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FOR AGENDA

EBS/03/78

June 11, 2003

To: Members of the Executive Board

From: The Secretary

Subject: **Cape Verde—Second Review Under the Poverty Reduction and Growth Facility**

Attached for consideration by the Executive Directors is a paper on the second review under the Poverty Reduction and Growth Facility for Cape Verde. A draft decision appears on pages 17–21. This paper, together with the poverty reduction strategy paper progress report for Cape Verde (EBD/03/52, 6/11/03) and the associated joint staff assessment (EBD/03/53, 6/11/03), is tentatively scheduled for discussion on **Wednesday, June 25, 2003**. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Cape Verde indicating that they consent to the Fund's publication of this paper.

Questions may be referred to Mr. Rogers (ext. 34031) and Mr. T. Roy (ext. 35338) in AFR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the African Development Bank, the European Commission, and the European Investment Bank, following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

CAPE VERDE

Second Review Under the Poverty Reduction and Growth Facility Arrangement

Prepared by the African Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Financial Affairs, Policy Development and Review, Statistics and Finance Departments)

Approved by Menachem Katz and Shigeo Kashiwagi

June 9, 2003

- **PRGF arrangement**. A three-year PRGF arrangement for SDR 8.64 million (90 percent of quota) was approved by the Executive Board on April 10, 2002 (EBS/02/54; 3/22/02). Two purchases totaling SDR 2.46 million have been made, and another SDR 1.23 million becomes available at the completion of this review.

- **Developments**. Economic performance in 2002 was broadly in line with the program, and all quantitative performance criteria for end-December 2002 and the one structural performance criterion for end-January 2003 were met. Real GDP growth increased to 4 ½ percent and inflation (end of period) fell to 3.0 percent. The overall fiscal deficit (including grants) contracted from 4.8 percent of GDP in 2001 to 1.9 percent.

- **Letter of intent and memorandum on economic and financial policies**. The authorities reaffirm their commitment to fiscal consolidation, the redirecting of public expenditures toward antipoverty programs, prudent monetary policy, and structural reforms designed to enhance international competitiveness.

- **Discussions**. During March 10-18 and April 21-May 1, 2003, the staff team met with the Finance Minister, Mr. Carlos Burgo, the Governor of the Bank of Cape Verde, Mr. Olavo Correia, and other senior officials and private sector representatives.

- **Staff**. The team comprised Mr. Rogers (Head), Messrs. Krichene and Roy, and Mses. Louppe, Sancak, and Chungu (Research Assistant) (all AFR).

- **Documentation**. This report focuses on developments and policies related to the completion of the second review of the PRGF arrangement and objectives and policies for 2003. The principal author of this report is W. Scott Rogers.

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I. Introduction

1. **On April 10, 2002, Directors approved Cape Verde's request for a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), in the amount of SDR 8.64 million (90 percent of quota), to support the authorities' economic program for January 2002–December 2004 (EBS/02/54; 3/22/02).** On the same occasion, the Executive Board approved Cape Verde's interim poverty reduction strategy paper (I-PRSP) (EBD/02/47), as did the Executive Directors of IDA shortly afterward. The first review under the PRGF arrangement was concluded on December 16, 2002, together with the 2002 Article IV consultation.

2. **In the attached letter dated June 9, 2003 (Appendix V), accompanied by its memorandum on economic and financial policies (MEFP, Attachment I), the government of Cape Verde requests the completion of the second PRGF review.** In support of this request, the MEFP reviews progress made under the first-year program and sets out the policies to be implemented in 2003, which will be monitored by quantitative and structural performance criteria for end-June, quantitative performance criteria for end-December, and structural benchmarks for end-June, end-September, and end-October. A third disbursement of SDR 1.23 million is being requested, conditional on the completion of the second review. Cape Verde's reform effort is also being financed by the World Bank, the African Development Bank (AfDB), the European Union (EU), and other bilateral and multilateral development partners.

3. **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 I and II, respectively. Statistical issues are discussed in Appendix III, and Cape Verde's social and demographic indicators are summarized in Appendix IV.

II. Performance Under the First-Year Program

4. **Economic performance in 2002 was broadly in line with the program, and all quantitative performance criteria for end-December 2002 and the one structural performance criterion for end-January 2003 were met.** Real GDP growth increased to 4 ½ percent,[1] and inflation fell to 3.0 percent (on an end-period basis) (Figure 1 and Table 1). The overall fiscal deficit (including grants) contracted from 4.8 percent of GDP in 2001 to 1.9 percent (Tables 2 and 3), a somewhat stronger fiscal adjustment than programmed, while the overall deficit (excluding grants), at 10.6 percent of GDP, was higher than targeted. Despite the sizable fiscal consolidation, the external current account deficit (including grants)

[1] National accounts data remain weak, and no official accounts have been published beyond 1997, although preliminary accounts are available through 2000. Real GDP growth since then has been estimated by the National Institute of Statistics and the Fund staff.

increased moderately to 11.2 percent of GDP, reflecting strong growth in imports of capital goods associated with an increase in private domestic investment; excluding official transfers, the deficit increased to 17 percent of GDP (Table 4). Net private capital inflows were larger than expected, and the overall balance of payments registered a sizable surplus for the second consecutive year. Gross international reserves increased to the equivalent of 2.1 months of imports of goods and services, compared with a target of 1.7 months.

