context of negotiations with employees and the union representatives, were not available when the first-year arrangement was negotiated.

<sup>14</sup> In particular, the government intends to offset about 0.6 percent of GDP in domestic arrears to one of the oil companies against an equivalent amount of tax arrears.

<sup>15</sup> Excluding grants, the deficit would contract more moderately, narrowing from 9.5 percent to 8.0 percent of GDP.

the VAT in its first year of implementation. The government is proposing a reduction in the corporate income tax rate from 35 percent to 30 percent—a measure that will not affect revenue until 2004.<sup>16</sup> No other changes in tax rates are envisaged, and new taxes will not be introduced. **Total expenditure is projected to remain in the range of 31½ percent of GDP.** The government will complete payments to retrenched workers of EMPA, amounting to an estimated 0.8 percent of GDP, which were not contained in the earlier projections. Expenditures on capital programs would also rise on the basis of the government's efforts to accelerate improvements in infrastructure. In the absence of additional budget support grants from donors, **the overall fiscal deficit (including grants) is projected to rise to 3.3 percent of GDP in 2003.** Net external financing would fall to 0.3 percent of GDP, based on current commitments, and domestic bank financing would need to be near zero for the authorities to realize their targets for international reserves and credit to the economy in the context of a slowdown in broad money growth. In addition, the government will settle the rest of the identified domestic arrears. Thus, **there is a financing gap of about 3.9 percent of GDP (EUR 27 million) in 2003,** somewhat larger than earlier projected but smaller than the amount of budget support received in 2002. The financing gap would emerge only in the second half of 2003, by which time the authorities will have held a roundtable donor conference to seek the needed budget support for that period of the year. The budget would be fully financed during the first half of the year, including recourse to domestic bank credit on the order of 1.5 percent of GDP.

23. **The staff noted the significant delays in implementing the VAT and customs tariff reform that had originally been scheduled for January 1, 2002, and in appointing an externally-financed budget advisor.** The authorities indicated that they and the Fund staff had underestimated the technical difficulties of implementing these reforms, and that regularizing arrears, liquidating TRANSCOR and EMPA, negotiating with the oil companies regarding the petroleum pricing mechanism, and building and maintaining political support for their economic program had utilized more of their time and political resources than they had expected. However, they assured the staff that the necessary preparations were under way to implement the reforms by June 2003. While the authorities have demonstrated their capacity to control overall expenditures, some weaknesses remain, including the monitoring and reporting of expenditures by line ministries, the lack of integration of the recurrent and capital budgets, and the controlling and monitoring of expenditures of autonomous agencies. To help address these issues, the authorities indicated that they would appoint a budget advisor by March 2003 and seek additional technical assistance to revise the organic budget law.

---

<sup>16</sup> Companies pay income tax on the previous year's income. The new rate will be somewhat lower than the 34 percent basic rate applicable in Portugal, and will enhance the competitiveness of Cape Verde's' textile and tourism industries, which depend heavily on foreign direct investment.

24. **The authorities agreed with the staff recommendation to undertake a thorough and comprehensive assessment of all tax exemptions, with a view to significantly reducing them over the medium term.** The customs department's own internal review indicated that the exemptions of about 25 percent of imports from customs duties and the consumption tax was costing the government about 3.5 percent of GDP annually. Numerous tax holidays are granted to investors in tourism and manufacturing through other laws. **The authorities noted that this would be a difficult battle, given entrenched interests.** As a first step, the 2003 budget will confer no new exemptions, although it will renew most existing ones. In addition, the exemption from the consumption tax currently applicable to imports will be eliminated with the introduction of the VAT.

25. **The authorities have been settling domestic payment arrears on the basis of invoices provided by suppliers, primarily oil companies.** The staff, while recognizing the urgent need to ensure adequate supplies of fuel, recommended—and the authorities agreed—that a thorough and comprehensive audit of all claims for payment be undertaken to establish their legal basis. If it is found that the government overpaid, it should embark on legal action for reimbursement; meanwhile, if there were an underpayment, it should meet its obligations. The authorities also agreed with the staff that the results should be submitted to the National Assembly as part of the regular review and approval of the public accounts.

26. As originally envisaged, the **domestic-debt reduction operation (DDRO)** was designed to reduce the government's domestic debt from about 46 percent of GDP in 1997 to zero over the medium term by swapping high interest-bearing domestic debt for lower interest-bearing foreign assets (TCMFs), to be financed by donors and privatization receipts. However, resources turned out to be lower than projected and the fiscal slippages of 1999 and 2000 resulted in additional domestic debt creation, leading to the suspension of the DDRO in early 2001. **The government wishes to restart the DDRO, but noted that the need for donor budget support was more urgent than support for debt reduction.** Total domestic debt (including arrears) is not projected to increase in 2002, but total securitized debt will rise to about 28 percent of GDP, with an interest burden of 1.8 percent of GDP.<sup>17</sup> The authorities will request DDRO assistance from donors who would otherwise be unwilling or unable to provide general budget support. The domestic interest burden is expected to ease during the medium term even in the absence of additional support for the DDRO, as domestic interest rates fall and government borrowing from the banking system diminishes.

---

<sup>17</sup> Domestic debt as reported in the supporting tables refers to government securities. This measure of debt increased in 2002 and is expected to rise further in 2003 as the government continues to issue securities to pay domestic arrears. Domestic interest payments in the fiscal accounts exclude interest on arrears.

#### **D. Monetary and Financial Sector Policies**

27. **The discussions on monetary policy focused on the authorities' desire to bring interest rates down in order to spur private investment and economic growth.** The staff, while supporting this objective, urged the authorities to proceed carefully in light of the potential short-term risk to the balance of payments, the liquidity impact of the government's domestic arrears payments, and the moderate easing of fiscal policy in the near term. The staff pointed out that the overall balance of payments had not generally been in surplus since March 2002 (Figure 3). Also, the growth in money supply since that time, driven by government borrowing from the banking system to clear domestic arrears, is likely to have exceeded growth in money demand, resulting in a monetary overhang. Finally, while the overall fiscal stance is tighter than programmed, it was loosened during the second half of the year and will ease further in 2003. Thus, pressures on the balance of payments have intensified somewhat since March, just when the monetary authorities began to reduce interest rates. The authorities pointed out that the overall balance of payments had not deteriorated following the lowering of interest rates in May and June, thereby indicating that there was room for further reductions. Following the approval of the 2003 budget by the National Assembly, which will send an important signal to financial markets that the authorities remain committed to fiscal restraint, they intend to eliminate the subsidy on emigrant deposits effective January 1, 2003. Subsequently, the BCV would reduce its refinancing rate if international reserves continued to perform well.

28. **The BCV has an adequate range of monetary instruments at its disposal, comprising open market operations (including repurchases), a lending-absorption facility, reserve requirements, and foreign exchange operations.** As noted above, all of the commercial bank demands for liquidity have been met so far in 2002 through the central bank's purchasing of foreign exchange. This has been instrumental in keeping commercial bank deposit rates relatively high, which, in turn, has provided a positive incentive for strong private capital inflows. Under the plan outlined above, the commercial banks will be induced to lower interest rates, first through a lowering of the central bank's own lending rates and subsequently through the use of open market operations. If international reserves continue to increase, the authorities could consider reducing the reserve requirement (currently 18 percent).

29. **Broad money growth is projected to fall to about 13 percent by end-December 2002 and to about 7½ percent by end-2003, as the current monetary overhang begins to unwind.**<sup>18</sup> Net bank claims on the government will increase further in the fourth quarter of 2002, as the government pays additional domestic arrears, and credit to the economy is projected to continue growing. Thus, the unwinding of the monetary overhang is expected to

---

<sup>18</sup> The 2003 projection of broad money assumes no change in money velocity. This assumption will be reviewed in the context of the negotiations of the 2003 annual program.



result in a decline in international reserves of about EUR 10 million in that period.<sup>19</sup> Given that fiscal policy is on track, and that the monetary overhang reflects the one-off effect of domestic arrears payments, the staff and the authorities agreed that some loss of international reserves would be acceptable, and the monetary authorities indicated that they would tighten monetary policy if the reserve loss became unsustainable. Assuming an adequate provision for credit to the private sector and a further increase in international reserves, government net borrowing from the banking system would need to be near zero for 2003 as a whole.

30. **The financial sector is basically sound.** The BCV receives monthly off-site reports from all commercial banks and has performed one on-site examination this year at Banco Commercial do Atlântico (BCA, the country's largest bank). The existence of relatively high interest rates has not had a noticeably deleterious impact on commercial bank balance sheets. The commercial banks report that nearly all of their nonperforming loans are more than five years old and that interest rate spreads are, at present, wide enough to ensure profitability. Commercial banks currently have moderately positive open positions with regard to foreign currency exposure. The BCV operates a central registry of borrowers and securing assets, and it considers commercial banks' ability to assess credit risk to be adequate, a view shared by the commercial banks themselves. The banking system remains highly concentrated, with the recently privatized BCA and Caixa Economica de Cabo Verde (CECV) accounting for about 90 percent of commercial loans and deposits and most of the banking system's excess liquidity. The authorities indicated that, while the legal framework for seizing collateral assets was adequate, the cumbersome and slow judicial process was suppressing lending activity.

31. **The BCV intends to undertake a number of measures to strengthen financial oversight and promote financial sector development in 2003, using technical assistance from the World Bank and bilateral donors.** It is preparing supervisory legislation with assistance from Macao, and is strengthening its capacity to detect money-laundering operations with assistance from Luxembourg. A draft law to combat money-laundering and the financing of terrorism has been submitted to the National Assembly, and approval is expected before the end of 2002. The BCV will also work toward completing on-site examinations of every bank once a year, beginning in 2003, and will computerize the commercial bank reporting system, with a view to creating near-real-time monitoring of commercial bank operations. To promote competition in the financial sector, the BCV will encourage the entry of new, qualified banks and will promote the development of venture capital, pension, and investment funds. The BCV will seek technical assistance from the Fund in the area of monetary operations.

---

<sup>19</sup> The staff believes this is a cautious projection, given the uncertainty surrounding the size of the monetary overhang and the rate at which the money supply will adjust. If the monetary overhang is smaller than the staff estimates, or if it unwinds less rapidly than projected, international reserves and money growth would be higher.

32. The safeguards assessment is being finalized. The assessment has identified some vulnerabilities in the safeguards framework of the BCV in the areas of external audit, internal audit and controls, and financial reporting. These issues are under consideration by the authorities, and the staff expects that measures, if necessary, will be incorporated in the second annual program under the current PRGF arrangement.

#### **E. External Sector Policies**

33. **The authorities have reached agreements with all but two external creditors (ICO, a Spanish public finance agency, and Russia), covering about US\$9 million in arrears.**<sup>20</sup> They indicated that ICO, to whom Cape Verde owed about US\$7.4 million in arrears (Table 5), had been slow to respond to the authorities' inquiries. The debt owed to Russia is quite old, and accurate records of the original debt are missing. Pending the conclusion of negotiations on the matter, the government continues to make payments to an agreed escrow account.

34. **The authorities indicated that the trade reform agenda would be largely complete with the introduction of the new customs tariff schedule in June 2003.** The new tariff structure will be streamlined into seven tariff bands ranging from zero to fifty percent, with the average unweighted tariff rate lowered from 23½ percent (including the 9 percent customs fee, which will be eliminated in the new structure) to 12½ percent. The present system has no restrictions, except for health and security reasons, and no quotas. No monopoly on imports is granted to any importer (except for the shared, regulated monopoly in the oil sector). Cape Verde has eliminated all previously identified exchange restrictions on the making of payments and transfers for current international transactions, and the **authorities intend to accept the obligations of Article VIII, Sections 2(a), 3, and 4.** The staff is preparing the necessary report.

35. Cape Verde is party to many trade agreements, including the Economic Community of West African States (ECOWAS), the African, Caribbean, and Pacific Countries (ACP)/Lomé Convention (Cotonou Agreement), the African Economic Community (AEC), and, recently, the U.S. African Growth Opportunity Act (AGOA). Cape Verde has multilateral trade agreements with Portuguese-speaking countries and with some west African countries. It has also preferential access to the Portuguese market. Cape Verde applied for membership in the World Trade Organization (WTO) in 1999. The stumbling block is the acceptance of Article 7 of the General Agreement on Tariffs and Trade (GATT), which addresses procedures of merchandise valuation and the tariff system. However,

---

<sup>20</sup> The authorities indicated that they had reached an understanding with the Brazilian creditor CACEX Brazil (covering US\$1.2 million in arrears), but that the executive board of CACEX had not yet issued the letter confirming the settlement.

negotiations are proceeding, and Cape Verde may qualify for a five-year grace period before fully implementing the provisions of Article 7.

#### **F. Structural Reforms**

36. **Privatization and utility reform and regulation are among the key structural reforms being implemented with assistance from the World Bank.** Only a few enterprises remain to be privatized: the airline (TACV), the ship repair facility (CABNAVE/CABMAR), and a fish-freezing enterprise (INTERBASE). The government attempted to privatize INTERBASE in 2002, but no investor interest emerged.<sup>21</sup> The authorities are exploring the possibility of assigning the management of the country's port facilities to private concessions. They intend to make the multisector regulatory agency (ARM) operational, with responsibility for implementing the automatic petroleum pricing mechanism and regulating utilities. They also indicated that electricity tariffs will be raised in 2003; this action will improve the financial position of the recently privatized power company, and should strengthen revenue performance in the budget.<sup>22</sup>

37. **The government is working with the World Bank on a growth and competitiveness project** that would focus on improving the investment climate through tax reform (including a study on the extent and impact of tax exemptions), the alleviation of administrative barriers to investment, legal reform, private sector capacity building, and the strengthening of financial sector supervision and regulation. Other World Bank lending is summarized in Appendix III.

#### **G. Social Sector Issues and the PRSP**

38. **The government will continue to maintain important social safety nets for those adversely affected by the reform process and external shocks.** In this regard, the government is providing financial support for employees who have lost their jobs owing to the liquidation of TRANSCOR and EMPA. In addition, outlays in the fourth quarter of 2002 for the public employment program (FAIMO) will help maintain incomes for farmers affected by this year's drought. The government will help ensure that poor households are not adversely affected by the decision to allow domestic petroleum product prices to reflect market conditions by allowing for cross-subsidization of certain products consumed by the poor (e.g., butane in small containers).

39. **The mission met with the poverty reduction strategy paper (PRSP) steering committee,** which indicated that it was having some difficulty in coordinating the

---

<sup>21</sup> The government is designing a backup strategy in consultation with the World Bank.

<sup>22</sup> The central government owns 29 percent of the power company, municipalities own another 20 percent, and the Portuguese utility, EDP, owns the remainder.

contributions from the various ministries. Limited implementation capacity in some municipal and local-level governments is inhibiting the full engagement civil society in the participatory process. The authorities expect to overcome these barriers and are still planning to complete their PRSP by mid-2003. On the positive side, the public expenditure review (PER) has been completed, as has the field work of the first half of the household survey, which will provide important inputs to the PRSP. The PER recommends increases in expenditures in selected areas, including secondary education, preventive health care, agricultural extension services for poor farmers, and roads. It also identifies areas of potential expenditure savings, including teachers' salaries and the streamlining of the procurement process. The mission urged the committee to ensure that the government actions outlined in the PRSP were fully costed and consistent with the budget. It also urged the committee to consider alternative macroeconomic scenarios and undertake a social impact analysis of government policies. The committee will prepare a PRSP preparation status report early in 2003.

#### **H. Medium-Term Growth and Balance of Payments Prospects**

40. **The staff and the authorities explored the implications of alternative medium-term economic growth scenarios on the external current account balance.** The analysis incorporated the current medium-term fiscal outlook, reasonable expectations regarding the future trend of private savings, and the potential impact of structural reforms and public expenditures on factor productivity (Table 7). In this framework, higher economic growth requires a higher rate of investment, which, with a given national savings rate, will lead to a larger external current account deficit. Moving from a 4½ percent growth rate in 2002 to 5 percent in 2003 and the medium term would still allow the external current account deficit (excluding official transfers) to decline throughout the period, reflecting steady increases in public and private savings and productivity. The investment requirement associated with 6 percent growth, however, would cause the current account deficit to increase by about 3½ percent of GDP in 2003, and the deficit in 2005 would not be much smaller than in 2002. **On the basis of the discussions, the mission and authorities agreed that a 5 percent real GDP growth rate would be a reasonable starting point for building a macroeconomic framework.** Higher growth rates and larger current account deficits, such as those experienced during the 1990s, could be sustained if private non-debt-creating capital inflows and concessional donor budget support were greater than currently projected.<sup>23</sup> The mission

---

<sup>23</sup> It should be noted that donor support in the form of grants fell steadily from 19 percent of GDP in 1992 to 5 percent in 2001, and recovered only modestly to 6 percent in 2002. Grants averaged 13 percent of GDP during the high-growth period of 1992-2000. The vast majority of grants are for project support, concentrated in the areas of agriculture, fishing, education, water and sanitation. It is not expected that donor support will rise to these levels again. Thus, higher growth in Cape Verde will depend crucially on fiscal restraint and international private capital flows.

urged the authorities to continue exploring the implications of alternative macroeconomic frameworks in the context of their PRSP.

41. **The principal barriers to growth were identified as poor infrastructure (roads, power, water, telecommunications, and port and airport facilities), high real interest rates, administrative barriers to private investment, a lack of modern management practices among small and medium-sized enterprises, labor market rigidities, an uncompetitive financial market, and a slow commercial justice system.** Improvements in infrastructure are being addressed in the context of the government's public investment program with substantial support from donors. The central bank has already begun to cautiously reduce interest rates. The issues of administrative barriers, management practices, the financial system, and judicial reform are being tackled under the growth and competitiveness project, and the authorities are reviewing existing labor legislation. There appears to be sufficient excess capacity in manufacturing, tourism, and air transport and sufficient slack in labor markets to allow for higher growth in the near term. The lead time for new textile factories and resort hotels is about 18-24 months, which should allow for a fairly smooth increase in supply in the medium term.

42. **The staff prepared a detailed medium-term scenario based on these discussions.** Real GDP growth would average 5 percent a year during 2003-05, driven by exports of textiles, tourism, and transportation services. The inflation rate would be contained at 2.0-2.5 percent. Broad money would grow in line with nominal GDP, and credit to the economy would grow somewhat more rapidly. Gross international reserves would rise gradually to 2.3 months of import coverage, still low for an economy as open as Cape Verde's. On these assumptions, bank financing of the budget would need to turn from positive to negative over the medium term. The fiscal deficit (including grants) would decrease to 1½ percent of GDP in 2004 and would swing to a small surplus of ¼ of 1 percent of GDP in 2005. Revenues would rise moderately relative to GDP, reflecting the buoyancy of the income and value-added taxes, as well as a reduction in tax exemptions. Recurrent primary expenditures would rise by about 1-3 percent in real terms, with the increased outlays associated with the poverty reduction strategy partially offset by a reduction in subsidies and transfers relative to GDP. The expenditure projections would be revisited once the PRSP was completed.

43. **The external current account deficit (excluding official transfers) is projected to gradually fall as export competitiveness is enhanced through increases in factor productivity and public and private savings offset the pressure associated with higher growth.** The projections, based on historical trends, incorporate a steady increase in foreign direct investment, reflecting new investor interest in manufacturing, fishing, tourism, and transportation services, as well as project disbursements. **Against this background, the financing gap would be about EUR 27 million in 2003 and then fall gradually to about EUR 9 million in 2005.** This gap would, it is hoped, be closed by additional balance of

payments support, including a potential poverty reduction support credit (PRSC) from the World Bank.<sup>24</sup> This medium-term scenario will be reviewed in the context of the discussions on the second annual PRGF-supported program in February 2003, which will help inform the authorities' roundtable donor conference, as well as the macroeconomic framework underpinning the PRSP.

44. **The medium-term outlook is subject to risks, both domestic and external.** Fiscal discipline could be difficult to maintain as the country approaches municipal elections in 2004 and national elections in 2006. However, the authorities cited a number of reasons to have confidence in the sustainability of the envisaged fiscal consolidation, including the implementation of an independent central bank law, a more informed civil society, and stronger democratic institutions, all of which will promote responsible governance and enforce accountability. With regard to external risks, a slowdown in world economic activity would adversely affect Cape Verde's exports, which are the key to high rates of economic growth and a strong balance of payments. In addition, stricter immigration controls in advanced economies may limit the growth of private remittances, which are the country's single largest source of foreign exchange earnings. However, there is also an upside risk, as economic growth and the balance of payments could be stronger than projected if foreign investor interest in textiles and tourism is more pronounced than currently envisaged.

45. The authorities expressed the view that the exchange rate regime and peg have helped stabilize expectations regarding foreign exchange operations, reduced uncertainty, and increased confidence among entrepreneurs. While a devaluation could enhance international competitiveness, its impact would be limited owing to the high import content of export production, and leaving the peg at this time could undermined the confidence the authorities have built during the past two years. It was agreed that the preferred strategy would be to increase international competitiveness through structural reforms. **Against this background, the staff and the authorities are of the view that the current exchange rate system and level of the peg are adequate to ensure the competitiveness of exports and a continued increase in international reserves in the medium term, with important provisos.** Exports have been performing well to date, and the prospects for continued growth in 2003 are good, but Cape Verde's balance of payments will remain fragile during the medium term. The staff and authorities agreed that the current peg should be adequate in the medium term, provided that fiscal policy remains appropriately tight, productivity gains are realized through structural reforms, sufficient donor support is forthcoming, and the euro does not further appreciate significantly. If developments turn out to be less favorable, then the issue of the

---

<sup>24</sup> The World Bank staff has indicated that the PRSC would not be ready for disbursement until 2004. No World Bank budget support is in the pipeline for 2003. The authorities have already approached the EU and Switzerland with a request to convert funds previously identified for the debt-reduction operation into budget support.

appropriateness of the exchange rate system and/or the level of the peg would need to be revisited. In the meantime, the level of international reserves should be monitored closely.

### I. Statistical Issues

46. **Cape Verde's statistical systems remain weak.** The mission urged the authorities to take a more active role in setting the work program of the National Statistics Institute (INE), and ensuring that it is fully funded and that line ministries provide it with the necessary information. At present, the data supplied by the INE are inadequate to fully assess the appropriateness of fiscal and monetary policy, or to monitor poverty indicators. The national accounts for 1998-2000 have yet to be finalized, and accounts for 2001 and 2002 are not scheduled for release until 2004; quarterly national accounts will only be available subsequently. Publication of a consumer price index reflecting an updated market basket is now expected in mid-2003, a year behind schedule, owing to delays in donor funding. Line ministries compile statistics that the INE could use to generate high-frequency indicators of current economic activity, but this information remains untapped because of poor institutional coordination.

47. **These weaknesses notwithstanding, there have been improvements in statistical compilation and dissemination, and the authorities are committed to use the GDSS as a framework for the development of the statistical system.** The BCV publishes a wide variety of monetary, external, real sector, and fiscal data on the worldwide web, and it has strengthened its balance of payments statistics with technical assistance from the Fund. The INE has completed the first part of the household income and expenditure survey, which will be a key input into the analysis of poverty to be contained in the PRSP; it has also launched a quarterly consumer confidence survey, which it intends to begin publishing in 2003.

### J. Program Monitoring

48. Proposed quantitative performance criteria for end-December 2002, benchmarks for March and June 2003, and structural performance criteria and benchmarks for the first half of 2003 are specified in the MEFP. The definitions of quantitative performance criteria and benchmarks and reporting requirements remain as set forth in the technical memorandum of understanding (TMU) (EBS/02/54, Appendix I, Attachment III). The assumptions regarding non-project donor support have been updated through June 2003 to include the World Bank supplemental structural adjustment credit of US\$ 3 million and the renewed disbursement of the Portuguese credit facility of € 5 million, and are reflected in Table 1 of the Supplementary MEFP (Appendix I, Attachment I). Discussions with staff for the second review and the second annual program are tentatively scheduled for February 2003.

## IV. STAFF APPRAISAL

49. **The staff commends the authorities for their success in restoring macroeconomic stability, rebuilding international reserves, and bringing order to public finances.** The government has consistently overperformed with respect to the fiscal and international

reserve targets that have been set since early 2001. The slowdown in economic activity during 2001-02 made it difficult to maintain political support for the authorities' economic program, but growth has recently increased, and the staff believes that the government's economic and financial policies have set the stage for higher rates of economic growth.

**50. The medium-term focus of further consolidating the fiscal position, reducing domestic interest rates, improving the delivery of social services, redirecting public expenditures towards social development and infrastructure, and implementing structural reforms to enhance productivity should establish the conditions for sustainable growth in the range of 5 percent per year.** The government's strategy appropriately focuses on removing the major barriers to economic growth and enhancing the competitiveness of exports.

**51. The staff supports the authorities' plans to reduce interest rates further in 2003 in order to spur private investment.** The lowering of interest rates in mid-2002 was appropriate in light of the strong balance of payments realized early in the year and the continued low inflation. However, given the openness of Cape Verde's economy and the still low level of international reserves, the monetary authorities' primary objective should continue to be to further expand reserve coverage. The strategy set forth for future reductions is suitably cautious and supports the monetary authorities' commitment to reduce interest rates only to the extent compatible with a sustainable balance of payments.

**52. The modest increase in the fiscal deficit projected for 2003 is appropriate in light of the expenditure cuts implemented relative to the program in 2002,** and the projected fiscal deficit should nevertheless help ensure a moderate improvement in the external current account deficit while supporting a continued growth in credit to the economy, in the context of lower interest rates. However, additional fiscal consolidation in the medium term will be necessary to support the objectives of achieving higher rates of economic growth and smaller external current account deficits.

**53. The staff urges the authorities to implement the VAT and new customs tariffs by June 2003 as planned,** as these reforms will be crucial to ensuring a buoyant fiscal revenue base and enhancing export competitiveness in the medium term. In addition, **all existing tax exemptions should be identified and a comprehensive strategy shaped for reducing them sharply,** in order to secure the additional resources needed to support rising public expenditures in the context of the PRSP, reduce economic distortions and rent-seeking activity, and help ensure fiscal sustainability. **To further ensure transparency and accountability of public finances, the staff also recommends that the authorities do a comprehensive audit of all arrears and make the results public.**

**54. Pushing ahead on other structural reforms in close consultation with the World Bank, including privatization and utility reform and regulation, will be crucial for enhancing productivity and ensuring the sustainability of the balance of payments and high rates of economic growth.** The staff welcomes the approval of the new central bank



law, which establishes an independent central bank, and liquidates two large loss-making enterprises. The staff looks forward to the implementation of the transparent and automatic pricing mechanism for retail petroleum products, which is key to ensuring fiscal sustainability.

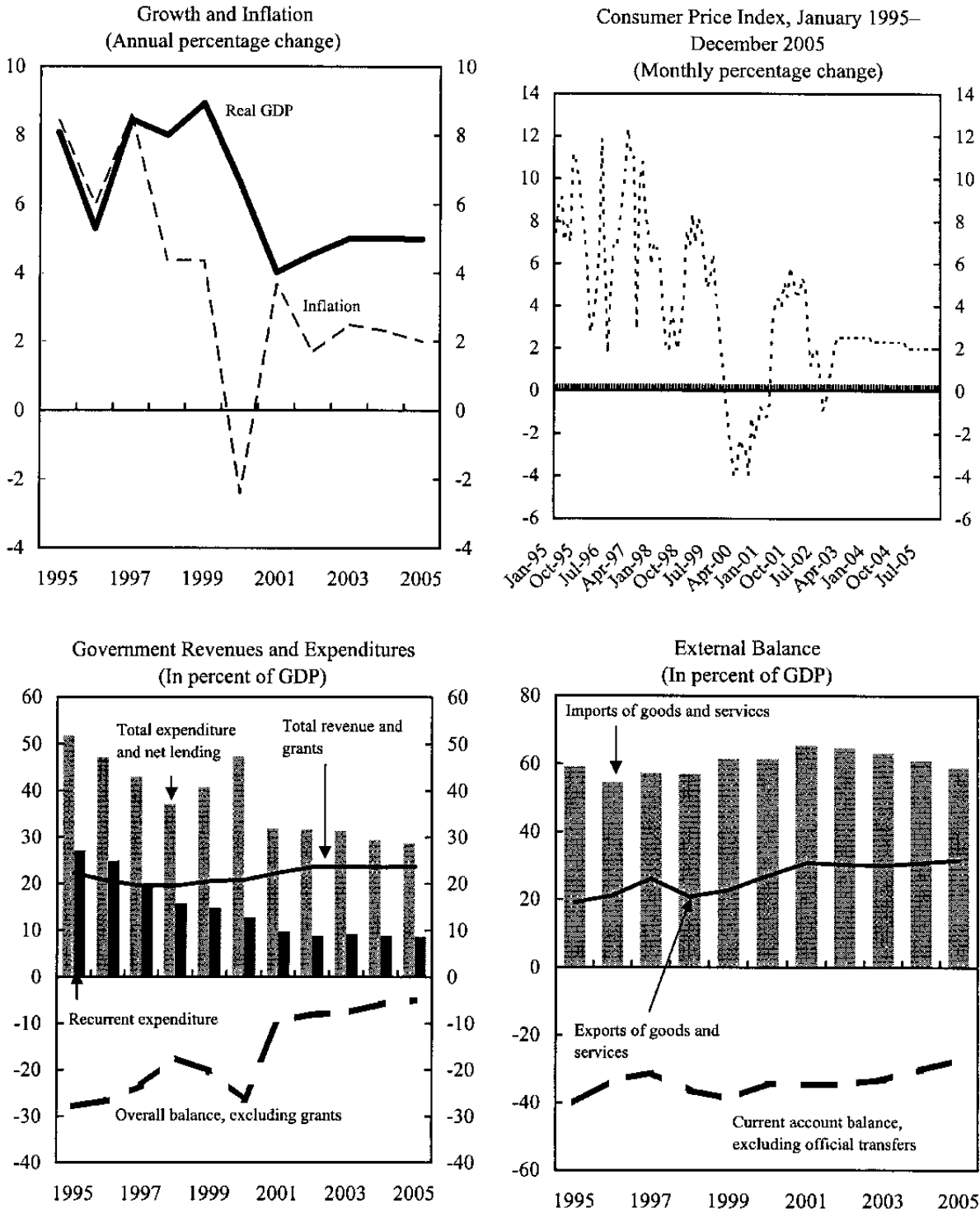
55. **The authorities' external sector strategy is appropriate**, with its emphasis on a gradual reduction in the external current account deficit through the promotion of exports and sustainable official transfers. **The staff agrees that the exchange peg remains adequate to ensure export competitiveness**, provided that fiscal policy remains tight and productivity gains are realized through the timely implementation of structural reforms. The authorities are encouraged to continue working toward the conclusion of negotiations on the rescheduling of arrears with ICO (Spain) and Russia.

56. **Cape Verde's statistical systems remain weak**, particularly in the real sector. The work plan of the INE should be reviewed to ensure that it is consistent with the needs of the government and other users. The INE's statistical program should also be fully funded, and all government agencies should provide the INE with its information requirements. The authorities are encouraged to complete the remaining steps necessary for participation in the GDDS, which would bolster their efforts to build statistical capacity and help secure technical assistance to improve the statistical system. These weaknesses notwithstanding, data have been adequate to enable monitoring of the PRGF-supported program.

57. **The staff recommends completion of the first review under the PRGF arrangement on the strength of the authorities' program through June 2002**. The staff also supports the authorities' request for waivers of the nonobservance of three performance criteria for end-June, because they have taken sufficient action to ensure their observance in the future and the underlying policies remain consistent with program understandings.

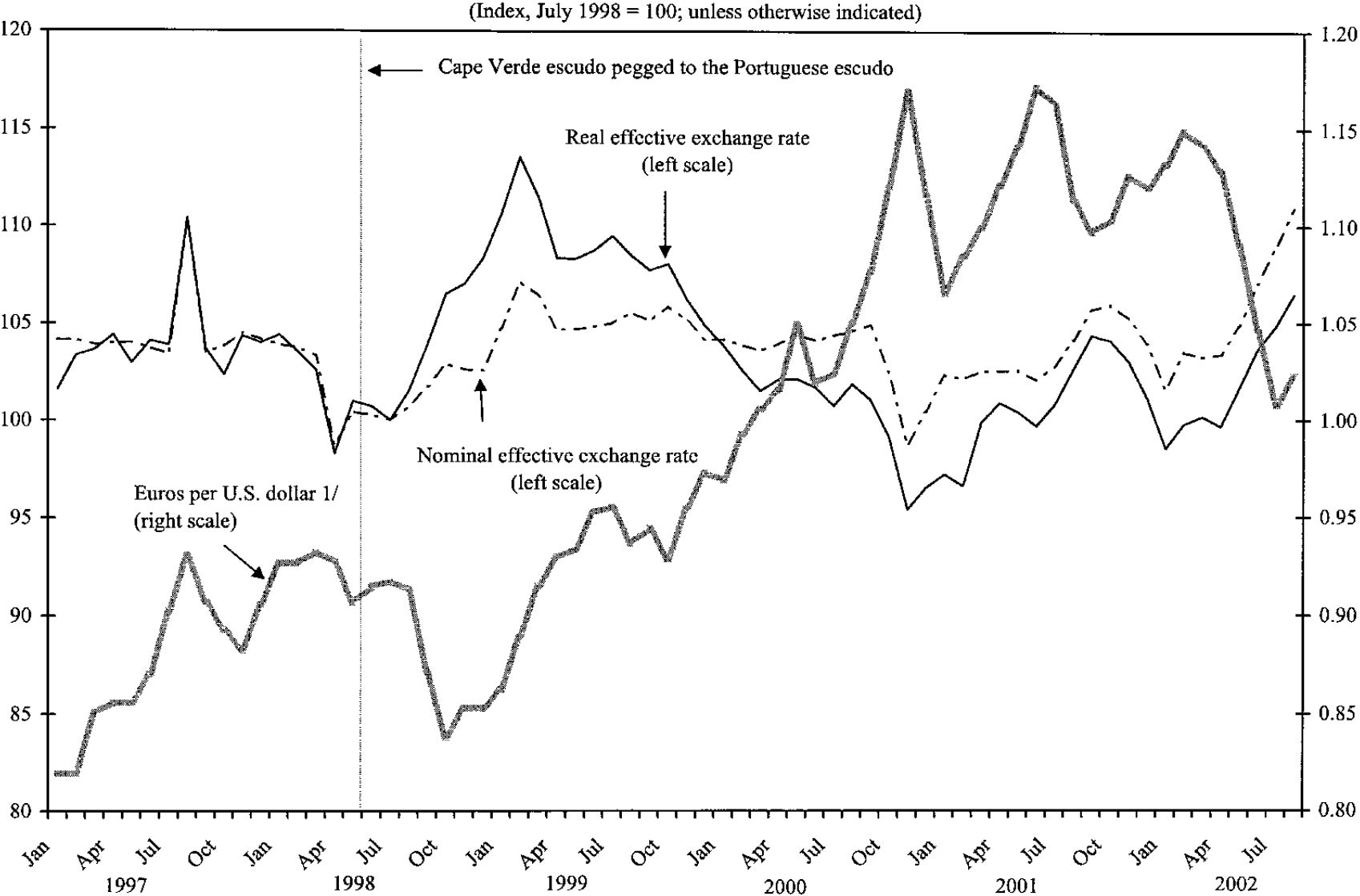
58. It is recommended that the next Article IV consultation with Cape Verde be held on the 24-month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

Figure 1. Cape Verde: Selected Economic Indicators, 1995–2005



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

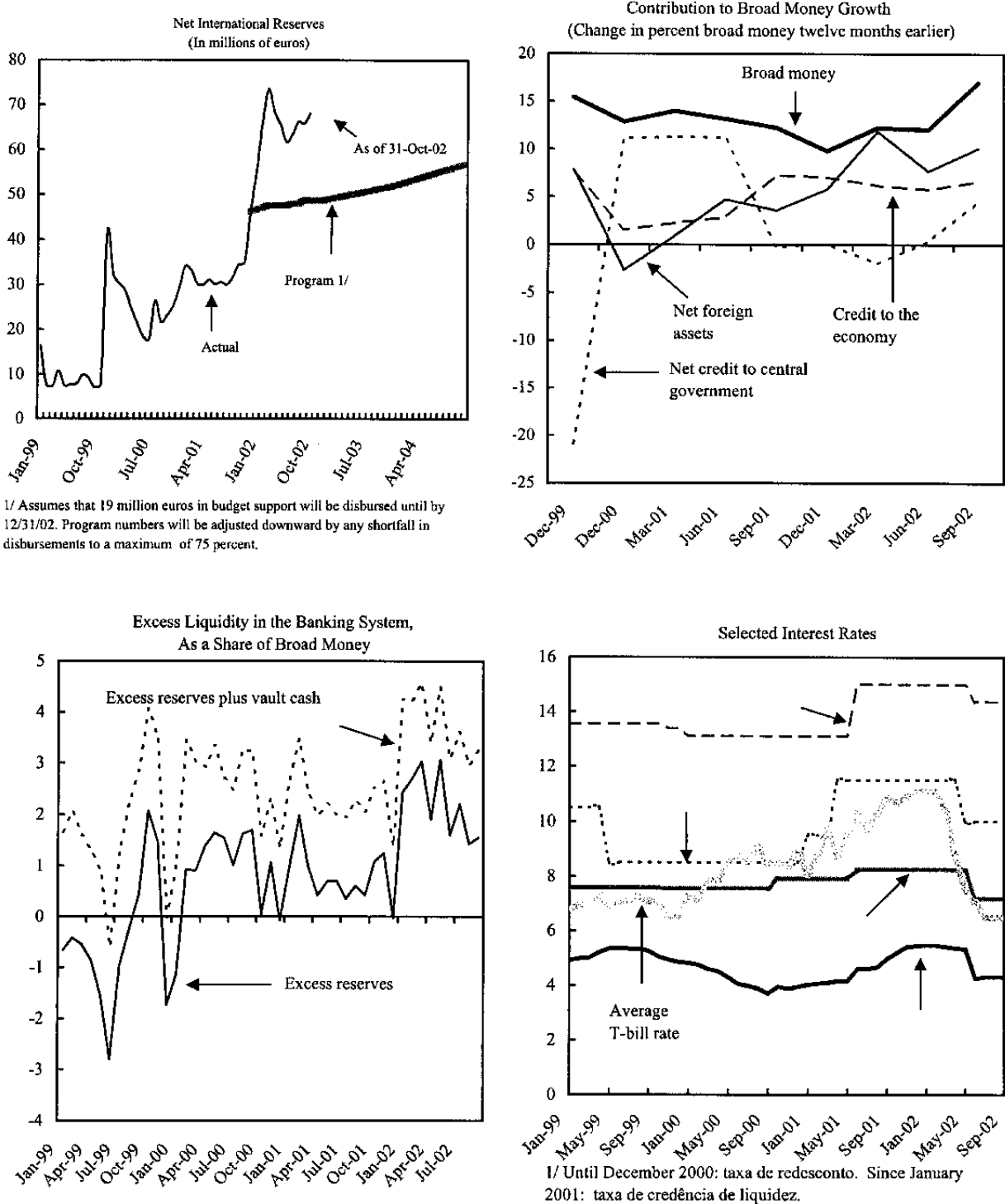
Figure 2. Cape Verde: Real and Nominal Effective Exchange Rates, January 1997-August 2002



Source: International Monetary Fund, Information Notice System.