5. **The larger-than-targeted fiscal deficit (excluding grants) reflected a higher level of donor-financed capital expenditures**. Domestic revenues performed better than envisaged, reflecting an aggressive collection of tax arrears and transfers from public agencies (Table 2). Recurrent expenditures were also higher than programmed because of the hiring of additional teachers and tax inspectors late in the year. Outlays for retrenchment were lower than targeted, as the government delayed some payments until 2003. The deficit was largely covered by net external flows (including grants) amounting to 10.4 percent of GDP, which allowed the authorities to meet the targeted level of total domestic financing. Domestic bank financing of 3.7 percent of GDP was within program limits and facilitated the clearance of domestic arrears amounting to 5 ½ percent of GDP.

6. **In light of the sizable increase in international reserves and continued low inflation, the Bank of Cape Verde (BCV) lowered its basic lending rate from 11.5 percent to 10.0 percent in May, and to 8.5 percent in January 2003**. The average commercial bank lending rate subsequently fell from 14.5 percent in May 2002 to 13.4 percent in March 2003, still high in real terms. The average rate on emigrant deposits fell by 230 basis points to 7.0 percent.[2] These rates remain high relative to comparable euro deposits (Figure 3), and the private capital inflows associated with the deposits have remained strong. After peaking at 17 percent in September 2002, broad money growth eased to 14 percent in December 2002 and 12 ½ percent in March 2003 (Table 3). While the monetary overhang identified at the time of the last staff report is unwinding broadly as expected, it has not resulted in a loss of international reserves as the staff had envisaged.[3] Nonetheless, the balance of payments remains fragile; gross international reserves have not increased since March 2002, despite fiscal consolidation and a fairly stable spread between domestic and European deposit rates.

7. **Progress with structural reforms was mixed.** The automatic petroleum pricing mechanism was implemented on January 1, 2003, thereby meeting the one structural

[2] Emigrant deposits are local currency deposits financed by capital inflows from Cape Verdeans living abroad.

[3] Instead, demand for bank credit was somewhat weaker than projected, indicating that the private sector may have used excess money balances to repay bank debt, and inflation was moderately higher than projected.

performance criterion for the second PRGF review. Retail prices will be adjusted following the payment for each import shipment. The government liquidated two large loss-making public enterprises, TRANSCOR (the municipal transportation company), and EMPA (the commodity import and distribution company). Retrenchment payments to former EMPA workers will be made in three tranches, the first of which was paid in March 2003. The financial situations of Electra (the minority state-owned electricity and water monopoly) and TACV (the wholly state-owned national airline) deteriorated in 2002, with combined losses equal to about 3.5 percent of GDP. The losses were financed by an external credit line for Electra, and, in the case of TACV, by an accumulation of arrears to the government-owned airport management agency. The government has already taken measures to reduce these losses in 2003, including raising electricity and water tariffs by 25 percent and 20 percent, respectively, on January 1, 2003, for the first time in over five years.

III. Medium-Term Poverty Reduction Framework, Economic Outlook, and Capacity to Repay the Fund

8. **As outlined in the government's interim PRSP, the poverty reduction strategy is based upon the principles of (i) good governance; (ii) private sector economic growth and diversification; (iii) the development of human capital; (iv) social development and cohesion; and (v) government provision of basic and economic infrastructure.** These principles are reaffirmed in the government's PRSP preparation status report.[4] The government's medium-term economic strategy is to (i) maintain fiscal discipline in order to free up financial resources for the private sector, reduce pressure on the external current account, and support a gradual reduction in domestic interest rates; (ii) reorient public expenditures toward health, education, and infrastructure; (iii) target monetary policy toward a further increase in international reserves; and (iv) implement structural reforms to enhance private sector competitiveness and promote economic growth, with a view to reducing unemployment and poverty. During discussions on the 2003 program, it became evident that, while progress was envisaged on most of these fronts in 2003, the further buildup of the import coverage of international reserves would have to be delayed.

9. **The medium-term macroeconomic framework was modified slightly to reflect recent developments**. Real GDP growth would average about 5 percent a year during 2003-05, and inflation would be contained at 2-2 ½ percent (on an end-period basis). Broad money would grow in line with nominal GDP, and credit to the economy would increase somewhat more rapidly. Gross international reserves would rise to 2 ½ months of imports of goods and services in 2005. The fiscal deficit (excluding grants) would fall to about 6 percent of GDP from 10 ½ percent in 2002, in the context of a moderately rising revenue-to-GDP ratio. Total expenditure is projected to decline relative to GDP, reflecting a more moderate rate of public investment and reductions in subsidies and retrenchment payments to former

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[4] See also paras. 7 and 8 of the MEFP.

employees of liquidated public enterprises. Excluding transfers and subsidies, primary recurrent expenditures would rise about 4 percent in real terms to allow for increased outlays in health, education, tax administration, and security. The expenditure projections will be revisited in the context of the medium-term expenditure framework being developed for the full PRSP. The medium-term outlook is consistent with a steady decline in the external and internal debt-to-GDP ratios.[5]

10. **The external current account deficit (excluding official transfers) is projected to increase moderately in 2003 and then decline to about 15 ½ percent of GDP by 2005**. Net official flows (including grants) are expected to continue their downward trend of the past decade, falling from about 10 ½ percent of GDP in 2002 to 7 percent of GDP by 2005 (including amounts needed to fill the projected financing gap). Private international capital flows are envisaged to pick up after 2003 in response to the improved investment climate and new export opportunities. Against this background, the financing gaps for 2004-05 amount to €34 million (the 2003 program is fully financed). The prospective IDA poverty reduction support credit would cover about €15 million of this amount, and other donors have indicated that another €8 million would likely become available. The residual financing gap of €11 million would need to be covered by additional balance of payments support, which the authorities will seek from donors at the PRSP donor conference scheduled for early 2004.