1/ Prior to January 1999, based on the Portuguese escudo multiplied by the December 1998 euro-escudo conversion rate.

Figure 3. Cape Verde: Monetary Indicators, January 1999–September 2002  
(In percent; unless otherwise indicated)



Sources: Bank of Cape Verde; IMF, *International Financial Statistics*; and staff estimates.

Table 1. Cape Verde: Selected Economic and Financial Indicators, 1999–2005

	1999	2000	2001	2002		2003	2004	2005
				Prog.	Proj.		Revised Proj.	
(Annual percentage change)								
<b>National income and prices</b>								
Real GDP	8.9	6.6	4.0	2.5	4.6	5.0	5.0	5.0
Real GDP (per capita)	7.1	4.4	1.8	0.3	2.3	2.7	2.7	2.7
Consumer price index (annual average)	4.4	-2.4	3.7	3.0	1.7	2.5	2.3	2.0
Consumer price index (end of period)	-1.5	-1.1	4.6	2.9	2.0	2.5	2.3	2.0
<b>External sector</b>								
Exports <sup>1/</sup>	16.4	26.2	19.8	-4.0	4.6	6.5	10.0	10.0
Imports <sup>1/</sup>	21.5	6.1	11.7	2.5	5.6	4.5	3.7	3.5
Real effective exchange rate (annual average)	8.4	-7.3	-2.7	...	-0.1	...	...	...
Terms of trade (minus = deterioration)	-4.8	-0.1	-4.3	-0.2	0.0	-0.1	0.1	-0.2
<b>Government budget</b>								
Total revenue (excluding grants)	22.3	7.8	12.8	3.6	12.3	7.6	7.2	7.4
Total expenditure	28.5	23.5	-29.5	17.9	5.6	6.4	0.7	4.4
Recurrent expenditure	29.3	56.3	-32.7	6.1	0.5	8.9	3.4	4.3
Capital expenditure and net lending	8.9	-7.9	-20.5	70.2	-2.7	11.3	2.9	4.6
(Annual change in percent of beginning-of-period broad money)								
<b>Money and credit <sup>2/</sup></b>								
Net domestic assets	7.3	15.8	4.0	5.4	10.5	6.3	...	...
<i>Of which:</i> net claims on the central government	-20.9	11.1	0.1	1.7	6.0	0.0	...	...
credit to the economy	7.6	1.6	7.0	3.6	6.4	6.3	...	...
Broad money	15.4	12.9	9.8	6.5	13.2	7.6	...	...
Income velocity (GDP/M2)	1.74	1.62	1.52	1.57	1.46	1.46	...	...
Discount rate <sup>3/</sup>	8.5	9.5	11.5	...	10.0	...	...	...
(In percent of GDP)								
<b>Saving-investment balance</b>								
Gross domestic investment	19.8	18.7	17.4	21.0	19.8	21.2	20.7	20.2
Public	7.4	6.4	4.8	3.9	4.4	4.6	4.4	4.3
Private	12.4	12.3	12.5	17.1	15.4	16.6	16.3	15.9
Gross national savings	6.9	7.5	6.6	9.7	9.3	10.4	12.2	14.3
<i>Of which:</i> public sector	1.8	-7.6	5.1	2.3	6.6	5.2	7.0	8.5
External current account (including official transfers)	-12.9	-11.2	-10.7	-11.3	-10.6	-10.7	-8.4	-5.9
<b>Government budget</b>								
Total revenue (including grants)	27.8	27.0	27.3	25.9	29.6	28.0	28.1	28.9
Total grants	7.3	6.2	4.9	3.7	6.0	4.4	4.5	5.2
Total expenditure	40.8	47.3	31.8	28.9	31.6	31.3	29.4	28.6
Overall balance after grants	-13.0	-20.4	-4.6	-2.9	-2.0	-3.3	-1.3	0.3
Domestic bank financing	1.3	8.2	0.1	1.1	3.9	0.0	-0.5	-0.8
Domestic public debt, net <sup>4/</sup>	20.1	26.1	26.1	...	28.4	26.5	24.2	21.9
External current account (excluding official transfers)	-17.3	-15.3	-14.6	-14.1	-14.7	-13.8	-11.7	-9.9
Overall balance of payments	7.0	-8.5	2.3	-1.8	0.7	-3.3	-0.8	0.0
Total external public debt (end of year; including arrears and Fund credit)	53.8	61.4	64.9	60.7	63.9	62.3	59.2	55.0
(In millions of U.S. dollars, unless otherwise specified)								
External current account (after grants)	-74.9	-61.7	-58.1	-68.1	-68.2	-74.4	-62.9	-46.7
External public debt (end of period; excluding arrears)	295.4	301.3	331.1	366.7	363.9	396.1	403.6	401.3
External arrears (public sector; end of period)	3.8	27.8	15.3	0.0	7.4	...	...	...
Gross international reserves (end of period)	43.5	28.2	41.9	48.1	58.0	67.6	79.3	89.9
Gross international reserves (in months of imports of goods and services)	1.5	1.0	1.4	1.7	1.7	1.9	2.1	2.3
External debt service (in percent of exports of goods and nonfactor services)	30.2	28.2	19.2	17.5	17.0	13.7	13.3	11.4
<b>Memorandum items:</b>								
(In units specified)								
Nominal GDP (in billions of Cape Verde escudos)	59.8	63.6	66.7	74.0	71.1	76.2	81.9	87.6
Nominal GDP (per capita, in U.S. dollars)	1,354.2	1,250.5	1,206.0	1,316.7	1,408.4	1,478.6	1,553.1	1,627.7
Exchange rate (Cape Verde escudos per U.S. dollar; period average)	102.7	115.9	123.2	...	...	...	...	...

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

<sup>1/</sup> Exports and imports of goods and nonfactor services.

<sup>2/</sup> Reflects revised presentation consistent with the Central Bank of Cape Verde.

<sup>3/</sup> Central bank lending rate; in percent.

<sup>4/</sup> Excluding the claims on the offshore Trust Fund.

Table 2. Cape Verde: Fiscal Operations of the Central Government, 1999-2005

	1999	2000	2001	2002				2003		2004		2005 Proj.	
				Jan.-Jun.		Jan.-Sep.	Jan.-Dec.		Prog.	Revised Proj.	Prog.		Revised Proj.
				Prog.	Est.	Est.	Prog. 1/ Revised Proj.						
(In billions of Cape Verde escudos)													
Revenue, grants, and net lending	16.6	17.2	18.2	8.8	10.2	15.2	19.2	21.0	21.0	21.4	22.9	23.0	25.3
Domestic revenue	12.3	13.2	14.9	6.8	7.7	11.9	15.9	16.2	17.2	17.1	18.6	18.5	20.0
Tax revenue	10.4	11.8	13.0	6.1	7.2	10.9	13.6	14.7	15.1	15.5	16.6	16.7	18.0
Income and profit taxes	3.2	3.9	4.8	2.1	2.7	4.0	5.0	5.2	5.9	5.6	6.6	6.1	6.6
Consumption taxes	1.8	1.9	2.1	1.0	1.1	1.7	2.2	2.3	4.7	2.4	5.1	2.5	2.7
International trade taxes	4.2	4.8	5.3	2.6	2.9	4.5	5.5	6.1	3.6	6.3	4.0	6.8	7.3
Other taxes 2/	1.2	1.2	0.8	0.4	0.4	0.7	0.8	1.2	0.9	1.2	0.9	1.3	1.5
Nontax revenue	1.9	1.5	1.9	0.7	0.5	1.1	2.4	1.5	2.1	1.6	2.1	1.8	2.0
Fees and penalties	0.4	0.4	0.3	0.2	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.5	0.5
Other nontax revenues	0.8	1.1	0.9	0.4	0.3	0.4	1.0	0.6	0.8	0.6	0.9	0.6	0.7
Profit transfers	0.6	0.0	0.6	0.1	0.0	0.3	1.0	0.5	0.9	0.6	0.7	0.7	0.8
Domestic capital participation	0.0	0.0	0.0	0.2	0.0	0.2	0.3	0.3	0.3	0.3	0.4	0.4	0.4
External grants	4.3	3.9	3.3	1.8	2.4	3.0	2.8	4.3	3.3	3.3	3.7	3.7	4.6
Capital grants	4.3	3.9	3.3	1.0	1.2	1.8	2.0	2.4	2.5	3.3	2.8	3.7	4.6
Budget support	0.0	0.0	0.0	0.8	1.2	1.2	0.8	1.9	0.8	0.0	0.9	0.0	0.0
Net lending	0.0	0.0	0.0	0.1	0.1	0.1	0.2	0.2	0.2	0.5	0.2	0.4	0.3
Total expenditure	24.4	30.1	21.2	10.4	9.2	14.9	21.7	22.4	22.4	23.9	23.4	24.0	25.1
Recurrent expenditure	14.1	17.5	14.8	7.6	6.1	10.2	15.6	14.8	16.3	16.2	16.6	16.7	17.4
Primary current expenditure	13.3	15.8	13.4	6.5	5.2	8.5	13.3	12.7	14.0	14.0	14.7	14.5	15.3
Wages and salaries	6.0	6.4	6.6	3.3	2.9	4.7	7.0	6.5	7.5	7.5	8.0	7.8	8.3
Goods and services	0.7	0.5	0.6	0.3	0.2	0.3	0.7	0.7	0.8	0.8	0.8	0.8	0.9
Transfers and subsidies 3/	3.5	6.8	5.7	2.3	1.9	3.1	4.7	4.9	4.7	4.7	4.7	4.8	4.9
Other expenditures	3.1	2.1	0.5	0.5	0.2	0.4	0.9	0.5	1.1	1.1	1.2	1.1	1.2
Domestic interest payments	0.4	0.8	0.9	0.8	0.4	1.0	1.7	1.3	1.4	1.5	1.1	1.5	1.5
External interest payments	0.4	0.9	0.5	0.3	0.5	0.8	0.6	0.9	0.8	0.6	0.8	0.7	0.7
Extraordinary expenditures	1.5	4.5	0.0	0.0	0.1	0.2	0.4	1.3	0.0	0.7	0.0	0.1	0.1
Social emergency measures	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.1	0.0	0.1	0.1
Restructuring costs	0.0	4.4	0.0	0.0	0.1	0.2	0.4	1.1	0.0	0.6	0.0	0.0	0.0
Capital expenditure	8.8	8.1	6.5	2.8	2.9	4.5	5.7	6.3	6.2	7.0	6.7	7.2	7.5
Foreign financed	7.9	6.8	5.3	2.2	2.6	3.8	4.4	5.0	4.5	5.5	4.8	5.7	5.9
Domestically financed	1.0	1.3	1.1	0.6	0.4	0.7	1.3	1.3	1.7	1.5	1.9	1.5	1.6
Overall balance, including grants 4/	-7.8	-13.0	-3.1	-1.6	1.0	0.3	-2.5	-1.4	-1.5	-2.5	-0.5	-1.0	0.2
Financing	8.2	12.9	4.0	1.6	0.3	0.8	0.4	2.2	-0.6	-0.5	-1.2	-0.5	-1.2
Foreign (net)	2.9	3.6	4.0	1.3	0.7	0.9	0.0	1.9	-0.4	0.2	-0.5	-0.1	-0.5
Total drawings	7.3	4.5	7.1	2.4	1.9	2.5	3.0	4.7	2.6	2.7	2.6	2.6	1.9
Balance of payments, budget	2.3	1.7	5.0	1.2	0.6	0.6	0.6	2.1	0.6	0.6	0.6	0.6	0.6
Project loans	5.0	2.9	2.1	1.2	1.4	2.0	2.4	2.6	2.0	2.2	2.0	2.0	1.4
Amortization	-3.7	-3.9	-3.5	-0.8	-1.2	-1.6	-2.4	-2.8	-2.3	-2.5	-2.7	-2.7	-2.5
Bridge loans and FAC	-1.7	-1.7	-2.3	0.0	0.0	0.0	-0.6	-0.6	-0.7	-0.7	-1.1	-1.1	-0.6
Other	-2.1	-2.3	-1.2	-0.8	-1.2	-1.6	-1.8	-2.2	-1.6	-1.8	-1.6	-1.6	-1.9
Change in arrears	-1.2	3.0	-1.4	-0.4	-1.6	-1.6	-0.7	-1.6	-0.7	-0.8	-0.5	0.0	0.0
Refinancing and rescheduling of arrears	0.5	0.0	1.6	...	1.6	0.0	...	1.6	...	0.8	...	0.0	0.0
Debt relief	0.0	0.0	0.1	0.1	0.0	0.0	0.1	0.0	0.1	0.0	0.1	0.0	0.0
Domestic (net)	5.3	9.3	0.0	0.3	-0.4	-0.1	0.4	0.2	-0.3	-0.7	-0.7	-0.4	-0.7
Banking system 5/	0.8	5.2	0.1	0.5	0.7	1.8	0.8	2.8	0.2	0.0	0.0	-0.4	-0.7
Nonbanks	3.7	2.1	1.4	2.8	0.0	0.0	2.8	0.0	-0.5	0.0	-0.7	0.0	0.0
Domestic arrears 2/	0.8	2.0	-1.5	-3.0	-1.2	-1.9	-3.2	-2.5	0.0	-0.7	0.0	0.0	0.0
Net errors and omissions	-0.4	0.0	-0.9	0.0	-1.3	-1.1	0.0	-1.1	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	2.1	0.4	2.1	3.0	1.6	1.5	1.0
Memorandum items:													
Overall balance, excluding grants 6/	-12.1	-16.9	-6.3	-3.4	-1.4	-2.7	-5.3	-5.7	-4.7	-5.8	-4.2	-4.7	-4.3
Primary current balance 7/	-1.0	-2.6	1.6	0.3	2.5	3.4	2.6	3.5	3.1	3.1	3.9	4.0	4.8
Primary balance 8/	-11.3	-15.1	-4.9	-2.4	-0.6	-1.2	-3.5	-4.0	-3.0	-4.6	-2.8	-3.3	-2.9
Domestic balance 9/	-3.9	-9.2	-0.5	-0.8	1.8	1.9	-0.3	0.2	-3.0	0.3	-2.8	1.6	2.3

Table 2. Cape Verde: Fiscal Operations of the Central Government, 1999–2005 (concluded)

	1999	2000	2001	2002				2003		2004		2005 Proj.	
				Jan.-Jun.		Jan.-Sep.	Jan.-Dec.		Prog.	Revised Proj.	Prog.		Revised Proj.
				Prog.	Est.	Est.	Prog. 1/	Revised Proj.					
(In percent of GDP)													
Revenue, grants, and net lending	27.8	27.0	27.3	11.9	14.3	21.4	25.9	29.6	26.5	28.0	26.9	28.1	28.9
Domestic revenue	20.5	20.8	22.4	9.2	10.8	16.8	21.5	22.8	21.7	22.5	21.9	22.6	22.9
Tax revenue	17.4	18.5	19.5	8.3	10.1	15.3	18.3	20.7	19.0	20.4	19.5	20.4	20.6
Income and profit taxes	5.4	6.1	7.2	2.8	3.8	5.6	6.8	7.3	7.4	7.4	7.7	7.4	7.5
Consumption taxes	3.0	3.0	3.1	1.4	1.5	2.4	2.9	3.2	5.9	3.1	5.9	3.1	3.1
International trade taxes	7.0	7.6	8.0	3.5	4.1	6.3	7.5	8.5	4.5	8.3	4.7	8.3	8.3
Other taxes 2/	2.0	1.8	1.1	0.6	0.6	0.9	1.1	1.6	1.1	1.6	1.1	1.6	1.7
Nontax revenue	3.2	2.3	2.9	0.9	0.7	1.5	3.2	2.1	2.7	2.1	2.4	2.2	2.3
Fees and penalties	0.7	0.6	0.5	0.2	0.3	0.4	0.5	0.6	0.5	0.6	0.5	0.6	0.6
Other nontax revenues	1.4	1.7	1.4	0.5	0.4	0.6	1.3	0.8	1.1	0.8	1.1	0.8	0.8
Profit transfers	1.1	0.0	1.0	0.1	0.0	0.5	1.3	0.8	1.1	0.8	0.9	0.9	0.9
Domestic capital participation	0.0	0.0	0.0	0.2	0.0	0.2	0.4	0.5	0.4	0.5	0.4	0.5	0.5
External grants	7.3	6.2	4.9	2.4	3.3	4.2	3.7	6.0	4.1	4.4	4.3	4.5	5.2
Capital grants	7.3	6.2	4.9	1.4	1.7	2.5	2.7	3.4	3.1	4.4	3.3	4.5	5.2
Budget support	0.0	0.0	0.0	1.0	1.6	1.6	1.0	2.6	1.0	0.0	1.0	0.0	0.0
Net lending	0.0	0.0	0.0	0.1	0.2	0.2	0.2	0.3	0.2	0.7	0.2	0.5	0.4
Total expenditure	40.8	47.3	31.8	14.0	12.9	21.0	29.4	31.6	28.3	31.3	27.4	29.4	28.6
Recurrent expenditure	23.5	27.5	22.1	10.3	8.6	14.4	21.1	20.9	20.5	21.2	19.6	20.4	19.9
Primary current expenditure	22.2	24.8	20.0	8.8	7.3	12.0	18.0	17.8	17.7	18.4	17.3	17.8	17.4
Wages and salaries	10.0	10.1	9.9	4.5	4.1	6.6	9.4	9.2	9.4	9.8	9.3	9.5	9.5
Goods and services	1.1	0.7	0.8	0.5	0.2	0.5	1.0	0.9	1.0	1.0	1.0	1.0	1.0
Transfers and subsidies 3/	5.9	10.7	8.6	3.2	2.7	4.4	6.3	6.9	5.9	6.2	5.6	5.9	5.6
Other expenditures	5.2	3.2	0.7	0.6	0.3	0.5	1.3	0.8	1.4	1.4	1.4	1.4	1.3
Domestic interest payments	0.7	1.3	1.4	1.1	0.5	1.3	2.3	1.8	1.8	2.0	1.3	1.9	1.7
External interest payments	0.7	1.4	0.7	0.4	0.7	1.1	0.9	1.3	1.0	0.8	1.0	0.8	0.8
Extraordinary expenditures	2.5	7.0	0.0	0.0	0.2	0.3	0.5	1.8	0.0	0.9	0.0	0.1	0.1
Social emergency measures	2.5	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.0	0.1	0.0	0.1	0.1
Restructuring costs	0.0	7.0	0.0	0.0	0.2	0.3	0.5	1.5	0.0	0.8	0.0	0.0	0.0
Capital expenditure	14.8	12.8	9.7	3.7	4.1	6.3	7.7	8.9	7.8	9.2	7.9	8.8	8.6
Foreign financed	13.1	10.7	8.0	3.0	3.6	5.3	5.9	7.0	5.6	7.2	5.6	6.9	6.8
Domestically financed	1.6	2.1	1.7	0.7	0.5	1.0	1.8	1.8	2.2	2.0	2.2	1.9	1.8
Overall balance, including grants 4/	-13.0	-20.4	-4.6	-2.1	1.4	0.4	-3.4	-2.0	-1.8	-3.3	-0.5	-1.3	0.3
Financing	13.7	20.3	6.0	2.2	0.4	1.1	0.6	3.0	-0.8	-0.7	-1.4	-0.6	-1.4
Foreign (net)	4.8	5.7	6.0	1.8	1.0	1.3	0.1	2.7	-0.5	0.3	-0.5	-0.2	-0.6
Total drawings	12.2	7.1	10.7	3.2	2.7	3.6	4.0	6.6	3.2	3.6	3.0	3.1	2.2
Balance of payments, budget	3.9	2.6	7.6	1.6	0.8	0.8	0.7	2.9	0.7	0.7	0.6	0.7	0.6
Project loans	8.4	4.6	3.1	1.6	1.9	2.8	3.2	3.6	2.5	2.8	2.3	2.4	1.6
Amortization	-6.2	-6.2	-5.2	-1.1	-1.7	-2.3	-3.2	-3.9	-2.9	-3.3	-3.1	-3.3	-2.8
Bridge loans and FAC	-2.8	-2.6	-3.5	0.0	0.0	0.0	-0.7	-0.8	-0.9	-1.0	-1.2	-1.3	-0.6
Other	-3.5	-3.6	-1.7	-1.1	-1.7	-2.3	-2.5	-3.1	-2.0	-2.3	-1.9	-2.0	-2.2
Change in arrears	-2.0	4.7	-2.1	-0.5	-2.3	-2.3	-0.9	-2.3	-0.9	-1.1	-0.5	0.0	0.0
Refinancing and rescheduling of arrears	0.8	0.0	2.5	...	2.3	0.0	...	2.3	...	1.1	...	0.0	0.0
Debt relief	0.0	0.0	0.2	0.1	0.0	0.0	0.2	0.0	0.2	0.0	0.1	0.0	0.0
Domestic (net)	8.9	14.6	-0.1	0.4	-0.6	-0.2	0.5	0.3	-0.4	-0.9	-0.8	-0.5	-0.8
Banking system	1.3	8.2	0.1	0.7	1.0	2.5	1.1	3.9	0.3	0.0	0.0	-0.5	-0.8
Nonbanks	6.3	3.3	2.1	3.8	0.0	0.0	3.8	0.0	-0.6	0.0	-0.8	0.0	0.0
Domestic arrears 2/	1.3	3.1	-2.2	-4.1	-1.6	-2.7	-4.4	-3.6	0.0	-0.9	0.0	0.0	0.0
Net errors and omissions	-0.7	0.0	-1.4	0.0	-1.8	-1.6	0.0	-1.6	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	2.8	0.5	2.7	3.9	1.9	1.9	1.1
Memorandum items:													
Overall balance, excluding grants 6/	-20.2	-26.5	-9.5	-4.5	-1.9	-3.7	-7.2	-8.0	-6.0	-7.7	-4.9	-5.8	-4.9
Primary current balance 7/	-1.7	-4.0	2.3	0.4	3.5	4.8	3.5	5.0	3.9	4.1	4.6	4.9	5.4
Primary balance 8/	-18.9	-23.8	-7.4	-3.3	-0.8	-1.7	-4.7	-5.7	-3.8	-6.0	-3.3	-4.1	-3.3
Domestic balance 9/	-6.4	-14.4	-0.8	-1.1	2.5	2.6	-0.4	0.3	-3.8	0.4	-3.3	2.0	2.6

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

1/ In this presentation, negative privatization revenues from the liquidation of the municipal transport company (TRANSCOR) and food import and distribution company (EMPA) are treated as extraordinary expenditures rather than a financing item. To reflect this change in presentation, fiscal balance numbers were changed as compared to the PRGF staff report.

2/ Includes an operation expected to amount to expected CVEsc 417 million by which a Cape Verde petrol company (ENACOL) will repay custom tax arrears in exchange for a reduction of its arrears claims on the government.

3/ Includes student scholarships.

4/ Overall balance, including grants = revenue, including grants - total expenditure.

5/ Due to TCMF operations, bank financing in 1999 and 2000 does not match change in banking systems' net credit to central government.

6/ Overall balance, excluding grants = revenue, excluding grants - total expenditure.

7/ Primary current balance = domestic revenue - primary current expenditure.

8/ Primary balance = domestic revenue - total expenditure + domestic and external interest payments.

9/ Domestic balance = domestic revenue - recurrent expenditure + external interest payments - extraordinary expenditures - domestically financed capital expenditure.

Table 3. Cape Verde: Monetary Survey, 1999–2003

	1999	2000	2001				2002				2003
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec. Proj.	
(In millions of Cape Verde escudos, unless otherwise specified)											
<b>The Banking System</b>											
Net foreign assets	8,110	7,139	7,024	7,458	7,326	9,557	12,077	10,784	11,706	10,761	11,413
Foreign assets	9,899	9,244	9,399	9,449	9,461	11,489	14,066	13,366	14,004	13,059	14,278
<i>Of which: foreign reserves</i>	4,678	3,349	3,409	3,396	3,552	5,238	8,185	7,070	7,375	6,385	7,434
Foreign liabilities	-1,789	-2,104	-2,375	-1,991	-2,135	-1,932	-1,989	-2,581	-2,298	-2,298	-2,865
Net domestic assets	28,830	34,561	35,558	35,736	36,054	36,239	35,734	37,627	39,054	41,065	44,353
Net domestic credit	32,885	41,184	42,500	43,036	43,002	44,093	44,179	45,930	47,937	49,947	53,235
Net claims on General Government	13,978	21,702	22,291	22,192	21,521	21,665	21,336	22,596	23,588	24,584	24,586
Claims on the Trust Fund (TCFMs)	6,803	10,600	10,600	10,600	10,600	10,600	10,600	10,600	10,600	10,600	10,600
Net claims on the central government	7,516	11,625	12,147	12,225	11,457	11,676	11,319	12,401	13,436	14,432	14,434
Credit to central government	9,098	13,082	13,936	13,867	13,016	13,356	14,543	14,868	16,257	16,367	16,369
Deposits of central government	-1,582	-1,457	-1,789	-1,641	-1,559	-1,680	-3,223	-2,466	-2,821	-1,935	-1,935
<i>Of which: project deposits</i>	-410	-211	-481	-86	-151	-331	-1,652	-811	-941	-350	-350
Net claims on local government	81	-57	-32	-29	20	3	-102	-10	5	5	5
Net claims on other government agencies (INPS)	-422	-466	-424	-604	-556	-614	-482	-395	-453	-453	-453
Credit to the economy	18,908	19,483	20,209	20,844	21,481	22,428	22,843	23,334	24,349	25,363	28,649
Credit to public enterprises	512	156	160	117	154	215	262	252	240	223	244
Credit to private sector	18,390	19,327	20,041	20,719	21,320	22,206	22,575	23,076	24,103	25,134	28,399
Claims on nonbank financial institutions	6	0	8	8	7	7	7	6	6	6	6
Other items (net)	-4,056	-6,624	-6,941	-7,300	-6,948	-7,854	-8,445	-8,304	-8,882	-8,882	-8,882
Broad Money (M2)	36,940	41,700	42,583	43,194	43,380	45,796	47,810	48,411	50,760	51,826	55,765
Narrow Money (M1)	18,397	20,131	20,035	19,938	18,835	20,759	20,932	20,693	21,590	22,563	24,277
Currency in circulation	6,026	6,458	5,774	5,624	5,519	6,703	6,020	5,856	5,668	6,478	6,971
Demand deposits	12,371	13,673	14,261	14,313	13,316	14,056	14,911	14,838	15,923	16,084	17,307
Quasi-Money	16,432	19,371	20,029	20,863	22,154	22,931	24,547	25,740	26,996	27,045	29,100
Time deposits	15,343	18,081	18,896	19,595	20,772	21,802	23,074	24,142	25,312	25,844	27,808
Other quasi-monetary deposits	1,090	1,290	1,132	1,268	1,382	1,130	1,472	1,598	1,684	1,201	1,292
Foreign currency deposits	2,110	2,198	2,519	2,393	2,391	2,106	2,332	1,978	2,174	2,219	2,388
(Change in percent of broad money 12 months earlier)											
Net foreign assets	7.9	-2.6	0.9	4.7	3.6	5.8	11.9	7.7	10.1	2.6	1.3
Net domestic assets	7.6	15.5	13.1	8.5	8.7	4.0	0.4	4.4	6.9	10.5	6.3
Net domestic credit	10.4	22.5	21.4	16.5	10.2	7.0	3.9	6.7	11.4	12.8	6.3
Net claims on the central government	-20.9	11.1	11.3	11.2	-0.2	0.1	-1.9	0.4	4.6	6.0	0.0
Credit to the economy	7.6	1.6	2.3	2.9	7.3	7.1	6.2	5.8	6.6	6.4	5.9
Other items (net)	-2.8	-7.0	-8.3	-8.0	-1.6	-2.9	-3.5	-2.3	-4.5	-2.2	0.0
Broad money	15.4	12.9	14.0	13.2	12.3	9.8	12.3	12.1	17.0	13.2	7.6
Narrow money	9.2	4.7	5.9	4.9	2.9	1.5	2.1	1.7	6.4	3.9	3.3
Currency outside banks	3.0	1.2	1.4	0.2	0.3	0.6	0.6	0.5	0.3	-0.5	1.0
Demand deposits	6.2	3.5	4.5	4.6	2.5	0.9	1.5	1.2	6.0	4.4	2.4
Time and savings deposits	5.0	7.4	6.9	7.9	8.3	8.9	9.8	10.5	10.5	8.8	3.8
Foreign currency deposits	1.5	0.2	1.2	0.3	0.8	-0.2	-0.4	-1.0	-0.5	0.2	0.3
(Expressed as ratios)											
Selected monetary indicators											
Excess reserves / total deposits	-0.01	0.01	0.02	0.02	0.02	0.01	0.05	0.03	0.04	0.02	0.01
Vault cash / total deposits	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.01	0.01
Money multiplier (M2 / M0)	3.16	3.08	3.13	3.20	3.24	3.14	3.00	3.19	3.16	3.29	3.43



Table 3. Cape Verde: Monetary Survey, 1999–2003 (continued)

	1999	2000	2001				2002				2003
			Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec. Proj.	
(In millions of Cape Verde escudos, unless otherwise specified)											
<b>Bank of Cape Verde</b>											
Net foreign assets	6,476	4,053	4,140	4,147	4,241	5,945	8,881	7,525	7,812	6,822	7,305
<i>Of which: net international reserves</i>	4,590	3,221	3,335	3,318	3,481	5,100	8,110	6,819	7,124	6,134	6,616
Foreign assets	6,596	4,212	4,247	4,257	4,345	6,115	8,988	7,808	8,095	7,105	8,155
International reserves	4,678	3,349	3,409	3,396	3,552	5,238	8,185	7,070	7,375	6,385	7,434
Non reserve assets	1,918	864	837	861	792	877	803	738	720	720	720
Foreign liabilities	-120	-160	-107	-110	-104	-170	-107	-283	-283	-283	-850
Short-term foreign liabilities	-88	-128	-75	-78	-72	-138	-76	-251	-251	-251	-818
Medium- and long-term foreign liabilities	-32	-32	-32	-32	-32	-32	-32	-32	-32	-32	-32
Net domestic assets	5,225	9,499	9,463	9,371	9,162	8,635	7,032	7,632	8,264	8,935	8,934
Net domestic credit	6,552	10,867	11,259	10,992	10,639	9,976	8,816	8,984	9,622	10,293	10,292
TCMFs	0	4,167	4,167	4,167	4,167	4,167	4,167	4,167	4,167	4,167	4,167
Net claims on central government	5,027	4,444	5,086	5,350	4,850	4,183	3,374	3,538	4,179	4,325	4,324
Credit to central government <i>1/</i>	5,865	5,043	5,931	5,935	5,405	4,857	5,400	4,685	5,597	4,857	4,856
Deposits of central government	-838	-598	-845	-585	-555	-675	-2,026	-1,147	-1,418	-532	-532
<i>Of which: project account</i>	-410	-211	-481	-86	-151	-331	-1,652	-811	-941	-350	-350
foreign currency deposits	-291	-272	-249	-364	-299	-256	-263	-236	-376	-120	-120
Credit to the economy	1,193	1,157	1,155	1,161	1,183	1,189	1,193	1,198	1,201	1,201	1,201
Credit to public enterprises	87	82	82	82	82	82	77	77	72	72	72
Credit to private sector	1,101	1,075	1,072	1,079	1,101	1,106	1,116	1,121	1,129	1,129	1,129
Claims on nonbank financial institutions	6	0	0	0	0	0	0	0	0	0	0
Credit to commercial banks	331	1,099	853	315	438	438	82	82	75	600	600
Other items (net)	-1,326	-1,368	-1,796	-1,622	-1,477	-1,341	-1,784	-1,353	-1,358	-1,358	-1,358
Assets	2,194	2,276	2,537	2,465	2,487	2,616	2,922	2,622	2,641	2,641	2,641
Liabilities	3,520	3,644	4,333	4,087	3,963	3,957	4,706	3,975	3,999	3,999	3,999
Reserve money	11,701	13,552	13,603	13,518	13,403	14,581	15,913	15,157	16,076	15,757	16,239
Currency outside banks	6,026	6,458	5,774	5,624	5,519	6,703	6,020	5,856	5,668	6,478	6,971
Cash in vaults	630	597	614	567	713	650	734	722	854	658	431
Deposits of commercial banks	4,955	6,496	7,215	7,326	7,171	7,227	9,158	8,579	9,553	8,621	8,836
Deposits of other financial institutions	90	1	1	1	1	1	1	1	1	1	1
(Twelve-month percentage change)											
Reserve money	6.7	15.8	10.2	7.3	5.2	7.6	17.0	12.1	19.9	8.1	3.1
Net foreign assets	27.2	-20.7	-7.4	3.2	4.8	14.0	34.9	25.0	26.6	6.0	3.1
Net domestic assets	-20.5	36.5	17.5	4.2	0.4	-6.4	-17.9	-12.9	-6.7	2.1	0.0
Net domestic credit	0.3	36.9	20.3	5.2	-0.7	-6.6	-18.0	-14.9	-7.6	2.2	0.0
Claims on the government	0.2	-5.0	-10.1	-2.8	-7.8	-1.9	-12.6	-13.4	-5.0	1.0	0.0
Credit to the economy	0.4	-0.3	-0.3	0.0	0.2	0.2	0.3	0.3	0.1	0.1	0.0
Credit to banks	-0.3	6.6	-3.1	-11.7	-12.6	-4.9	-5.7	-1.7	-2.7	1.1	0.0
Other items net	-20.8	-0.4	-2.7	-1.1	1.0	0.2	0.1	2.0	0.9	-0.1	0.0

Table 3. Cape Verde: Monetary Survey, 1999–2003 (concluded)

	1999	2000	2001				2002				2003 Proj.
			Mar.	Jun.	Sept.	Dec.	Mar.	Jun.	Sept.	Dec. Proj.	
(in millions of Cape Verde escudos, unless otherwise specified)											
<b>Commercial Banks</b>											
Net foreign assets	1,633.9	3,086.3	2,884.3	3,310.8	3,084.9	3,611.6	3,195.5	3,259.1	3,893.3	3,938.9	4,107.6
Foreign assets	3,303.5	5,031.1	5,152.6	5,192.4	5,115.7	5,373.5	5,077.3	5,557.6	5,908.6	5,954.2	6,122.9
Foreign liabilities	-1,669.6	-1,944.8	-2,268.3	-1,881.6	-2,030.8	-1,761.9	-1,881.8	-2,298.5	-2,015.3	-2,015.3	-2,015.3
Net domestic assets	29,189.5	32,154.7	33,923.4	34,258.2	34,775.2	35,480.8	38,593.2	39,295.3	41,198.1	41,408.1	44,686.1
Net domestic credit	31,918.9	37,410.4	39,068.7	39,936.2	40,246.8	41,993.4	45,254.6	46,246.4	48,722.6	48,932.6	52,210.6
Net claims on general government	8,950.6	13,090.5	13,038.5	12,675.2	12,503.8	13,315.9	13,794.3	14,891.5	15,241.9	16,092.3	16,095.5
TCMFs	6,803.3	6,433.2	6,433.2	6,433.2	6,433.2	6,433.2	6,433.2	6,433.2	6,433.2	6,433.2	6,433.2
Other government deposits: INPS	-422.1	-465.8	-424.2	-604.2	-556.1	-613.8	-481.5	-394.9	-453.3	-453.3	-453.3
Net claims on central government	2,488.9	7,180.4	7,061.5	6,875.4	6,606.6	7,493.3	7,944.8	8,863.3	9,257.1	10,107.4	10,110.6
Loans and overdrafts	1,085.2	5,056.4	5,095.7	5,121.4	5,155.6	5,483.4	5,549.1	6,470.7	6,649.4	7,499.7	7,502.9
Holding of government securities	2,147.5	2,983.0	2,910.0	2,810.0	2,455.0	3,015.0	3,593.5	3,711.8	4,010.3	4,010.3	4,010.3
Deposits of central government	-743.8	-859.0	-944.2	-1,056.0	-1,004.0	-1,005.1	-1,197.8	-1,319.2	-1,402.6	-1,402.6	-1,402.6
Net claims on local government	80.5	-57.3	-32.0	-29.2	20.1	3.2	-102.2	-10.1	4.9	5.0	5.0
Claims on local government	238.0	289.3	273.2	277.6	274.5	260.9	267.7	265.1	266.1	265.0	265.0
Deposits of local government	-157.5	-346.6	-305.2	-306.8	-254.4	-257.7	-369.9	-275.2	-261.2	-260.0	-260.0
Credit to the economy	17,714.5	18,325.5	19,054.5	19,683.1	20,298.2	21,239.1	21,650.6	22,135.9	23,147.7	24,162.3	27,447.6
Credit to public enterprises	425.3	73.3	77.9	35.1	71.3	132.9	184.5	174.8	167.5	151.2	171.8
Credit to private sector	17,289.2	18,252.2	18,968.5	19,640.3	20,219.5	21,099.2	21,459.4	21,954.8	22,974.3	24,005.2	27,269.9
Claims on nonbank financial institutions	0.0	0.0	8.1	7.7	7.4	7.0	6.7	6.3	5.9	5.9	5.9
Net claims on the Bank of Cape Verde	5,253.8	5,994.4	6,975.7	7,577.9	7,444.8	7,438.4	9,809.7	9,219.0	10,333.0	8,678.1	8,667.5
Total reserves	5,585.2	7,093.3	7,828.3	7,892.9	7,883.2	7,876.8	9,891.2	9,300.5	10,407.5	9,278.1	9,267.5
Vault cash	630.1	597.0	613.5	567.1	712.7	649.8	733.7	721.6	854.3	657.5	431.2
Deposits with central bank	4,955.1	6,496.3	7,214.8	7,325.8	7,170.5	7,227.0	9,157.5	8,578.9	9,553.2	8,620.5	8,836.3
Required reserves	5,310.0	6,042.5	6,324.1	6,408.4	6,488.2	6,698.8	7,153.1	7,301.7	7,735.4	7,781.6	8,402.0
Excess reserves	-354.9	453.8	890.7	917.4	682.3	528.2	2,004.4	1,277.2	1,817.8	838.9	434.3
Credit from the Bank of Cape Verde	-331.4	-1,098.9	-852.6	-315.0	-438.4	-438.4	-81.5	-81.5	-74.5	-600.0	600.0
Other items (net)	-2,729.4	-5,255.7	-5,145.3	-5,678.0	-5,471.6	-6,512.6	-6,661.4	-6,951.1	-7,524.5	-7,524.5	-7,524.5
Deposit liabilities to nonbank residents	30,823.4	35,241.0	36,807.7	37,569.0	37,860.1	39,092.4	41,788.7	42,554.4	45,091.4	45,347.0	48,793.7
Local currency deposits	28,713.1	33,043.2	34,289.0	35,175.9	35,469.6	36,986.8	39,456.7	40,576.0	42,917.9	43,127.9	46,405.9
Demand deposits	12,280.8	13,672.4	14,260.4	14,312.6	13,315.3	14,055.6	14,910.1	14,836.4	15,921.5	16,083.3	17,305.7
Of which: emigrant deposits	1,055.4	1,387.1	1,403.7	1,550.3	1,555.9	1,764.9	1,798.3	1,835.9	1,993.9	2,092.2	2,312.1
Quasi money	16,432.3	19,370.8	20,028.6	20,863.3	22,154.3	22,931.2	24,546.6	25,739.6	26,996.4	27,044.6	29,100.2
Time deposits	15,342.7	18,080.7	18,896.4	19,595.2	20,771.9	21,801.6	23,074.3	24,142.0	25,312.4	25,843.6	27,807.8
Of which: emigrant deposits	8,002.2	10,015.4	10,524.5	10,972.1	11,954.6	12,672.0	13,583.8	14,224.9	15,161.8	15,909.6	17,581.1
Other quasi-monetary deposits	1,089.6	1,290.1	1,132.2	1,268.1	1,382.4	1,129.6	1,472.3	1,597.6	1,684.0	1,201.1	1,292.4
Foreign currency deposits	2,110.3	2,197.8	2,518.7	2,393.1	2,390.5	2,105.6	2,332.0	1,978.4	2,173.5	2,219.1	2,387.8
Of which: emigrant deposits	1,002.3	1,074.6	1,108.2	1,126.2	1,088.7	1,148.0	1,135.1	1,088.8	1,134.3	1,190.2	1,315.3
(Expressed as ratios)											
Memorandum item:											
Emigrant deposits / total deposits	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4