11. **Cape Verde is expected to be able to meet its repayment obligations to the Fund without difficulty**. The country's outstanding obligations to the Fund are currently SDR 2.46 million and will rise to SDR 8.64 million by 2005, when the last purchase under the PRGF arrangement is made (Table 7). This will amount to 3 percent of Cape Verde's projected external debt stock. By 2005, gross international reserves are projected to rise to €113 million (SDR 89 million), and the debt-service ratio is projected to fall to 11 percent of exports of goods and services from 15 ½ percent in 2002.

12. **The medium-term framework is subject to risks**. Fiscal discipline could weaken as the country approaches municipal elections in 2004 and national elections in 2005. If this were to occur, international confidence in the government's commitment to macroeconomic stability could erode, and international private capital flows could be adversely affected, putting pressure on international reserves and undermining the credibility of the exchange rate peg. In addition, there could be additional fiscal costs associated with public enterprise reform, such as severance payments for TACV staff.[6] Given the importance of private capital flows for the balance of payments, an increase in world interest rates would necessitate a

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[5] This is true even if one assumes that the financing gap is closed with loans instead of grants.

[6] Staff reductions have been identified by the government as one of the cost-reducing measures to be undertaken by the TACV, but since much of the staff was hired in 2002, severance costs are expected to be relatively low.

tightening of domestic monetary policy to maintain the attractiveness of domestic interest-bearing financial assets. This, in turn, would dampen private investment and reduce real economic growth. Finally, a continued appreciation of the euro against the U.S. dollar would undermine export competitiveness, which could be difficult to compensate for through productivity-enhancing structural reforms. This appreciation too, could undermine the sustainability of the exchange rate peg.

IV. Discussions on the 2003 Program

13. **The discussions on the 2003 program focused on (i) fiscal policies, including policies to close the financing gap for 2003 identified at the conclusion of the first PRGF review in December 2002 (EBS/02/211; 12/9/02); (ii) the prospects for fine-tuning monetary policy to support a gradual lowering of domestic interest rates consistent with a continued increase in international reserves; (iii) the implementation of structural reforms to enhance international competitiveness and economic growth prospects; and (iv) the social impact of selected key structural reforms.**

A. Fiscal Policy

14. **The discussions on fiscal policy focused on balancing the need for domestic bank financing for fiscal operations with the desire to increase international reserves and provide adequate bank credit to the economy.** The authorities expressed the view that given the choice between increasing international reserve coverage in 2003 and budgeting additional priority outlays (and payment of domestic arrears), they would prefer the latter. A further buildup in international reserve coverage would begin in 2004, when budgetary pressures are projected to ease. Given that international reserve coverage at end-2002 was higher than what had been projected for end-2003, and that inflation and the fiscal deficit (including grants) remain low, the staff agreed with this strategy.

15. **The overall fiscal deficit (excluding grants) is projected to fall to 9.2 percent of GDP in 2003.** The deficit is fully financed by net external flows (including grants of 7.3 percent of GDP), allowing for a moderate reduction in the government's net domestic financial liabilities. Nonetheless, domestic bank financing of about 0.6 percent of GDP would be needed to facilitate the settlement of domestic arrears.[7] Total revenue is projected to rise by 11 percent, to 24.5 percent of GDP, on the basis of increasing receipts from trade taxes, the elimination of the subsidy and excise tax exemption for diesel fuel consumed by Electra, and the collection of tax arrears. Total expenditure is programmed to increase by 5.7 percent

[7] The program incorporates a reduction in domestic arrears amounting to 1.2 percent of GDP. Of this amount, 0.6 percent of GDP would be cleared by the government's offsetting its payments arrears to one domestic company against that company's tax arrears. The remaining domestic arrears would be paid in cash.

(falling relative to GDP), reflecting a more moderate pace of implementing donor-financed capital projects. The wage bill would rise to allow for the recruitment of additional teachers, medical doctors, and police, and for a 2.5 percent wage increase. The government will continue to make payments to retrenched workers of the liquidated public enterprises amounting to an estimated 1 percent of GDP.

16. **The authorities pressed hard for the inclusion of a temporary subsidy to Electra of 0.4 percent of GDP in the program.** They indicated that Electra was having difficulty mobilizing cash to purchase fuel, and that, unless the government provided the proposed financial support, the company would cease serving high-cost rural areas. The World Bank is providing financial and technical support to Cape Verde's water and power sector, and participated fully in the discussions in this area. The staff urged the authorities to undertake an external audit of Electra to confirm the magnitude of its financial losses before committing themselves to the subsidy. In addition, the staff noted that the combination of higher electricity and water tariffs and the recent decline in world fuel prices would by itself reduce Electra's losses. The staff also pointed out that there were preferable means for providing Electra with the financial resources needed to purchase fuel, including the government's paying all its arrears to the utility. Finally, the staff noted that there were measures that Electra's management could implement to reduce financial losses, such as improving its bill collecting. These discussions led to an agreed strategy with regard to Electra, supported by the World Bank staff, that included making the subsidy contingent upon measures undertaken by Electra's management (see para. 22 of the MEFP). Against this background, it was agreed to include a contingent provision in the fiscal program to help ensure that blackouts did not occur due to liquidity constraints experienced by Electra.