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

Table 4. Cape Verde: Balance of Payments, 1999–2005

	1999	2000	2001	2002	2002	2003	2004	2005
				Prog.	Projections			
(In millions of Cape Verde escudos, unless otherwise indicated)								
Current account	-7,692	-7,144	-7,157	-8,339	-7,505	-8,181	-6,916	-5,135
Excluding official current transfers	-12,756	-9,758	-9,758	-10,411	-10,468	-10,520	-9,587	-8,696
Trade balance	-22,109	-22,438	-23,958	-24,133	-27,573	-28,640	-29,355	-30,000
Exports, f.o.b.	2,697	4,598	4,577	4,578	4,957	5,353	5,889	6,477
Imports, f.o.b.	-24,806	-27,036	-28,535	-28,711	-32,529	-33,993	-35,243	-36,477
Services (net)	-1,082	563	928	675	3,054	3,440	4,676	6,094
Credit	10,898	12,561	15,981	13,950	16,554	17,547	19,302	21,232
<i>Of which:</i> tourism	2,961	4,686	6,539	6,100	7,136	7,707	8,478	9,325
Debit	-11,980	-11,998	-15,053	-13,275	-13,500	-14,108	-14,626	-15,139
Factor income (net)	-867	-1,437	-509	-980	-814	-779	-831	-859
<i>Of which:</i> scheduled interest payments	-393	-917	-476	-629	-901	-623	-665	-687
Current transfers (net)	16,366	16,167	16,381	16,099	17,828	17,798	18,594	19,631
Official	2,633	2,614	2,601	2,072	2,963	2,339	2,671	3,561
Private	13,733	13,554	13,781	14,027	14,865	15,459	15,923	16,070
Capital and financial account (net)	13,392	3,984	8,534	7,044	8,014	5,654	6,285	5,138
Direct investment (net)	5,432	2,437	81	2,983	800	1,269	2,623	2,381
Capital transfers	3,608	3,629	1,556	1,390	1,590	2,040	1,504	1,000
Official capital flow	7,825	3,882	7,117	3,195	4,679	2,712	2,550	1,927
Amortization due	-3,716	-3,920	-3,465	-2,381	-2,760	-2,513	-2,674	-2,467
Trust Fund investments	-3,991	-3,708	0	-735	0	0	0	0
Private capital flows	4,233	1,664	3,245	2,592	3,706	2,148	2,283	2,298
Portfolio flows	293	0	0	98	0	0	0	0
Banking system	464	-1,452	-525	212	-327	-169	-176	-180
Emigrants' deposits	2,044	2,417	3,108	...	3,607	2,016	2,158	2,277
Commercial credits	1,433	-773	663	1,056	426	300	300	200
Other	0	1,472	0	1,225	0	0	0	0
Net errors and omissions	1,509	2,259	-135	0	0	0	0	0
Overall balance	4,190	-5,419	1,512	-1,296	509	-2,526	-630	3
Financing	-4,190	5,419	-1,512	1,296	-509	2,526	630	-3
Change in net foreign assets of the central bank	-2,980	2,423	-1,892	-275	-877	-483	-915	-977
<i>Of which:</i> IMF disbursements (net)	0	0	0	381	183	567	378	189
Arrears (+=increase)	-1,210	2,996	-1,394	-650	-1,620	-810	0	0
Rescheduling/cancellation of arrears	0	0	1,774	123	1,620	810	0	0
Financing gap	0	0	0	2,098	368	3,009	1,545	974
Memorandum items:								
Current account, incl. official transfers 1/	-12.9	-11.2	-10.7	-11.3	-10.6	-10.7	-8.4	-5.9
Current account, excl. official transfers 1/	-21.3	-15.3	-14.6	-14.1	-14.7	-13.8	-11.7	-9.9
Overall balance 1/	7.0	-8.5	2.3	-1.8	0.7	-3.3	-0.8	0.0
Gross international reserves	4,678	3,349	5,238	5,772	6,385	7,434	8,727	9,893
In months of imports of goods and services	1.5	1.0	1.4	1.7	1.7	1.9	2.1	2.3
Scheduled debt service 2/	30.2	28.2	19.2	17.5	17.0	13.7	13.3	11.4
External debt (excluding arrears) 1/	50.7	54.9	61.2	60.7	53.9	54.5	52.5	49.6

Sources: Bank of Cape Verde; and staff estimates.

1/ In percent of GDP.

2/ In percent of exports of goods and non factor services.

Table 4. Cape Verde: Balance of Payments, 1999–2005 (concluded)

	1999	2000	2001	2002	2002	2003	2004	2005
				Prog.	Projections			
(In millions of euros, unless otherwise indicated)								
Current account	-69.8	-64.8	-64.9	-75.6	-68.1	-74.2	-62.7	-46.6
Excluding official current transfers	-115.7	-88.5	-88.5	-94.4	-94.9	-95.4	-86.9	-78.9
Trade balance	-200.5	-203.5	-217.3	-218.9	-250.0	-259.7	-266.2	-272.1
Exports, f.o.b.	24.5	41.7	41.5	41.5	45.0	48.5	53.4	58.7
Imports, f.o.b.	-225.0	-245.2	-258.8	-260.4	-295.0	-308.3	-319.6	-330.8
Services (net)	-9.8	5.1	8.4	6.1	27.7	31.2	42.4	55.3
Credit	98.8	113.9	144.9	126.5	150.1	159.1	175.0	192.5
<i>Of which: tourism</i>	26.8	42.5	59.3	55.3	64.7	69.9	76.9	84.6
Debit	-108.6	-108.8	-136.5	-120.4	-122.4	-127.9	-132.6	-137.3
Factor income (net)	-7.9	-13.0	-4.6	-8.9	-7.4	-7.1	-7.5	-7.8
<i>Of which: scheduled interest payments</i>	-3.6	-8.3	-4.3	-5.7	-8.2	-5.6	-6.0	-6.2
Current transfers (net)	148.4	146.6	148.6	146.0	161.7	161.4	168.6	178.0
Official	23.9	23.7	23.6	18.8	26.9	21.2	24.2	32.3
Private	124.5	122.9	125.0	127.2	134.8	140.2	144.4	145.7
Capital and financial account (net)	121.4	36.1	77.4	63.9	72.7	51.3	57.0	46.6
Direct investment	49.3	22.1	0.7	27.1	7.3	11.5	23.8	21.6
Capital transfers	32.7	32.9	14.1	12.6	14.4	18.5	13.6	9.1
Official capital flow	71.0	35.2	64.5	29.0	42.4	24.6	23.1	17.5
Amortizations due	-33.7	-35.5	-31.4	-21.6	-25.0	-22.8	-24.3	-22.4
Trust Fund investments	-36.2	-33.6	0.0	-6.7	0.0	0.0	0.0	0.0
Private capital flows	38.4	15.1	29.4	23.5	33.6	19.5	20.7	20.8
Portfolio flows	2.7	0.0	0.0	0.9	0.0	0.0	0.0	0.0
Banking system	4.2	-13.2	-4.8	1.9	-3.0	-1.5	-1.6	-1.6
Emigrants' deposits	18.5	21.9	28.2	...	32.7	18.3	19.6	20.7
Commercial credits	13.0	-7.0	6.0	9.6	3.9	2.7	2.7	1.8
Other	0.0	13.3	0.0	11.1	0.0	0.0	0.0	0.0
Net errors and omissions	13.7	20.5	-1.2	0.0	0.0	0.0	0.0	0.0
Overall balance	38.0	-49.1	13.7	-11.8	4.6	-22.9	-5.7	0.0
Financing	-38.0	49.1	-13.7	11.8	-4.6	22.9	5.7	0.0
Change in net foreign assets of the central bank	-27.0	22.0	-17.2	-2.5	-8.0	-4.4	-8.3	-8.9
<i>Of which: net IMF disbursements</i>	0.0	0.0	0.0	3.5	1.7	5.1	3.4	1.7
Arrears (+increase)	-11.0	27.2	-12.6	-5.9	-14.7	-7.3	0.0	0.0
Rescheduling/cancellation of arrears	0.0	0.0	16.1	1.1	14.7	7.3	0.0	0.0
Financing gap	0.0	0.0	0.0	19.0	3.3	27.3	14.0	8.8
Memorandum items:								
Current account, incl. official transfers 1/	-12.9	-11.2	-10.7	-11.3	-10.6	-10.7	-8.4	-5.9
Current account, excl. official transfers 1/	-21.3	-15.3	-14.6	-14.1	-14.7	-13.8	-11.7	-9.9
Overall balance 1/	7.0	-8.5	2.3	-1.8	0.7	-3.3	-0.8	0.0
Gross international reserves	42.4	30.4	47.5	52.3	57.9	67.4	79.1	89.7
In months of imports of goods and services	1.5	1.0	1.4	1.7	1.7	1.9	2.1	2.3
Scheduled debt service 2/	30.2	28.2	19.2	17.5	17.0	13.7	13.3	11.4
External debt (excluding arrears) 1/	50.7	54.9	61.2	60.7	53.9	54.5	52.5	49.6

Sources: Bank of Cape Verde; and staff estimates.

1/ In percent of GDP.

2/ In percent of exports of goods and non factor services.

Table 5. Cape Verde: External Debt Arrears by Creditor, 1999–2002  
(In thousands of U.S. dollars)

	End-December 1999			End-December /2000			End-December 2001			End-September 2002		
	On principal	On interest	Total	On principal	On interest	Total	On principal	On interest	Total	On principal	On interest	Total
Multilateral	1,505	205	1,710	2,403	686	3,089	2,903	804	3,706	0	0	0
A/DF 1/	0	20	20	0	17	17	0	0	0	0	0	0
BADEA 1/	0	0	0	813	0	813	406	413	819	0	0	0
EIB 1/	1,050	0	1,050	734	225	959	893	129	1,022	0	0	0
IFAD 1/	0	128	128	91	44	135	0	0	0	0	0	0
OPEC 1/	0	57	57	388	291	679	1,166	262	1,428	0	0	0
NDF 1/	0	0	0	0	9	9	0	0	0	0	0	0
NTF 1/	0	0	0	0	0	0	0	0	0	0	0	0
Saudi Fund	455	0	455	377	100	477	438	0	438	0	0	0
World Bank - IDA	...	...	...	...	...	...	...	...	...	0	0	0
Bilateral	1,627	439	2,066	22,768	1,947	24,715	8,829	2,733	11,562	6,075	1,293	7,368
Government	25	439	464	14,741	308	15,049	1,148	792	1,940	0	0	0
Abu Dhabi	25	0	25	14	7	21	86	0	86	0	0	0
Kuwait	0	407	407	803	175	978	1,021	248	1,269	0	0	0
Portugal	0	32	32	13,924	126	14,050	40	544	584	0	0	0
China	...	...	...	...	...	...	...	...	...	0	0	0
Agencies	1,602	0	1,602	8,027	1,639	9,666	7,681	1,941	9,622	6,075	1,293	7,368
CACEX (Brazil)	0	0	0	757	167	924	1,006	185	1,191	0	0	0
ICO (Spain)	0	0	0	6,070	1,277	7,347	6,075	1,293	7,368	6,075	1,293	7,368
SOMAGUE (Portugal)	1,602	0	1,602	1,200	195	1,395	600	457	1,057	0	0	0
CGD (Portugal)	...	...	...	...	...	...	0	7	7	0	0	0
Private	...	...	...	...	...	...	0	2	2	0	0	0
MSF (Portugal)	...	...	...	...	...	...	0	2	2	0	0	0
Total	3,132	644	3,776	25,171	2,633	27,804	11,732	3,539	15,270	6,075	1,293	7,368

Source: Cape Verdean authorities

1/ AfDB = African Development Fund; BADEA = Arab Bank for Economic Development in Africa; EIB = European Investment Bank; IFAD = International Fund for Agricultural Development; OPEC = Organization of Petroleum Exporting Countries; NDF = Nordic Development Fund; NTF = Nigeria Trust Fund; and Saudi Fund = Saudi Fund for Development.

Table 6. Cape Verde: External Public Debt, 1999–2001  
(In millions of U.S. dollars; end of period)

	1999			2000			2001		
	Contracted	Disbursed	Outstanding	Contracted	Disbursed	Outstanding	Contracted	Disbursed Est.	Outstanding
Multilateral	427.9	265.4	210.8	422.1	291.3	226.9	446.2	348.7	252.2
AfDF 1/	115.6	74.4	71.6	125.8	81.6	77.9	124.9	96.6	86.2
IDA	152.8	88.2	86.8	144.6	103.7	101.9	157.6	111.9	110.1
IMF	2.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BADEA 1/	48.0	30.4	14.9	48.0	32.5	12.5	61.3	49.3	20.6
AfDB 1/	21.1	21.1	6.8	17.1	17.1	1.3	16.5	16.5	1.3
EIB 1/	16.9	14.3	10.4	16.9	14.3	9.0	15.6	12.0	8.1
OPEC 1/	27.1	16.1	4.7	29.6	19.3	7.3	28.1	25.1	7.7
IFAD 1/	25.4	10.9	10.1	24.1	11.1	10.2	25.0	21.7	8.9
Saudi Fund 1/	2.3	2.8	0.7	2.3	2.3	0.0	4.0	4.0	0.3
NDF 1/	2.9	2.3	2.3	2.9	2.3	2.3	2.9	2.9	2.9
NTF 1/	13.0	4.8	2.7	10.8	7.1	4.5	10.4	8.7	6.2
Bilateral	119.1	100.0	84.6	126.0	100.0	74.4	139.7	111.8	70.7
Government	84.8	66.6	61.6	91.7	66.6	55.5	88.0	75.9	56.0
China	21.3	13.4	13.4	21.3	13.4	13.4	9.6	9.6	0.0
Kuwait	20.1	13.3	9.1	20.1	8.6	2.5	19.6	9.0	4.4
Portugal	21.6	18.4	18.4	29.2	24.2	24.2	44.9	43.2	41.3
South Africa	6.9	7.9	7.2	6.9	7.9	3.8	1.6	1.8	0.0
Abu Dhabi	1.5	0.2	0.2	1.5	0.2	0.2	0.2	0.2	0.2
Germany	13.4	13.4	13.4	12.7	12.3	11.4	12.1	12.1	10.1
Export credit agencies	34.3	33.4	23.0	34.3	33.4	18.9	51.6	35.9	14.7
Caisse Général des Dépôts	12.0	11.6	4.7	12.0	11.6	3.9	26.4	14.3	4.7
ICO (Spain)	7.3	6.8	6.8	7.3	6.8	6.7	7.3	6.8	1.3
CACEX (Brazil)	3.0	3.0	2.7	3.0	3.0	2.2	5.9	3.7	2.4
SOMEK (Portugal)	12.0	12.0	8.7	12.0	12.0	6.2	12.0	11.1	6.3
Private companies	...	...	...	...	...	...	16.8	8.5	8.2
Banco Espirito Santo	...	...	...	...	...	...	15.8	7.5	7.5
MSF (Portugal)	...	...	...	...	...	...	1.0	1.0	0.7
Total 2/	547.0	365.3	295.4	548.1	391.3	301.3	602.7	469.0	331.1

Source: Cape Verdean authorities.

1/ AfDF = African Development Fund; BADEA = Arab Bank for Economic Development for Africa; EIB = European Investment Bank; OPEC = Organization of Petroleum Exporting Countries; IFAD = International Agricultural Development; Saudi Fund = Saudi Fund for Development; NDF = Nordic Development Fund; and NTF = Nigeria Trust Fund.

2/ Excluding external arrears.

Table 7. Cape Verde: Alternative Macroeconomic Scenarios, 1992–2005 1/  
(In percent of GDP)

	1992-2000 Average	2001	2002	2003	2004	2005
<b>Real GDP growth</b>						
Poverty Reduction and Growth Facility	6.9	3.0	2.5	3.5	4.5	...
Medium	7.0	4.0	4.6	5.0	5.0	5.0
High	7.0	4.0	4.6	6.0	6.0	6.0
<b>Investment</b>						
Poverty Reduction and Growth Facility	27.8	20.3	21.0	21.5	22.5	...
Medium	27.4	17.4	19.8	21.2	20.7	20.2
High	27.4	17.4	19.8	25.5	24.9	24.3
<b>Gross national savings</b>						
Poverty Reduction and Growth Facility	23.4	10.0	9.7	13.7	16.9	...
Medium-high	24.3	6.6	9.3	10.4	12.2	14.3
Public	4.6	5.1	6.6	5.2	7.0	8.5
Private	17.9	1.5	2.7	5.2	5.2	5.9
<b>External current account (including official transfers)</b>						
Poverty Reduction and Growth Facility	-10.2	-10.3	-11.3	-7.8	-5.6	...
Medium	-9.5	-10.7	-10.6	-10.7	-8.4	-5.9
High	-9.5	-10.7	-10.6	-15.1	-12.6	-9.9
<b>External current account (excluding official transfers)</b>						
Poverty Reduction and Growth Facility	-19.5	-11.4	-15.0	-11.9	-9.9	...
Medium	-18.7	-14.6	-14.7	-13.8	-11.7	-9.9
High	-18.7	-14.6	-14.7	-18.3	-16.7	-13.9
<b>Memorandum items:</b>						
<b>Incremental capital-output ratios</b>						
Poverty Reduction and Growth Facility	0.27	0.15	0.12	0.16	0.20	...
Medium and high growth scenarios	0.28	0.23	0.23	0.24	0.24	0.25

Sources: Cape Verde authorities and Fund staff estimates and projections.