17. **The program envisages a number of reforms to strengthen revenues and improve fiscal management.** The implementation of the value-added tax (VAT) and new customs tariffs have been subject to numerous delays. However, all necessary legislative action by the National Assembly was completed in April 2003, and the authorities are confident that the VAT and new customs tariffs will be in place by January 1, 2004.[8] Two important actions remain to be taken by the Council of Ministers: the approval of the VAT preregistration decree and the amendment of the National Accounting Plan. These actions will constitute, respectively, a structural performance criterion for June 2003 and a structural benchmark for September 2003. The authorities are seeking donor assistance to replace the support for VAT-related hardware and training that was recently withdrawn by Luxembourg because of domestic budget constraints; however, they believe they can meet the new target date with available resources.[9] To strengthen fiscal accountability and oversight, the

[8] The revised schedule was developed with technical assistance from FAD.

[9] Donors had pledged a total of US$700,000 to finance the implementation of the VAT through the first two years of operation, of which Luxembourg pledged US$500,000. The

(continued…)

government will begin submitting quarterly fiscal reports to the National Assembly this year. A donor-funded budget advisor has been identified and is expected to begin work on strengthening expenditure management by June 2003. The authorities intend to complete a comprehensive assessment of tax and customs exemptions by the end of 2003, with a view to reducing their number in the medium term. Also, the treasury will compile a report on the stock of verified domestic arrears outstanding as at end-2002 to help the government plan for their orderly reduction over the medium term.

B. Monetary Policy

18. **The discussions on monetary policy focused on the authorities' dual objectives of augmenting international reserves while promoting a gradual decline in domestic interest rates.** In the medium term, these objectives can be achieved if fiscal discipline is maintained, external competitiveness enhanced through structural reforms, and the climate for foreign investment improved. However, the staff and authorities agreed that it may be difficult to attain both these goals in 2003 in light of the recent weakness in the balance of payments and the continued unavoidable need for some bank financing of fiscal operations. Consequently, the BCV indicated that it would not reduce its lending rates further until there were clear indications that international reserves were on an upward trend, and that it would tighten monetary policy if there were signs of an unsustainable decline in reserves. **Broad money is projected to expand by 7.8 percent in 2003, in line with nominal GDP**. Credit to the economy would grow by about 12 percent (6 percent of the beginning stock of broad money), and net bank credit to the central government would increase by 3 percent (0.9 percent of the beginning stock of broad money). Against this background, gross international reserves would increase by a moderate €6 million, sufficient to maintain reserve coverage at 2.1 months.

19. **The BCV is implementing its work plan to strengthen financial oversight**. It has completed on-site examinations of two of the country's six banks, including the two recently licensed offshore banks, and intends to complete two more by the end of the year. The monthly off-site examination reports have been computerized, and the BCV is receiving technical assistance from partner institutions to strengthen its on-site and off-site supervisory capacity. It is also seeking technical assistance to undertake a comprehensive review of financial sector legislation, with a view to establishing a legislative framework conducive to financial diversification and deepening. The staff and the authorities also discussed the need of small enterprises and poor households for access to credit and financial services. It was agreed that, even though one of the commercial banks had successfully absorbed a commercially viable credit program for small enterprises and households in Santiago (the main island), there was still a need to expand microfinance services. This issue will be

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World Bank has made up US$300,000 of the shortfall, arising from the withdrawal of Luxembourg's support, by reprogramming funds from another project.

addressed in the context of the authorities' Competitiveness and Growth Project, supported by the World Bank.

20. **The BCV has implemented most of the recommendations of the safeguards assessment report**. The organic central bank law passed in 2002 mandates that the accounts of the BCV be audited in accordance with International Auditing Standards (IAS), and the BCV is concluding negotiations with a new external auditor. The authorities indicated that the 2002 central bank audit was broadly consistent with IAS, and they intend to publish the accounts and the associated assessment before end-June 2003. The staff will continue to monitor the implementation of the outstanding recommendations as the deadlines fall due and will obtain updated documents and data as necessary.

C. External Sector Policies

21. **The authorities' external sector strategy focuses on enhancing export competitiveness through structural reforms, targeted export promotion activities, and improvements in the business environment, especially for foreign direct investment.** Thus, the government's public investment program continues to focus on infrastructure, and recurrent expenditures are being redirected toward health and education, including vocational and professional training. Export processing zones have been developed, and new tourist destinations have been opened. Recent access to new textile markets under the U.S. African Growth and Opportunity Act (AGOA), and a similar arrangement with Canada (which the authorities expect to conclude soon) will enhance prospects for manufactured exports. The authorities' trade reform agenda will be largely complete once the new VAT and customs tariffs have been introduced. The new tariff structure will be streamlined into seven tariff bands, ranging form 0 to 50 percent, with the average unweighted tariff lowered from 23 ½ percent (including the 9 percent customs fee, which will be eliminated in the new structure) to 12 ½ percent. The present system has no restrictions on current account transactions, except for reasons of health and security, and there are no quotas.