1/ Medium and high growth scenarios reflect revised national accounts estimates through 2002.

Table 8. Cape Verde: Vulnerability Indicators, 1997–2001

	1997	1998	1999	2000	2001
	(In units as indicated)				
Real effective exchange rate (annual percentage change) 1/	3.1	-2.5	8.4	-7.4	0.3
Nominal effective exchange rate (annual percentage change) 1/	-0.5	-2.9	3.8	-1.9	0.2
Nominal Cape Verde escudos-U.S. dollar rate (annual percentage change) 1/	12.8	5.3	4.6	12.8	6.3
Domestic credit growth (annual percentage change)	20.3	6.1	11.4	25.3	7.1
Overall fiscal balance, including grants (in percent of GDP)	-10.0	-4.3	-10.5	-19.3	-4.4
Public debt (in percent of GDP)	87.0	80.9	85.3	104.2	106.9
Domestic debt, including TCMFs (in percent of GDP)	39.7	35.7	31.5	42.7	42.0
Domestic debt, excluding TCMFs (in percent of GDP)	39.7	35.7	20.1	26.1	26.1
External debt (in percent of GDP)	47.3	45.2	53.8	61.4	64.9
Scheduled external debt service relative to gross international reserves (in percent)	79.9	180.8	89.5	150.2	77.3
Gross international reserves (in months of imports of goods and NFS)	0.8	0.3	1.6	1.0	1.4
Broad money relative to official reserves (in percent)	725.0	910.1	564.2	1,023.6	874.3
Broad money relative to net foreign assets (in percent)	551.8	563.5	450.5	581.1	479.2
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	20.6
Current account, excluding official current transfers (in percent of GDP)	-18.0	-20.9	-21.1	-20.4	-14.6
Exports of goods and nonfactor services relative to imports of goods and nonfactor services (in percent)	45.6	36.5	33.5	37.9	47.2
Tourism receipts and foreign direct investment (in percent of GDP)	5.2	5.4	15.3	12.9	9.9
Tourism receipts (annual percentage change)	50.9	42.1	48.9	59.7	39.5

Sources: Cape Verdean authorities; and staff estimates.

1/ A minus sign symbolizes a depreciation.

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



December 6, 2002

Mr. Horst Köhler  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
U.S.A.

Dear Mr. Köhler:

On April 4, 2002, the Executive Board of the IMF approved a three-year arrangement for Cape Verde under the Poverty Reduction and Growth Facility (PRGF) in the amount of SDR 8.64 (90 percent of quota). The purpose of this letter is to inform you of the progress in implementing the first-year economic program, and to request the second loan disbursement upon completion of the first review under the arrangement.

The attached memorandum of economic and financial policies (MEFP) supplements the MEFP of March 11, 2002, and sets out the objectives and policies the government of Cape Verde is pursuing during the remainder of 2002 and the first half of 2003.

Cape Verde's economic performance in 2002 has been generally better than envisaged under the program, despite the adverse effects of the global economic slowdown and the impact of the events of September 11, 2001. Macroeconomic policies have been restrained, and progress has been made in key structural areas. The government believes that the policies it intends to pursue in the period through June 2003, as described in the attached MEFP, will build on this favorable performance and establish the conditions for achieving a high level of sustainable economic growth and a reduction in poverty. On this basis, the government requests the completion of the first review under the arrangement and waivers for the nonobservance of the end-June 2002 performance criteria pertaining to nonconcessional debt, the accumulation of domestic arrears, and the implementation of an automatic retail pricing mechanism for petroleum products.

The government believes that the measures and policies set forth in the attached memorandum are adequate to achieve its program objectives, but it will take any further action that may prove necessary for this purpose. For as long as Cape Verde has outstanding financial obligations to the Fund arising from the loans under the arrangement, the government will consult with the Fund, at the initiative of the government or whenever the Managing Director requests consultation, on Cape Verde's economic and financial policies.

The government authorizes the Fund to provide this letter, the attached memorandum, and the associated staff report to all interested parties that request them, including through the Fund's external website.

Sincerely yours,

/s/

---

Carlos Augusto Duarte Burgo

Minister of Finance and Economic Planning

Attachment: Memorandum of Economic and Financial Policies

**CAPE VERDE**

**SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES**

**FOR SEPTEMBER 2002-JUNE 2003**

**I. INTRODUCTION**

1. Cape Verde's ongoing medium-term economic program is being supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). Consistent with the goals set out in our memorandum on economic and financial policies dated March 11, 2002, this supplementary memorandum reviews the implementation of the program so far in 2002 and sets forth our policies for the remainder of the first program year through June 2003.

**II. PERFORMANCE UNDER THE PRGF-SUPPORTED PROGRAM**

2. Economic performance in 2002 has been better than envisaged under the program: (i) the inflation rate is lower; (ii) real economic growth is higher; (iii) the fiscal deficit is smaller; and (iv) the balance of payments is stronger. Exports, tourism receipts, and private transfers performed better than expected, and strong imports of capital and intermediate goods indicate the beginning of a rebound in investment. Based on this and other information, real economic growth in 2002 will be on the order of 4-5 percent, against the 2.5 percent projected earlier. The inflation rate was -0.6 percent for the 12 months ended September, and on this basis the inflation rate should average about 1.7 percent for the year as a whole, against the 3.0 percent envisaged in the MEFP dated March 11, 2002.

3. Macroeconomic policy has been generally on track, the nonobservance of two quantitative and one structural performance criteria notwithstanding (Appendix I, Table 1). The government signed a US\$2.5 million nonconcessional loan agreement in January 2002 to finance a road construction project that had been contracted in 2000. A bilateral donor is paying the interest on the loan, thereby bringing the grant element of the loan to about 18 percent. We are seeking additional assistance with regard to principal repayments to bring the grant element to at least 35 percent. The government accumulated arrears to the recently privatized power company, which had been accumulating tax and debt-service liabilities to the government. The government has cleared all the arrears it incurred this year to the power company and will henceforth pay all its domestic bills when due.

4. The fiscal outcome has been better than programmed, reflecting stronger revenue performance across all categories and the restraint of recurrent expenditures. Outlays for capital projects have been higher than programmed, owing to a more rapid pace of donor disbursements than projected. The government's commitment to clear all domestic arrears as quickly as possible required a higher level of access to domestic bank financing than envisaged, but domestic financing of the budget is the same as programmed. The

rescheduling of external payment arrears has helped to reestablish foreign credit lines and increase the pace of implementing the public investment program.

5. Monetary policy continues to be oriented toward sustaining the exchange rate peg, which has been the key to Cape Verde's price stability. Broad money increased by 17 percent during the 12 months ended September 2002, primarily because of the strong balance of payments, but also because of an increase in commercial bank credit to government used to clear domestic arrears. The overall balance of payments registered a surplus of EUR 18 million through September, compared with a programmed surplus of EUR 2.5 million for the year as a whole. This reflects the stronger-than-expected performance of exports, tourism receipts, private and official transfers, and private capital flows. Against the background of the continued tight fiscal policy, strong balance of payments, and low inflation rates, the Bank of Cape Verde (BCV) lowered its refinancing rate in May, leading to a subsequent small decline in commercial lending and deposit rates in June; nonetheless, these rates remain high in real terms.

6. Progress on the structural front has been mixed, but the government is taking measures to address the slippages that have occurred so far. The key measures are noted below, and the status of other structural measures is indicated in Table 3:

- The new organic central bank law was unanimously approved ahead of schedule by the National Assembly. The new law clearly establishes the independence of the Bank of Cape Verde and prohibits the extension of central bank credit to the government, except for a temporary overdraft facility that must be cleared at the end of each year.
- The structural performance criterion pertaining to the implementation of an automatic and transparent pricing mechanism for retail petroleum products was not met. This issue proved to be technically more complex than initially thought, and negotiations with the oil companies have taken longer than expected. However, the Council of Ministers approved the mechanism in August 2002 and announced that it would become effective on January 1, 2003. This will be a performance criterion under the second PRGF review.
- The National Assembly unanimously approved the new value-added tax (VAT) law and a new customs tariff schedule in June. The government will submit all necessary supporting regulations to the National Assembly for approval before the end of this year and implement the new tax package by June 1, 2003, as indicated in the 2003 budget.
- The government is liquidating two large loss-making public enterprises: EMPA (food import and distribution) and TRANSCOR (municipal transport). The fiscal impact of the attendant retrenchment costs is substantial but manageable. The government is seeking additional donor assistance in this area.

7. The government completed the National Development Plan for 2002–05, which forms the foundation of our poverty reduction strategy paper (PRSP). High rates of real economic growth will be necessary to significantly reduce poverty in Cape Verde, and we have been exploring the possibilities of achieving sustained rates of economic growth in the range of 5-6 percent. The recent completion of the household income and expenditure survey, and of the public expenditure reviews, will enable the government to strengthen its analysis of the relationship between economic growth and poverty reduction in Cape Verde. The government will review the 2003 work plan of the National Institute of Statistics, with a view to clarifying its priorities to ensure that key economic indicators are collected and disseminated in a timely manner. The government is preparing a PRSP preparation status report and expects to complete Cape Verde's full PRSP by May-June 2003.

### **III. MACROECONOMIC FRAMEWORK AND POLICIES FOR SEPTEMBER 2002-JUNE 2003**

8. The government believes that the strategy and policies supported by the PRGF arrangement remain appropriate. A number of factors indicate that real economic growth in 2003 could be higher than the 3.5 percent projected in the medium-term framework underpinning the PRGF:

- a continued implementation of fiscal restraint, which will reduce the government's domestic borrowing needs and strengthen investor confidence;
- gradual lowering of domestic interest rates to help support private sector investment without endangering the balance of payments;
- an improved domestic business environment realized through structural reforms, including tax and regulatory reform;
- the upturn in world economic activity;
- the opening of key Cape Verde tourist destinations to foreign investors;
- access to U.S. textile markets under the African Growth and Opportunity Act;
- the expected lifting of the European Union embargo on Cape Verde's seafood products; and
- more rapid implementation of the government's public investment program, now that arrears have been regularized with our development partners.

9. Against this background, the government's draft 2003 budget projects real economic growth in the range of 5-6 percent and an inflation rate of 2–2.5 percent. The external position is expected to improve moderately, with the external current account deficit (excluding official transfers) in the range of 13-14 percent of GDP and an increase in international reserves to about 1.8-2.0 months of imports of goods and nonfactor services. In addition to completing the reforms that had been envisaged for 2002, the government will

take additional measures to ensure the sustainability of high levels of economic growth and a reduction in the incidence of poverty.

#### **A. Fiscal Policy**

10. The overall fiscal deficit for 2002 is being limited to CVEsc 1.41 billion, somewhat smaller than targeted. Revenues are performing better than expected across all categories, especially taxes on imports, and conditions for the disbursement of all programmed budget support have been met. Capital expenditure will be higher than projected because improved implementation of the public investment program will lead to quicker disbursements of donor support.

11. The fiscal program for 2003 reaffirms the government's commitment to providing an expanding the level of key social services, develop Cape Verde's infrastructure, and foster private-sector-led economic growth, while maintaining overall fiscal discipline. Continued fiscal consolidation will support the BCV's policy of pursuing lower interest rates in the context of a sustainable balance of payments. Revenue (including domestic capital participation and net lending) is projected to remain in the range of 23-24 percent of GDP. Total expenditure will be in the range of 31½ percent of GDP. The government will continue to run a sizable primary recurrent surplus in the context of increased outlays for health, education, and security.

12. The government's total external financing requirement (grants plus loans) will be on the order of EUR 80 million for 2003, including about EUR 27 million in budget support, in order to help support the government's poverty reduction strategy and to defray some one-off expenditures, including substantial outlays for retrenchment costs. The government will convene a roundtable conference early in 2003 to help secure financing and to inform donors of its progress in preparing Cape Verde's full PRSP. In the meantime, the economic program is fully financed for the first half of 2003. To help ensure that domestic debt falls to a sustainable level, we will also be seeking donor assistance to restart the domestic debt-reduction operation (DDRO).

13. With regard to tax reform, the government will focus its efforts on ensuring that the VAT and new customs tariff structure are fully implemented by June 2003. The government is also proposing to reduce the corporate income tax rate from 35 percent to 30 percent. This will not have an impact until 2004, as these taxes are paid on the previous year's income. The government inherited a large number of customs and tax exemptions, that undermine its objectives of exercising fiscal restraint and providing more resources for antipoverty programs. While the government continues to support certain exemptions in high-priority sectors and for diplomatic missions in Cape Verde, a preliminary review of customs and consumption tax exemptions estimates that the revenue loss from these alone will amount to nearly CVEsc 2.5 billion (3.5 percent of GDP) in 2002. In addition, income tax holidays are granted via a number of different laws. As a first step to address these revenue losses, all consumption tax exemptions will be eliminated with the introduction of the VAT, and no new exemptions will be granted in the 2003 budget. Meanwhile, the government will seek

technical assistance to undertake a comprehensive and thorough review of the impact of all tax exemptions, with a view to further reducing their number.

14. The government intends to strengthen the budget process and expenditure control and will appoint an externally financed budget advisor before March 2003. Sector specialists within the Ministry of Finance have been appointed to review spending agencies' budget submissions and ensure that their budget proposals are consistent with the government's overall public expenditure program. Technical assistance will be sought to help revise our organic budget law.

### **B. Monetary and Financial Sector Policies**

15. Monetary policy will be oriented toward price stability and the continued strengthening of international reserves in the context of a gradual lowering of domestic interest rates. Continued fiscal restraint will be a key component of this strategy. Broad money growth is expected to fall to about 13 percent by the end of this year and to a range of 7-9 percent in the coming year, in line with nominal GDP. Growth in credit to the economy is projected to expand on the order of 12-14 percent. The rapid growth in broad money through September 2002 may result in a one-off decline in international reserves in the coming months, but net international reserves are still projected to increase for 2002 as a whole.

16. The BCV is implementing a number of projects to strengthen its operational and oversight responsibilities. The BCV will continue to strengthen banking supervision through the training of staff, in cooperation with partners in other countries, by increasing the number of on-site examinations, modernizing the off-site reporting system, and strengthening its supervision of offshore financial institutions. The National Assembly has approved the first reading of the new anti-money-laundering law and is expected to approve it before the end of the year. The BCV will also continue to license qualified banks and other financial institutions in order to increase competition and promote the development of a competitive financial sector. The BCV is also working closely with the National Institute of Statistics to develop monthly indicators of economic and financial activity. It is also seeking additional technical assistance to improve balance of payments statistics and the implementation of monetary policy in a fixed exchange rate regime.

### **C. External Sector Policies and Competitiveness**

17. Private-sector-led economic growth is a crucial component of Cape Verde's poverty reduction strategy and external viability. It is the government's objective to promote exports, especially of manufactured goods, tourism, and transportation services, and to attract a higher level of foreign direct investment and other private capital inflows. This strategy will require a dynamic private sector that is able to compete effectively in world markets, and structural reforms, human development, legal reforms, and investment promotion will all be necessary to achieve these objectives. To this end, the government's public investment program will continue to focus on improving basic infrastructure (roads, water, power, and telecommunications). In addition, the government will focus recurrent expenditures on

education, health, and basic social services. The government is reviewing the country's labor laws, with a view to removing barriers to employment, and it is also working to eliminate administrative barriers to foreign and domestic investment. Many of these issues will be addressed in the context of the government's growth and competitiveness project, for which donor assistance is being sought.

#### **IV. PROGRAM MONITORING**

18. Program implementation through June 2003 will be monitored according to the performance criteria and benchmarks presented in Appendix I, Tables 1 and 2. Table 3 describes the government's broader economic reform objectives for 2002 and notes their status of implementation. The definition of the variables monitored as quantitative performance criteria and benchmarks and reporting requirements remain as set forth in the technical memorandum of understanding (EBS/02/54, Appendix I, Attachment II). The second review will be conducted by April 30, 2003.



Table 1. Cape Verde: Quantitative Performance Criteria and Benchmarks Under the First Annual Program Supported by the PRGF Arrangement, 2001-03 1/ 2/

	Cumulative Flows from End-December 2001												
	2001	2002						2003					
		Dec. Est.	Mar. Indicative benchmark	Mar. Actual	Jun. Perform. criteria	Jun. Perform. criteria (adjusted)	Jun. Actual	Sep. Indicative benchmark	Sep. Adjusted benchmark	Sep. Actual	Dec. Indicative benchmark	Dec. Perform. criteria	Mar. Indicative benchmark
<b>Quantitative benchmarks</b>	(In billions of Cape Verde escudos)												
Ceiling on net domestic credit to the central government from the banking system 3/	11.7	0.2	-0.4	0.5	1.1	0.7	-1.7	0.4	1.8	0.8	2.8	3.5	4.2
Ceiling on net domestic assets of the central bank 3/	8.6	0.0	-1.6	0.2	0.8	-1.0	0.2	2.3	-0.4	0.5	0.3	0.1	0.5
Ceiling on the accumulation of new domestic payment arrears by the central government	3.2	0.0	...	0.0	0.0	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.0
	(In millions of U.S. dollars)												
Ceiling on the accumulation of new external debt arrears by the central government 4/	15.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on the contracting or guaranteeing of non-concessional external debt with original maturity of more than one year by the central government 5/	0.0	0.0	2.5	0.0	0.0	2.5	0.0	0.0	2.5	0.0	2.5	0.0	0.0
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one year by the central government 6/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(In millions of euros)												
Floor on net international reserves of the Bank of Cape Verde (BCV) 7/	46.2	1.4	27.3	1.4	-4.3	15.6	2.5	-16.5	18.3	2.5	9.4	12.0	4.3
<b>Memorandum items:</b>	(In billions of Cape Verde escudos)												
Floor on the primary current fiscal balance (indicative target)	2.0	-0.2	2.0	0.3	0.3	2.5	2.9	2.9	3.4	2.6	3.5	4.0	4.9
Nonproject external financial assistance, including credit line (program assumption)	5.0	1.3	1.7	1.9	1.3	1.7	3.4	1.3	1.7	3.4	3.8	4.3	4.3

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

1/ Quantitative performance criteria and benchmarks are described in the technical memorandum of understanding (EBS/02/54, Appendix I, Attachment III).

2/ Program exchange rates for 2002 are CVEsc 110.3 = EUR 1 and CVEsc 122.5 = US\$1.

3/ The ceiling will be adjusted upward (downward) by the cumulative downward (upward) deviations from program assumptions about nonproject disbursements from the World Bank (US\$7.5 million), the African Development Bank (SDR 4 million), European Union adjustment grants (EUR 12 million), the Portuguese credit facility (EUR 5 million), and the World Bank supplemental credit (US\$3 million). Maximum cumulative adjustments in 2002 will not exceed 75 percent of programmed disbursements. In 2003, adjustments will apply to any deviations in nonproject external financial assistance relative to program assumptions.

4/ This performance criterion is on a continuous basis.

5/ This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are rescheduling arrangements, the Portuguese credit line, and borrowings from the Fund.

6/ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) August 24, 2000).

Excluded from this performance criterion are rescheduling arrangements, the Portuguese credit line, borrowings from the Fund, and normal import-related credits.

7/ The floor on net international reserves of the BCV will be adjusted downward (upward) by the cumulative downward (upward) deviations from program assumptions about nonproject disbursements from the World Bank (US\$7.5 million), the African Development Bank (SDR 4 million), European Union adjustment grants (EUR 12 million), the Portuguese credit facility (EUR 5 million), and the World Bank supplemental credit (US\$3 million). Maximum cumulative adjustments in 2002 will not exceed 75 percent of programmed disbursements. In 2003, adjustments will apply to any deviations in nonproject external financial assistance relative to program assumptions.

Table 2. Cape Verde: Structural Performance Criteria and Benchmarks Under the First Annual Program Supported by the PRGF Arrangement

Measures	Test Dates	Status or Amended Test Dates
<b>Prior action</b>		
Submission of value-added tax (VAT) legislation to the National Assembly	Done	
Approval by the Council of Ministers of new central bank organic law to strengthen statutory independence of the central bank	Done	
<b>Structural performance criteria</b>		
Coming into effect of new organic central bank law to strengthen statutory independence of central bank	End-June 2002	Done
Approval by the Council of Ministers of the automatic and transparent pricing mechanism for retail petroleum products, publication of such mechanism in the official gazette, and implementation of such mechanism	End-June 2002	January 31, 2003
<b>Structural performance benchmarks</b>		
Inclusion of VAT and external tariff reform in 2003 budget	October 2002	June 30, 2003
Establishment of external debt-management committee to oversee external debt strategy and ensure timely payments of debt service falling due	February 2002 (Done)	

Table 3. Cape Verde: Structural Reform Objectives in 2002

Measures	Test Dates	Status
<b>Fiscal and monetary</b>		
Preparation of tax reform, including introduction of value-added tax (VAT) and external tariff reform on January 1, 2003	Continuous	
Inclusion of VAT and external tariff reform in 2003 budget	October 2002	To be implemented June 2003
Strengthening of tax administration department of Ministry of Finance to implement VAT	Continuous	
Review of tax exemption policy and preparation of action plan to reduce exemptions	September 2002	Preliminary review completed
Strengthening of implementation of new tax collection system through commercial banks	Continuous	
With donor assistance, rationalization of strategy and financing for university-level scholarships	December 2002	Done
Strengthening of fiscal management and control through improved treasury expenditure control procedures	Continuous	
Completion of preliminary public expenditure review with World Bank assistance	July 2002	Final report completed
Transmission of final fiscal-year 2001 budget accounts to National Assembly for review	December 2001	Delayed
Introduction of new organic central bank law to strengthen statutory independence of central bank	June 2002	Done
<b>External sector</b>		
Preparation for introduction of new streamlined tariff regime on January 1, 2002	Continuous	
Establishment of external debt-management committee to oversee external debt strategy and ensure timely payments of debt service falling due	February 2002	Committee established and working
<b>Structural and data issues</b>		
Acceleration of domestic debt reduction operation, including hosting donors' conference during the first half of 2002	Continuous	
With World Bank assistance, acceleration of program to liquidate the food import and distribution company (EMPA) and the municipal transport operator (TRANSCOR)	Continuous	
Introduction of automatic and transparent pricing mechanism for petroleum products	June 2002	January 1, 2003
Development of improved information systems to track poverty and poverty programs of the government	December 2002	
Improvement of the quality of key economic and financial sector data, including the real sector, balance of payments, and external debt statistics	Continuous	

**Cape Verde: Relations with the Fund**  
(As of October 31, 2002)

I. **Membership Status:** Joined 11/20/1978; Article XIV

II. <b>General Resources Account:</b>	<u>SDR million</u>	<u>%Quota</u>
Quota	9.60	100.0
Fund holdings of currency	9.60	99.96
Reserve position in Fund	0.00	0.02

III. <b>SDR Department:</b>	<u>SDR million</u>	<u>%Allocation</u>
Net cumulative allocation	0.62	100.0
Holdings	0.00	0.73

IV. <b>Outstanding Purchases and Loans:</b>	<u>SDR million</u>	<u>% Quota</u>
Poverty Reduction and Growth PRGF arrangements	1.23	12.81

V. **Financial Arrangements:**

<u>Type</u>	<u>Approval date</u>	<u>Expiration date</u>	<u>Amount approved (SDR million)</u>	<u>Amount drawn (SDR million)</u>
PRGF	Apr 10, 2002	Apr 09, 2005	8.64	1.23
Stand-By Arrangement	02/20/1998	03/15/2000	2.50	0.00

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	<u>Forthcoming</u>				
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	0.02	0.04	0.05	0.06	0.06
Total	0.02	0.04	0.05	0.06	0.06

**VII. Safeguards Assessments:**

Under the Fund's assessment policy, the Bank of Cape Verde (BCV) is subject to a full safeguards assessment with respect to the PRGF arrangement. The safeguards assessment of the BCV is under way and is expected to be completed by the first review of the program.

**VIII. Exchange Arrangements:**

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 EUR 1. 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.

**IX. Article IV Consultation:**

The Article IV consultation discussions were held in Praia during the period March 3-16, 2001. The staff report (SM/01/145; 5/11/01) was completed on May 16, 2001. The Executive Board approved its conclusion on June 15, 2001. The previous Article IV consultation had been concluded on May 24, 1999. Cape Verde's standard 12-month cycle had been delayed because authorities in 2000 had requested a postponement of the mission twice, for preparations for the elections.

**X. Technical Assistance:**

Since 1985, the Fund has provided technical assistance to both the Bank of Cape Verde and to the Ministry of Finance in several areas: (i) by MAE 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 separations of the functions of the Bank of Cape Verde; and (ii) by FAD for the Ministry of Finance, in organization and budgetary procedures, budgeting, tax policy, and tax administration. The Cape Verdean authorities also benefited from the expertise of several STA missions aiming at improving the money and banking, balance of payments, national accounts, and general statistics. The most recent technical assistance mission on balance of payments statistics was conducted during August 26-September 6, 2002.

An FAD mission, in June-July 1999, and a resident advisor, since March 2000, 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), scheduled for the beginning of 2003. In November 2000, an MAE technical assistance mission advised the authorities on the desirability of establishing a strongly anchored exchange rate regime.

**XI. Resident Representatives**

None.

## **Cape Verde: Fund-Bank Relations**

### **Partnership in Cape Verde's development strategy**

1. The government of Cape Verde's development strategy is set forth in the Interim Poverty Reduction Strategy Paper (I-PRSP) (EBD/02/47). The I-PRSP focuses on promoting governance, entrepreneurial capacity, competitiveness and growth; developing human capital through the education and training system; promoting an overall policy of social development, combating poverty and strengthening cohesion and solidarity; and developing basic and economic infrastructure. A joint Staff Assessment (JSA) (EBD/02/48) on the I-PRSP was discussed by the Boards of the World Bank and the IMF on April 4, 2002.

2. The IMF is supporting Cape Verde's poverty reduction efforts in the context of a three year arrangement under the Poverty Reduction and Growth facility (PRGF). The Fund's program supports the continued pursuit of sound macroeconomic policies, while increasing the share of poverty reduction-related public spending. The Fund takes the lead in the policy dialogue on macroeconomic policies including overall fiscal and monetary policy. In addition to macroeconomic targets, the first-year PRGF program established structural performance criteria relating to the domestic pricing of oil products, and the implementation of a law to strengthen the independence of the central bank.

### **World Bank Group strategy**

3. The objective of the World Bank Group's assistance strategy is to help Cape Verde reduce poverty through support of the government's implementation of its Interim Poverty Reduction Strategy. The Bank's strategy for Cape Verde supports the government's efforts in the areas of (i) macroeconomic management and institutional capacity building; (ii) consolidation of policy reforms in support of private sector development and (iii) human resource development and poverty reduction. The Bank's Country Assistance Strategy (CAS) Progress Report of August 1, 2001, supports the Government's efforts to restore macroeconomic stability and implement structural reforms to promote economic growth. The World Bank is also supporting the government's growth and competitiveness strategy, which aims at broadening the basis of the private sector participation in Cape Verde's economy and enhancing private sector competitiveness. The strategy aims at enhancing private sector competitiveness by improving the investment climate, modernizing the business laws, and enforcing the property rights; building institutional capacity; and improving supply chains in key sectors, namely fishing, tourism, and international transportation services. It also supports pension reforms and the modernization and restructuring of the finance sector.

### **World Bank-Fund collaboration in specific areas**

5. The Fund and the Bank continue to collaborate in many areas, including fiscal operations and tax reform; public enterprise reform privatization, utility regulation, and private sector development; and strengthening human resource development and the poverty reduction strategy. In close collaboration with the World Bank, the Fund staff has discussed and reached understandings on a structural reforms program with the Government of Cape Verde in the context of the PRGF arrangement. Structural reforms include (i) the preparation and introduction of the value added tax

(VAT) and external tariff reform in 2003; (ii) reform of the central bank organic law to increase the bank's statutory independence; (iii) and the introduction of an automatic and transparent pricing mechanism for retail petroleum products. The Fund and the Bank have collaborated in the areas of the privatization program, public expenditure management, and civil service and pension system reform.

6. The current World Bank portfolio gives a high priority to capacity building. The **Privatization Technical Assistance Project** is developing 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** through large-scale contracting of road works to local construction enterprises. The **Public Sector Reform Project** aims to prepare the next phase and modernization of the public sector. The **Energy/Water Project** aims to improve the supply of power, water and sanitation systems, to increase operational and end-use efficiency in the power and water sectors, to lessen the barriers to the development of renewable energy sources, and to foster the sound management of water resources.

7. Two projects were approved in fiscal year (FY) 99 in the social sectors. The **Social Sector Development Project** supports poverty reduction among the 30 percent of the population living below the poverty line by (i) assisting the government in the restructuring of the labor-intensive public works program (FAIMO) by creating an institutional capacity (AGECABO) to execute public works; (ii) strengthening the capacity of municipalities, communities and nongovernmental organizations, in planning, implementing, and monitoring cost-effective poverty alleviation intervention; and (iii) establishing a central capacity to coordinate, monitor, and evaluate the Poverty Alleviation Programs. The aim of the **Education and Training Consolidation Project** is to support the development of a technically and financially sustainable education and training system that will ensure an educated and flexible workforce responding to Cape Verde's social and economic goals. An HIV/AIDS project was approved in March 2002. The credit supports (i) mitigation of the health and socio-economic impact of HIV/AIDS at individual, household and community levels thus sustaining an economically productive population, and (ii) establishment of a strong and sustainable national capacity to respond to the epidemic.

8. A structural adjustment operation was approved in December 2001. The credit supports the government's stabilization program and helps implement critical structural reforms in support of renewed growth and poverty alleviation by (i) implementing structural reforms in the petroleum sector; (ii) supporting an accelerated privatization program in the transport and infrastructure sector; (iii) creating an environment conducive to private sector development and enhancing revenue mobilization; and (iv) strengthening fiscal and balance of payments sustainability.

9. As of October 31, 2002, IDA had extended 18 credits to Cape Verde, amounting to about US\$178.4 million equivalent, of which about US\$127.3 million equivalent has been disbursed. Ten projects have closed, and the current portfolio includes eight active projects with associated credit amounts of about US\$80.6 million equivalent, with an undisbursed balance of about US\$47.3 million. The lending program in the run-up to the new CAS (projected Board presentation in FY 04) includes a growth and competitiveness project.

10. As of June 30, 2002, the IFC had two ongoing investments in Cape Verde in shoe manufacturing and transport, totaling about US\$0.70 million, with US\$0.70 million currently undisbursed. Past IFC investments in Cape Verde have included activities in construction. The IFC will continue to focus on the development of small and medium-scale enterprises. Cape Verde became a member of MIGA in May 1993. MIGA's portfolio in Cape Verde consists of two contracts of guarantee in the mining sector with a \$1.14 million gross and net exposure. The total amount of foreign direct investment facilitated to date is \$2.21 million.

11. The World Bank, IFC, and MIGA will continue to coordinate their respective roles to support development activities in Cape Verde.

12. Questions may be referred to Mr. John McEntire (tel. 221-849-5011).



**Relations with the World Bank Group**  
Statement of IDA Operations

(As of October 31, 2002; in millions of U.S. dollars)

Credit No.	Projects	Principal Amount	Disbursed	Undisbursed	Approved Date	Closing Date
	10 credits closed	97.8	94.7	0.07		
36290	HIV/AIDS	9.0	0.0	9.7	28-Mar-02	31-Dec-06
35870	Structural Adjustment Loan	15.0	7.7	7.3	13-Dec-01	31-Dec-02
24661	Transport Infrastructure Suppl.	5.0	0.6	4.7	30-Jan-01	31-Dec-03
32940	Public Sector Reform & Capacity Building	3.0	2.2	0.7	23-Nov-99	30-Jun-02
32230	Education & Training Consolidation	6.0	3.4	2.5	25-May-99	30-Jun-03
31210	Privatization Technical Assistance	9.0	6.6	2.4	21-Jul-98	31-Dec-03
32050	Energy/Water	17.5	5.1	11.3	11-May-99	30-Jun-04
32240	Social Sector Development	16.1	6.9	8.7	25-May-99	31-Aug-03
	Total active projects	80.6	32.5	47.3		
	Active and closed projects	178.4	127.3	47.4		

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)

FY Approv.	Company	Type of business	Original Gross Commitments				Disbursed			
			Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Participation
1992	Growela 1/	Shoe manufacturing	0.15	0.00	0.00	0.00	0.15	0.0	0.0	0.0
2001	Moura 2/	Transport	0.55	0.00	0.20	0.00	0.00	0.0	0.0	0.0
	Total portfolio		0.70	0.00	0.20	0.00	0.15	0.0	0.0	0.0

1/ Growela = shoe manufacturing.

2/ Moura = public transportation

### **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. The Statistics Department (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 that was started in 1996 to improve macroeconomic statistical systems. The mission found that notable improvements had been made in many aspects of Cape Verde's statistical systems. Cape Verde has indicated its intention to participate in the GDDS and has nominated a GDDS coordinator. Cape Verde participated in the General Data Dissemination System (GDDS) workshop held in Lisbon in October 2002 for countries participating in a GDDS project for lusophone African countries.

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 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. The preliminary results of the population and housing census in 2000 are now available from the National Statistics Institute. Data on population and housing statistics will be published separately for each island.

#### **Real sector**

With assistance from the World Bank, national accounts estimates have been prepared through 1996. Preliminary national accounts estimates through 1997 have been prepared with the assistance of the STA statistical advisor and the French government. National accounts from 1996 and 1997 were finalized at end-2001. Work on data for 1998-99 started in late 2000 and is expected to be finalized by summer 2002. Meanwhile, preliminary GDP estimates for 1999 and forecasts for 2000 on the basis of a quick-accounts calculation system have been prepared jointly with AFR. The STA mission (1999), as well as the technical assistance assessment mission (2000), 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 the old series 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 National Statistics Institute intends to use the results of the 2001 household income and expenditure survey to shift the base year of national accounts in constant prices from 1980 to 2001.

The official consumer price index (CPI) is obsolete, as the weights date back to 1989, four years before the liberalization of imports considerably changed the composition of consumption. The introduction of a reweighted CPI is planned for 2002. 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 STA multisector statistics 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 an FAD technical assistance mission on expenditure control in 1996.<sup>1</sup> 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 have 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*.

---

<sup>1</sup> Abdelali Tazi and others, "Cape Verde: Consolidation of Public Expenditure" (Praia, Cape Verde: IMF, Fiscal Affairs Department, 1997).

## Money and banking

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

Since 1996, significant progress has been made in the area of monetary and financial statistics, both in terms of the analytical quality and timeliness of the data: (i) the methodology used by the BCV's money and banking division (MBD) for the compilation of the monetary aggregates follows closely the *Monetary and Financial Statistics Manual*; (ii) monthly consolidated accounts for the banking system are compiled within four weeks of the end of the reference month; and (iii) the MBD verifies regularly the consistency of the foreign accounts of the banking system with the data compiled by the balance of payments division (BPD).

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. However, there is still a need to improve the timeliness of the monetary data reported to the Fund, particularly the consolidated analytical accounts for the commercial banks.

## Balance of payments

The quality and timeliness of balance of payments statistics have improved since the last two missions in that area. The BCV currently compiles quarterly statistics. A greater use of surveys has permitted a significant expansion of data sources and statistical coverage, which, to a large extent, follow 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) that 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, so as to expand the coverage of external debt. In spite of the recent overall improvement in the balance of payments statistics of Cape Verde, large inconsistencies continue to affect items of exceptional financing and some transactions related to recent privatizations. A major remaining problem is the lack of information on private capital flows, particularly foreign direct investment and commercial credits. A two-week STA mission on balance of payments statistics visited Cape Verde on August 6, 2002 and found that the progress made in implementing the recommendations of the previous mission was partial, owing to the poor

results of the enterprise surveys and inadequate organization of the structure of the Balance of Payments Division (BPD) of the BCV.

The last published data in the 2002 edition of the *Balance of Payments Statistics Yearbook (BOPSY)* and in *IFS* refer to 1999. The Cape Verdean authorities also 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 2002 *BOPSY*.

### **External debt and arrears**

An adequate database seems to be in place, although additional improvements will be necessary to allow for reliable debt sustainability analyses. The treasury department of the Ministry of Economic Coordination is able to provide a breakdown by creditors for debt and arrears.

**Cape Verde: Selected Social and Demographic Indicators 1/**

	Cape Verde	Sub-Saharan Africa 2/
<b>Population</b>		
Population (in thousands)	440	642,812
Annual rate of growth (1996-2000)	2.3	2.8
Density (persons per thousand hectares)	1,090	272
<b>Population characteristics</b>		
Life expectancy at birth (years)	69	47
Male	66	46
Female	72	48
Infant mortality (per thousand)	23	92
Crude death rate (per thousand; 1999)	7	16
Crude birth rate (per thousand; 1999)	32	40
Fertility rate (births per woman)	4.0	5.3
Urban population (percent)	54	34
<b>Health</b>		
Population per physician (1999)	4,274	7,464
Population per hospital bed (1999)	631	737
Immunization rate (percent under 12 months)		
DPT	69	57
Measles	61	59
<b>Access to improved water source</b>		
Percent of population	70	55
Urban	76	82
Rural	26	41
<b>Education</b>		
Adult illiteracy (percent)	25	40
Male	16	31
Female	33	47
Primary school enrollment (net)	96	...
Pupils-teacher ratio (primary schools; 1999)	29	40
<b>Labor force</b>		
Total (in thousands; 1998)	166	282,666
Female (percent; 1998)	39	42

Sources: World Bank; Cape Verde, interim poverty reduction strategy paper; and staff estimates.

1/ Figures for Cape Verde refer to the year 2000, unless otherwise indicated.

2/ Figures for sub-Saharan Africa refer to the latest year available from the 1997-2000 period.

### **Tentative Work Program**

December 2002	Executive Board meeting on 2002 Article IV consultation and first review under the PRGF arrangement
February 2003	Mission to discuss program for 2003 and conduct second review
April 2003	Executive Board meeting on second review and second annual program
June-September 2003	Executive Board meeting on PRSP
September 2003	Mission for third review
November 2003	Executive Board meeting on third review

**Statement by the IMF Staff Representative  
December 16, 2002**

1. The following information has become available since the staff report was prepared. These developments do not alter the thrust of the staff appraisal.