22. **The external current account deficit (excluding official transfers) is projected to rise to €126 million (17.8 percent of GDP) in 2003, owing to more moderate growth in private transfers.** Net official flows are projected at €66 million, including €17 million in budget support from the World Bank, the AfDB, the EU, and the Netherlands.[10] Net private capital and financial flows would fall relative to 2002, owing to a cautious outlook for flows associated with the creation of emigrant deposits, and a more moderate use of external credit lines by Electra and other international companies. Against this background, the overall balance of payments is projected to register a surplus of €3 million.

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[10] Of the €17 million in budget support, €12 million was originally programmed to be disbursed in 2002. The remainder represents new commitments from the AfDB and the Netherlands.

23. **The authorities remain committed to a policy of prudent external debt management.** The government reaffirmed that it will contract or guarantee external loans only on concessional terms. Cape Verde remains current on its external debt-service obligations and has rescheduled arrears with all but two external creditors: the ICO (Instituto Crédito Oficial) and Russia. The government estimates that arrears to the former amount to US$7.5 million and is negotiating rescheduling terms. The magnitude and terms of the debt to Russia are being clarified through bilateral discussions, and the authorities are continuing to pay about US$90,000 a year on the debt.

D. Other Structural Reforms

24. **The discussions on structural reforms centered on stemming the financial losses of Electra and the TACV and improving their operating efficiency.** Recognizing that Electra's financial losses are due, in part, to an inflexible and ad hoc tariff rate structure, the government will establish and staff a new multisector regulatory agency by September 2003. This would be a structural benchmark under the program.[11] The responsibilities of the new agency will include the implementation of the automatic petroleum-pricing mechanism and a similar mechanism for electricity and water tariffs. The TACV's costs are being reduced by dropping nonprofitable routes, replacing high-cost aircraft with more energy-efficient lease aircraft, and reducing the number of staff. The government will reestablish the momentum of its privatization program, which has waned recently, focusing its efforts on privatizing the fish-freezing company (INTERBASE) and the ship repair facility (CABNAVE/CABMAR).

25. **The World Bank approved on May 13, 2003 the comprehensive Competitiveness and Growth Project in the amount of SDR 11.5 million, covering the period June 2003—February 2008.** The project will support the government's efforts to foster private sector development through market-based mechanisms. It focuses on modernizing and restructuring the financial sector, removing administrative barriers to business activity, developing efficient supply chains, modernizing the legal environment for business, and building capacity among private businesses, especially small and medium-sized enterprises. Other World Bank lending is summarized in Appendix II.

E. Poverty and Social Impact Analysis

26. **The discussions on the social impact of reforms focused on the implications of the financial difficulties of Electra and the TACV and the recent increase in utility**

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[11] This is a cross-cutting measure that will help establish a flexible regulatory framework for all utilities, the TACV and other transport services. While the financial losses of the TACV in 2002 were larger than those of Electra, the discussions on structural conditionality focused on the latter because it is the only enterprise seeking direct budgetary support and because the government has already begun to address effectively the financial losses of the TACV.

rates. The poverty and social impact of higher electricity and water tariffs on the poor is a major concern for the authorities, especially as these tariffs are expected to rise again when the VAT is implemented. Little concrete data are yet available to make an accurate assessment of the social impact, but the recent household income and expenditure survey should shed some light on the issue; meanwhile, the staffs of the Fund and World Bank agreed that this aspect should be the top priority for the Bank's poverty and social impact analysis. The reforms being undertaken by the TACV to reduce costs are not likely to have a significant social impact. However, given the current fare structure, the company will continue to lose money on its interisland service, which is the principal means of interisland transport for Cape Verdeans, many of whom work on islands away from their homes. The question of how to ensure an equitable and affordable interisland transport service in the context of a profitable national (and eventually privatized) airline is being addressed in the context of the comprehensive transport strategy that is being developed with financial and technical assistance from the World Bank. The government will maintain the cross subsidy on small containers of butane (used for cooking) to mitigate the adverse social impact of the automatic petroleum-pricing mechanism. In addition, budgetary resources amounting to 0.1 percent of GDP have been set aside to provide financial support through the public employment program (FAIMO) to farmers who are adversely affected by poor harvests.

F. Statistical Issues

27. **The authorities have nearly completed the steps necessary to bring Cape Verde's statistical system in compliance with the General Data Dissemination System (GDDS) framework**. They have adopted the GDDS as the country's statistical framework, appointed a country coordinator, and prepared the metadata; the remaining action is the preparation of demographic data. Both the BCV and the National Institute of Statistics (INE) publish a wide variety of economic, financial, and social statistics on the worldwide web. The INE has completed the fieldwork for the household income and expenditure survey and is currently drafting the poverty analysis, which will be a key input into the PRSP. It is also now publishing a quarterly business confidence index. Nonetheless, the statistical system still suffers from weaknesses, including the lack of published national accounts after 1997, which limits the robustness of the analysis of linkages between economic growth and poverty. In addition, because of poor coordination between INE and the line ministries, large quantities of social and economic data collected by the latter remain underutilized. The INE has indicated that it will soon publish the national accounts through 2000 and begin preparing quarterly accounts for quick dissemination, and the authorities have stated in their PRSP preparation status report that coordination between line ministries and the INE will be improved as part of the PRSP monitoring process.