**2003 budget**

2. The National Assembly approved the 2003 budget on December 11, 2003. The budget differs from the preliminary fiscal program agreed with the authorities in the context of the first PRGF review. The 2003 budget is based on higher revenues, grants, expenditures, and external financing than projected in the staff report. The budgeted overall fiscal deficit (including grants) is 4.7 percent of GDP, compared with a projected 2.5 percent in the staff report, reflecting a more optimistic outlook regarding donor disbursements of project loans. However, the budgeted domestic surplus (revenue less domestic expenditure) is somewhat larger than projected in the program, and recourse to domestic bank financing is in line with program limits.

3. The authorities have assured the staff that they will adhere to the fiscal targets for the first half of 2003 as set forth in Table 1 of the Supplementary Memorandum of Economic and Financial Policies (Attachment I to Appendix I of the staff report). They have informed staff that the budgeted expenditures are spending ceilings, that are contingent upon available revenues, and not authorizations to spend. The Minister of Finance will release warrants for expenditures only if revenues are adequate to ensure the fiscal targets contained in the MEFP are attainable. The authorities have followed the same approach this year, and have kept domestic expenditures not only below budget, but also below the program limit. While this approach has been an effective means of controlling expenditure and adhering to programmed fiscal targets, it is not transparent, and the staff has informed the authorities that the issue of realistic budgeting will need to be taken up during the negotiations of the second annual program.

**Other developments**

- The Safeguards Assessment Report has been completed. The authorities accepted the findings and recommendations of the assessment and an implementation plan is underway.
- The government has issued the decree liquidating EMPA (the food import and distribution public enterprise).
- The law for combating money laundering and the financing of terrorism has been approved by the National Assembly.
- World Bank staff have indicated that all conditions for disbursement of the second tranche under the Structural Adjustment Credit (SAC) have been met and the request for a supplementary credit under the SAC has been sent to the Bank Board. Approval



of the supplementary credit will close the remaining financing gap for 2002.

- Net international reserves fell by about euro 3.6 million between end-October and December 6, but are still about euro 30 million above the revised target for end-December 2002.



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 03/72  
FOR IMMEDIATE RELEASE  
June 13, 2003  
**Corrected:** June 20, 2003

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Concludes 2002 Article IV Consultation with Cape Verde**

On December 16, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Cape Verde.<sup>1</sup>

### **Background**

In 1992, following the country's first multiparty elections, the new government launched a far-reaching economic reform program aimed at reducing the size of the public sector and promoting growth led by private sector exports. The reform agenda focused on privatization, trade and exchange liberalization, financial sector restructuring, tax reform, and price liberalization. Real GDP growth averaged about 7 percent a year in the period 1992-2000, but recurrent fiscal slippages undermined macroeconomic stability, first during 1992-96 and subsequently in 2000, resulting in a loss of international reserves, the accumulation of domestic and external payment arrears, a rapid increase in domestic debt, and a slowdown in economic growth.

The current government was elected in early 2001 and has focused on reducing internal and external imbalances, restoring order to public finances, regularizing domestic and external arrears, maintaining a tight monetary policy to rebuild international reserves, and implementing structural reforms to achieve a high rate of economic growth. Economic performance during the period July-December 2001 was monitored under a Fund staff-monitored program. On

---

<sup>1</sup> 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.

April 4, 2002, the Fund approved an arrangement under the Poverty Reduction and Growth Facility (PRGF), in support of the authorities' economic program for 2002-04. The government of Cape Verde's medium-term development strategy is set forth in the Interim Poverty Reduction Strategy Paper (I-PRSP), which focuses on combating poverty by promoting private-sector led economic growth, developing human capital through education and training, improving social and economic infrastructure, and promoting good governance. The I-PRSP was approved by the Boards of the Fund and the World Bank on April 4, 2001.

Economic performance in 2002 has been encouraging. Real economic growth and international reserves are higher, inflation lower, and the fiscal deficit smaller than originally projected. Real GDP growth is expected to rise to about 4 ½ percent in 2002, up slightly from 4 percent in 2001. The better-than-expected economic growth is being driven by exports of manufactured goods, tourism, and transportation services, all of which performed more favorably than envisaged in the first half of 2002, as did private transfers, which have helped support the domestic construction industry. Consumer price inflation (on an annual average basis) is projected at 1.7 percent for 2002 as a whole.

The fiscal deficit (including grants) is projected to fall to 2.0 percent of GDP in 2002, from 4.6 percent in 2001, reflecting a higher level of revenues and grants (as a share of GDP) and reductions in recurrent expenditures. Broad money has grown more rapidly than earlier envisaged, reflecting a stronger balance of payments position and, more recently, government borrowing from the banking system to repay domestic arrears. International reserves are well above target and, at end-September, stood at about 1.7 months of imports of goods and services, up from 1.0 month at end-2000. In May 2002, given the strong balance of payments position and low inflation rate, the Bank of Cape Verde lowered its refinance rate to 10.0 percent.

Fiscal and trade reforms encountered some delay. The value-added tax (VAT) and new customs tariff schedule were unanimously approved by the National Assembly in June 2002, but the reforms will not be in place until June 2003, as more time is needed to establish the administrative framework and to draft supporting regulations. On the positive side, three of four public expenditure reviews were completed, which will provide important inputs into Cape Verde's full Poverty Reduction Strategy Paper. In addition, a new central bank law was approved, establishing the independence of the Bank of Cape Verde, and two large loss-making public enterprises were liquidated. The social impact of the liquidations is being mitigated through the provision of financial support for former employees, with support from the World Bank.

### **Executive Board Assessment**

Executive Directors commended the Cape Verde authorities for their strong efforts to restore macroeconomic stability by reducing the fiscal deficit substantially, keeping down inflation, regularizing domestic and external arrears, and strengthening international reserves. They also saw encouraging indications that economic growth is reviving. The challenge now facing the authorities is to consolidate the recent macroeconomic achievements and to further

strengthen the foundations for growth through structural reforms to enhance private sector competitiveness, while tackling poverty by fostering human development and social services.

Directors considered that macroeconomic policies appropriately aim at further reducing the fiscal deficit over the medium term, while using available scope for easing monetary policy to gradually reduce domestic interest rates consistent with continued low inflation. They noted that given the openness of Cape Verde's economy, it will remain important to reduce interest rates cautiously. The primary objective of monetary policy should remain to further accumulate international reserves from their still low level, while sustained fiscal consolidation and the steadfast implementation of structural reforms to enhance competitiveness will be key to support the sustainability of the balance of payments, and gradually reduce aid dependency over the long term. These policies will also be essential to ensure the continued adequacy of the exchange rate peg of the Cape Verde escudo to the euro. Director underscored the importance of closely monitoring monetary and exchange rate developments in the period ahead.

Directors noted the modest increase in the fiscal deficit projected for 2003, following the recent substantial expenditure cuts, and taking into account the anticipated higher external financing. They urged the authorities to stand ready to step up revenue mobilization and expenditure restraint efforts in case of a shortfall in foreign financing.

Looking ahead, Directors underscored the critical importance of implementing the VAT, the new customs tariffs, and the automatic pricing mechanism for retail petroleum products in a timely manner to ensure that fiscal consolidation can be sustained. They also encouraged the authorities to identify the numerous tax exemptions which currently result in significant revenue losses, and to develop a comprehensive strategy for substantially reducing them over time. Directors also looked forward to the implementation of plans to redirect public expenditures toward social development and infrastructure, address remaining public weaknesses in budget management with assistance from a budget advisor, and carry out a comprehensive and transparent audit of domestic arrears. They encouraged the authorities to continue working toward the conclusion of negotiations on the rescheduling of remaining external arrears in order to fully normalize relations with creditors.

Directors welcomed the progress in implementing structural reforms, including the approval of a new central bank law, new custom tariffs, and the liquidation of two large, loss-making public enterprises. They encouraged the authorities to continue to cooperate closely with the World Bank and bilateral donors in addressing the challenges ahead. This will include the privatization of remaining public enterprises, the reform and regulation of utilities, the promotion of competition in the financial market, the further strengthening of financial sector supervision, and continued development of the tourism sector. Directors commended the authorities for further strengthening the framework to combat money laundering and the financing of terrorism and welcomed the approval of recent legislation.

Directors supported the authorities' intention to mitigate the social impact of reforms by providing financial assistance to the employees who are adversely affected by the liquidation of large public enterprises.

Directors observed that Cape Verde's statistical systems remain weak, especially with regard to the national accounts. They encouraged the authorities to complete the remaining steps necessary for participation in the GDDS, which would bolster their efforts to build statistical capacity and help secure technical assistance.

**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.

**Table 1. Cape Verde: Selected Economic Indicators, 1998-2002**

	1998	1999	2000	2001	2002 Proj.
<b>Domestic economy</b>					
Real GDP	8.0	8.9	6.6	4.0	4.6
Real GDP (per capita)	5.2	7.1	4.4	1.8	2.3
Consumer price index (annual average)	4.4	4.4	-2.4	3.7	1.7
Gross domestic investment	19.9	19.8	18.7	17.4	19.8
Gross national savings	7.8	6.9	7.5	6.6	9.3
<b>External economy</b>					
Export, f.ob. (in local currency, annual percentage change)	-2.9	16.4	26.2	19.8	4.6
Imports, f.o.b. (in local currency, annual percentage change)	14.8	21.5	6.1	11.7	5.6
Current account balance, excl. grants (in millions of U.S. dollars)	-112.6	-100.5	-84.2	-79.2	-95.2
Current account balance, excl. grants (in percent of GDP)	-21.5	-17.3	-15.3	-14.6	-14.7
Capital and financial account (in millions of U.S. dollars)	55.6	130.4	34.4	69.3	72.9
Debt service (in percent of exports of goods and nonfactor services)	11.3	30.2	28.2	19.2	17.0
External debt (in percent of GDP)	45.2	53.8	61.4	64.9	63.9
Real effective exchange rate (end of period, percentage change)	-2.5	8.4	-7.3	-2.7	-0.1
<b>Financial variables</b>					
Government revenues	33.0	27.8	27.0	27.3	29.6
Total grants	13.4	7.3	6.2	4.9	6.0
Current expenditure	21.2	23.5	27.5	22.1	20.9
Overall fiscal deficit (incl. grants)	-4.0	-13.0	-20.4	-4.6	-2.0
Broad money (annual percentage change)	2.5	15.4	12.9	9.8	13.2

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

**NEWS  BRIEF**

FOR IMMEDIATE RELEASE

---

News Brief No. 02/127  
FOR IMMEDIATE RELEASE  
December 16, 2002

International Monetary Fund  
700 19th Street, NW  
Washington, D. C. 20431 USA

**IMF Completes First Review Under Cape Verde's PRGF Arrangement  
and Approves US\$1.65 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Cape Verde's performance under an economic program supported by the Poverty Reduction and Growth Facility (PRGF). As a result, Cape Verde will be able to draw up to SDR 1.23 million (about US\$1.65 million) immediately.

The Executive Board also waived Cape Verde's non-observance of performance criteria pertaining to nonconcessional debt, the accumulation of domestic arrears, and the implementation of an automatic retail pricing mechanism for petroleum products.

Cape Verde's three-year arrangement was approved on April 10, 2002 for SDR 8.64 million (about US\$11.6 million) (see [Press Release No. 02/18](#)). So far, Cape Verde has drawn SDR 1.23 million (about US\$1.65 million) under the arrangement.

The PRGF is the IMF's concessional facility for low income countries. It is intended that PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period on principal payments.

---

EXTERNAL RELATIONS DEPARTMENT

Washington, D.C. 20431 • Telephone 202-623-7100 • Fax 202-623-6772 • [www.imf.org](http://www.imf.org)

After the Executive Board's discussion on Cape Verde, Mr. Eduardo Aninat, Deputy Managing Director and Acting chair, stated:

"The Cape Verde authorities are to be commended for having achieved significant progress in stabilizing public finances, regularizing domestic and external arrears, rebuilding international reserves, and continuing their structural reform agenda. Economic growth in 2002 is better than originally projected, inflation is lower, and most performance criteria for end-June were met, with fiscal performance and the accumulation of international reserves exceeding the targets by substantial margins.

"The authorities' plan to gradually reduce domestic interest rates to spur private sector investment is appropriate. It will, however, need to be implemented cautiously, consistent with a further strengthening of the level of international reserves, and be supported by sufficiently tight fiscal policies.

"Notable achievements in the structural area include the new central bank law, the liquidation of two loss-making public enterprises, and the impending implementation of an automatic adjustment mechanism for domestic petroleum prices. The timely introduction of a value-added tax and new customs tariffs will be essential to ensure a buoyant fiscal revenue base and enhance export competitiveness.

"Given favorable developments in tourism and in Cape Verde's trade environment, the outlook for 2003 remains good, and an economic growth rate of about 5 percent appears within reach. Prudent monetary and fiscal policies, continued donor support, and the steadfast implementation of structural reforms to enhance productivity, will be key to underpin the prospects for sustained high growth and poverty reduction," Mr. Aninat said.



**Statement by Damian Ondo Mañe, Executive Director for Cape Verde  
December 16, 2002**

Since early 2001, the economic and financial situation of Cape Verde has registered substantial improvement, in response to the comprehensive program of financial and structural adjustment implemented by the authorities. The economy has over performed in almost all areas, in 2002. Performance under the Fund supported PRGF arrangement has been satisfactory. All but three of the quantitative and structural performance criteria were met.

The policies followed by the authorities have contributed to an increase in real economic growth and international reserves, in 2002. The inflation rate is lower, and the fiscal deficit is smaller than programmed. On the structural front, significant progress has been made. The new central bank law, that establishes its independence has been approved by the National Assembly, and the government is proceeding with the privatization of the two public enterprises. However, delays have been encountered in the implementation of the petroleum price mechanism and the VAT. On the price mechanism, negotiations with the oil companies took longer than expected, but the mechanism has now been approved by the Council of Ministers and will be put into effect as of January 1, 2003. On the VAT, the National Assembly has approved the law in June 2002, but the setting up of the administrative framework and the drafting of the supporting legislation are taking more time. It is expected that the VAT will enter into effect in June 2003. My authorities would like to reaffirm their strong commitment to these reforms, and will ensure that they are implemented as envisaged. In view of the actions being taken, my authorities are requesting waivers for the nonobservance of the missed performance criteria.

**Policies for the Remainder of 2002 and the First Half of 2003**

The authorities believe that the strategy and policies envisaged under the PRGF remain appropriate and will continue their full implementation in 2003. The process of fiscal consolidation will be continued, and the authorities would like to reiterate their commitment to fiscal discipline. Nevertheless, as the fiscal adjustment has come mainly from expenditure cuts, which have affected social and security spending, the authorities are increasing slightly the level of spending in the last quarter of 2002 in order to hire additional teachers and police.

For 2003, no new revenue measure is envisaged, except for the lowering of the corporate tax from 35 to 30 percent. This is being done in the context of the authorities' efforts to encourage the development of a strong private sector. However, this measure is not expected to affect revenue in 2003, as companies pay their income taxes on the previous year's income. The ratios of revenue and expenditure to GDP are expected to remain broadly the same in 2003, although revenue is projected to fall slightly due to lower import and conservative projections as regards the yield from the VAT. The authorities will review these with the staff at the time of the next review. The authorities are also in the process of

reviewing the many customs and tax exemptions which are causing revenue losses. It is their intention not to grant any new exemption in 2003, and to eliminate most of the consumption tax exemptions with the introduction of the VAT. Furthermore, the authorities will undertake a comprehensive assessment of all tax exemptions over the medium term, with the view to their elimination.

As regards expenditure, my authorities are confident that they will be able to maintain it under control. However, to address some of the weaknesses noted by the staff, they will appoint a budget advisor early next year and will also seek technical assistance to review the organic budget law. With regard to the settling of domestic payment arrears, they agree with the staff's proposals for a thorough and comprehensive audit of all claims for payment be undertaken and submit the result to the National Assembly.

### **Monetary and Financial Sector Policies**

The tight monetary stance along with the moderate easing of fiscal policy has resulted in low inflation rate and price stability. The monetary framework will still be dominated by the objective of keeping inflation under control. To this end, the central bank has a range of indirect instruments at its disposal to control liquidity. However, the decline in inflation has given the authorities some leeway to effect a gradual lowering of nominal interest rates. My authorities consider this policy option as an appropriate shift in the context of low inflation and the need to support economic growth. They would like to reassure the Fund that they will proceed with caution, and remain committed to maintaining the gains realized in the area of macroeconomic stability. They also stand ready to take appropriate measures, should the need be, to avoid losses of international reserves.

The financial sector of Cape Verde is sound. However, the authorities will continue to take steps to strengthen banking supervision and to increase on-site examinations. The authorities are also strengthening the measures to strengthen its capacity to detect money-laundering operations. In this regard, a draft law to combat money-laundering and the financing of terrorism has been submitted to the National Assembly. In addition, the vulnerabilities identified by the safeguards assessment in the areas of external audit, internal audit and controls and financial reporting are being given full consideration.

### **External Sector Policies**

Cape Verde has made progress in liberalizing its trade regime. There are no restrictions, or quotas, apart from those needed for health and security reasons. The work on the new tariff structure which will be simpler and more streamlined is nearly completed, and will be introduced in mid-2003. Moreover, it is to be noted that all previously identified restrictions on the making of payments and transfers for current international transactions has been eliminated, and it is the intention of the Cape Verde authorities to accept the obligations of Article VIII, Sections 2(a),3, and 4, in the near future.

## **Other Structural Reforms**

Important progress has been made in the area of privatization and in the reform of the utilities and regulations with the assistance of the World Bank. The authorities will build upon achievements realized by speeding the remaining reforms, including assigning the management of the country's port facilities to private managers, and operationalizing the multisectoral regulatory agency.

My authorities view structural reforms as key to strengthen economic growth. In this regard, they are creating incentives to improve the investment climate through a package of reforms with the support of the World Bank, including tax reform, the alleviation of administrative barriers to investment, legal reform, private sector capacity building and the strengthening of financial sector supervision.

## **PRSP**

With regard to the PRSP, my authorities would like to reaffirm their commitment to the design of a PRSP that will provide an adequate framework for guiding the implementation of a credible poverty reduction strategy. Limited implementation capacity has partly constrained the consultation process. The authorities, however, remain determined to overcome these constraints and complete their PRSP by mid-2003. In the meantime, the public expenditure review has been completed, as has the field work of the first half of the household survey.

## **Medium-Term Strategy**

The authorities consider achieving high growth rate as an important objective in the fight against poverty, and in the improvement of the livelihood of the population in general. In this context, they have discussed various scenarios with the staff, and agree that a 5 percent real GDP growth rate would be a reasonable starting point for the building of the macroeconomic framework. The major constraints to growth have been identified, and plans are being put into place to address them. At the same time, the authorities will give attention to further consolidation of the fiscal position, improving the efficiency of public expenditure, raising the level of international reserves, and increasing social spending.

## **Conclusion**

In conclusion, I would like to reiterate my authorities' firm commitment to the adjustment process, evidenced by the encouraging results obtained so far under the PRGF. My authorities are hopeful that the international community will continue to give them their full support, and they look forward to this assistance in the context of the donors' conference scheduled for mid-2003.