G. Program Monitoring

28. **Proposed quantitative performance criteria for end-June and end-December 2003, indicative targets for end-September 2003, and structural performance criteria and benchmarks for end-June, end-September, and end-October are specified in Tables**

2 and 4 of the MEFP (Appendix V, Attachment I). The definitions of the quantitative performance criteria and indicative targets, as well as the reporting requirements, are contained in the amended technical memorandum of understanding (TMU), attached to the MEFP (Appendix V, Attachment II). The TMU has been modified to reflect the introduction of the automatic petroleum-pricing mechanism, which has obviated the need for reporting on petroleum imports and sales. Thus, paragraph 20 of the earlier TMU (EBS/02/54; 3/22/02) has been dropped. The relevant sections of the TMU have also been amended to reflect the new adjusters for deviations of external debt service, nonproject donor support, and cash payments of domestic arrears from the program assumptions.

V. Staff Appraisal

29. **The staff commends the authorities for their continued commitment to restore macroeconomic stability and implement structural reforms to establish the foundation for high rates of economic growth and poverty reduction**. All quantitative and structural performance criteria established under the program for the completion of the second review were met. Economic growth is reviving, inflation remains low, and international reserves have increased. This favorable performance is due in large measure to sound macroeconomic policies and progress in structural reforms.

30. **The medium-term economic strategy is appropriate**. Embedding the poverty reduction strategy in a macroeconomic framework founded on continued fiscal restraint will allow the government to realize its dual objectives of reducing poverty and maintaining macroeconomic stability. Fiscal consolidation will be necessary to ease pressure on the external current account and domestic credit markets, thereby creating the conditions for an increase in international reserves and a reduction in domestic interest rates. Structural reforms to enhance export competitiveness and improve the prospects for larger private international capital flows will also be crucial to attaining these objectives.

31. **The 2003 program strikes an appropriate balance between the need, on the one hand, to increase budgetary provisions for priority antipoverty programs, the retrenchment of public-sector workers, and cash payments of domestic arrears and the need, on the other hand, to limit government recourse to domestic bank financing in order to ease pressure on domestic credit markets and the balance of payments.** The program allows for adequate credit to the government to meet its financing requirements and sufficient credit to the economy to finance private investment. Holding international reserve coverage constant for one year is a reasonable decision given the current level of international reserves and the prospects for additional accumulation in the medium term.

32. **The staff believes that the risks to the program are acceptable**. However, the stock of international reserves remains low and does not provide an adequate buffer against recurrent external shocks. Against this background, the staff underscores the importance of adhering to the fiscal targets in order to ensure that domestic demand pressures do not undermine the still fragile balance of payments position. In addition, it strongly urges the

Bank of Cape Verde not to reduce its lending rates further until there is clear evidence of an upward trend in international reserves, and to tighten monetary policy if there are signs of an unsustainable decline in reserves. The prospects for lowering interest rates further should improve in the medium term as the central government's need for domestic bank financing eases and export competitiveness improves.

33. **The staff welcomes the progress made in preparing the full PRSP and looks forward to its completion by the end of this year.** The full PRSP will increase the coherency of the government's evolving poverty reduction strategy and help ensure that additional fiscal outlays for key antipoverty programs are consistent with macroeconomic stability. In addition, the full PRSP will provide the necessary framework for requesting the additional budget support that will be needed in the medium term.

34. **The implementation of the VAT and the new customs tariffs has been subject to repeated delays.** Now that all necessary legislation has been passed by the National Assembly, the staff urges the authorities to make every effort to implement the VAT and new customs tariffs by January 1, 2004. These measures are needed to ensure a buoyant fiscal revenue base and enhance export competitiveness, both of which are indispensable to increasing antipoverty expenditures in the context of continued macroeconomic stability. Lowering the number of tax exemptions over the medium term will also be necessary to support the rising antipoverty expenditures, reduce economic distortions, and ensure fiscal sustainability.

35. **The staff welcomes the measures to stem the losses of Electra and the TACV.** It is important that scarce budgetary resources not be diverted to cover losses in these enterprises in the future, as this could undermine both the poverty reduction strategy and macroeconomic stability. The staff also welcomes the authorities' implementation of the Competitiveness and Growth Project, in close consultation with the World Bank, which, together with utility reform, will help establish the conditions for a high rate of private-sector-led economic growth.

36. **Cape Verde's statistical system remains weak, but it is improving.** The staff urges the authorities to quickly implement the remaining measures necessary for participation in the GDDS; these actions will enhance their prospects for securing technical assistance in this area. The staff also urges the authorities to improve the timeliness of the national accounts, which will help strengthen the analysis of the linkages among economic growth and poverty reduction, and the soundness of macroeconomic policies. These weaknesses notwithstanding, the data continue to be adequate to monitor the PRGF-supported program.

37. **Based on the authorities' performance under the first-year program and the strength of their second-year program, the staff recommends completion of the second review under the PRGF arrangement.**

Box 1. Structural Conditionality

Status of structural measures under the program for 2002

Structural measures under the 2002 program aimed at deepening fiscal stabilization, strengthening monetary policy, and improving the efficiency of the tax and tariff structure. **Structural performance criteria** as set out at the beginning of the PRGF (EBS/02/54; 3/22/02) included (i) the implementation of a new central bank law by end-June 2002 and (ii) the approval and implementation of an automatic and transparent pricing mechanism for retail petroleum products by end-June 2002. The central bank law was enacted as scheduled, but the implementation of the automatic oil pricing mechanism was delayed until January 2003, due to technical difficulties. A waiver for the nonobservance of this performance criterion was granted at the time of the first review, and the action was made a performance criterion for January 2003. **Structural performance benchmarks** comprised (i) the inclusion of the VAT and external tariff reform in the 2003 budget and (ii) the establishment of an external debt management committee. While the debt committee was set up in early 2002, preparations for the VAT and customs tariff reform implementation, originally scheduled for January 2003, suffered from technical and legal difficulties. Implementation of the VAT and the new customs tariff rates was made a structural benchmark for end-June 2003 at the time of the first review.

Coverage of structural conditionality in the program for 2003

The structural performance criteria and benchmarks for the 2003 program, as set out in Table 4 of the MEFP (Appendix V, Attachment I), focus on supporting the implementation of the VAT and customs tariff reform by January 2004 and on improving the financial condition of Electra, the power and water utility. Approval by the Council of Ministers of the VAT preregistration decree by June 2003 is a **structural performance criterion**. In addition, the authorities are committed to gaining approval of the National Accounting Plan by the Council of Ministers by September 2003, and to including the VAT and external tariff reform in the 2004 budget by October 2003. Both measures are **structural performance benchmarks**. Other benchmarks include (i) the beginning of an external audit of Electra by June 2003, so as to evaluate its financial position and assess the need for a temporary subsidy to the utility, and (ii) the approval by the Council of Ministers of the decree establishing the multisector regulatory agency by September 2003.

Structural areas covered by World Bank lending and conditionality

While the World Bank and Fund continue to cooperate closely with regard to Cape Verde's structural reform program, there is no overlap of conditionality with the PRGF arrangement in 2003, as the World Bank's Structural Adjustment Credit (SAC) has been fully disbursed. Project-related conditionality includes the execution of a memorandum of understanding between the Cape Verde Chamber of Commerce and the government as a prerequisite for the World Bank's Competitiveness and Growth Project to become effective. Conditionality with regard to the utilities and transportation sector is governed by established benchmarks in project execution. The World Bank is preparing to provide financial budgetary assistance in the form of a Poverty Reduction Support Credit (PRSC) in 2004 and 2005.

Other relevant structural conditions not included in the current program

Following the implementation of the new VAT and customs tariff regime, structural conditions might guide the authorities' efforts at streamlining the numerous tax and tariff exemptions. Future programs could also cover the government's privatization program and, in the medium term, the reform of Cape Verde's pension system.

VI. Proposed Decision

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

1. Cape Verde has consulted with the Fund in accordance with paragraph 2(e) of the three-year arrangement for Cape Verde under the Poverty Reduction and Growth Facility (PRGF) (EBS/02/54; 4/5/02) and paragraph 41 of the letter dated March 11, 2002 from the Minister of Finance and Economic Planning of Cape Verde in order to review program implementation.

2. The letter dated June 9, 2003 from the Minister of Finance and Economic Planning of Cape Verde (the "letter"), and its attached memorandum on economic and financial policies (the "memorandum") and technical memorandum of understanding (the "technical memorandum"), shall be attached to the PRGF arrangement for Cape Verde, and the letter dated March 11, 2002, as amended, from the Minister of Finance and Economic Planning of Cape Verde, and its attachments, shall be read as supplemented and modified by the letter.

3. Accordingly, the PRGF arrangement for Cape Verde shall be amended as follows:

   (a) the following shall be added as a new paragraph 1(cc):

      "(cc) During the second year of this arrangement:

(i) the fourth disbursement, in an amount equivalent to SDR 1.23 million, will be available on December 16, 2003 at the request of Cape Verde and subject to paragraph 2 below; and

(ii) the fifth disbursement, in an amount equivalent to SDR 1.23 million, will be available on June 16, 2004 at the request of Cape Verde and subject to paragraph 2 below."

(b) the following shall be added as a new paragraph 1(dd):

"(dd) The phasing of, and conditions for, disbursements during the third year of this arrangement shall be determined in the context of the fourth review of Cape Verde's program with the Trustee contemplated in paragraph 2(eee) below."

(c) paragraphs 2(a)(v) and 2(a)(vi) shall be deleted in their entirety;

(d) the following shall be added as new paragraphs 2(aaa), 2(bbb) and 2(cc) and 2(ccc):

"(aaa) Cape Verde will not request the fourth and fifth disbursements referred to in paragraphs 1(cc)(i) and 1(cc)(ii), respectively, if the Managing Director of the Trustee finds that, with respect to the fourth disbursement, the data as of

June 30, 2003, and with respect to the fifth disbursement, the data as of December 31, 2003, indicate that any of the ceilings and floors referred to in paragraphs 2(a)(i) to 2(a)(iv) of this arrangement as referred to in paragraph 26 of the memorandum and specified in Table 2 of the letter and Sections I.B, I.C, I.E, and I.F of the technical memorandum, were not observed; or"

"(bbb) Cape Verde will not request the fourth disbursement referred to in paragraph 1(cc)(ii) above if the Managing Director of the Trustee finds that Cape Verde has not carried out, by June 30, 2003, its intentions with respect to the structural performance criterion on the approval by the Council of Ministers of the VAT preregistration decree referred to in paragraph 14 of the memorandum and specified in Table 4 of the letter; or"

"(cc) if, at any time during this arrangement, the central government contracts or guarantees any nonconcessional external debt with a maturity of more than one year as specified in Table 2 of the letter and Section I.D of the technical memorandum;

"(ccc) if, at any time during this arrangement, the central government does not observe the ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one year owed or guaranteed by it as specified in Table 2 of the letter and Section I.D of the technical memorandum;.

(e) the following shall be added as new paragraph 2(eee):

"(eee) Cape Verde will not request the fourth disbursement specified in paragraph 1(cc)(i) above until the Trustee has determined that the third review of Cape Verde's program referred to in paragraph 5 of the letter is completed by December 15, 2003. Cape Verde will not request the fifth disbursement specified in paragraph 1(cc)(ii) above until the Trustee has determined that the fourth review of Cape Verde's program referred to in paragraph 5 of the letter is completed by June 15, 2004."

4. The Fund has reviewed the PRSP preparation status report submitted by Cape Verde (EBD/03/52) and concludes that it provides a sound basis for the development of a fully participatory PRSP and for Fund concessional assistance.

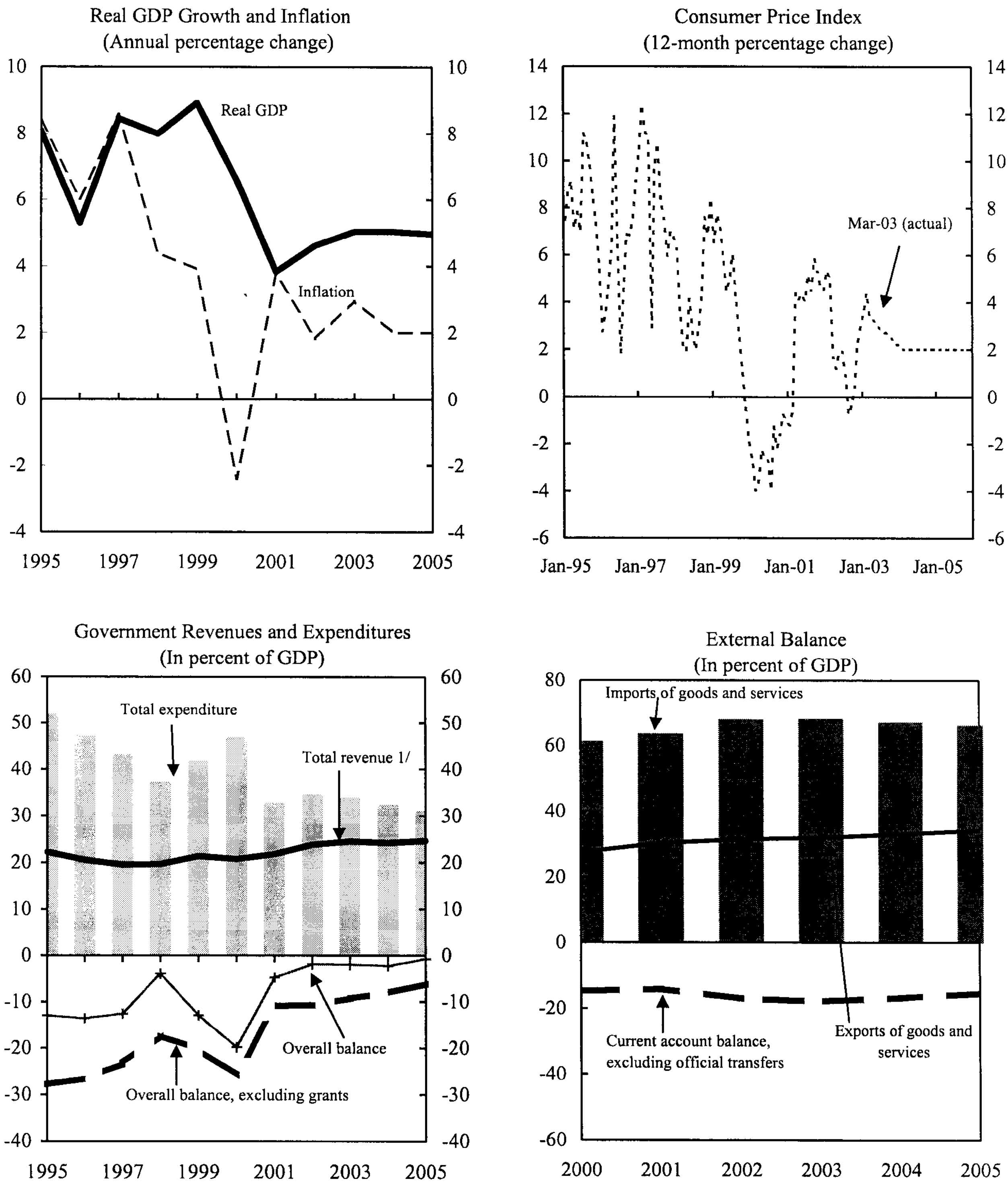
5. The Fund decides that:

A. The review contemplated in paragraph 2(e) of the PRGF arrangement for Cape Verde is completed in principle;

B. The completion of the review shall become effective on the date on which the Fund decides that the World Bank has concluded that the PRSP preparation status report provides a sound basis for the development of a fully participatory PRSP and for Bank concessional assistance; and

C. When the review is completed, Cape Verde may request the disbursement of the third loan in an amount equivalent to SDR 1.23 million.

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

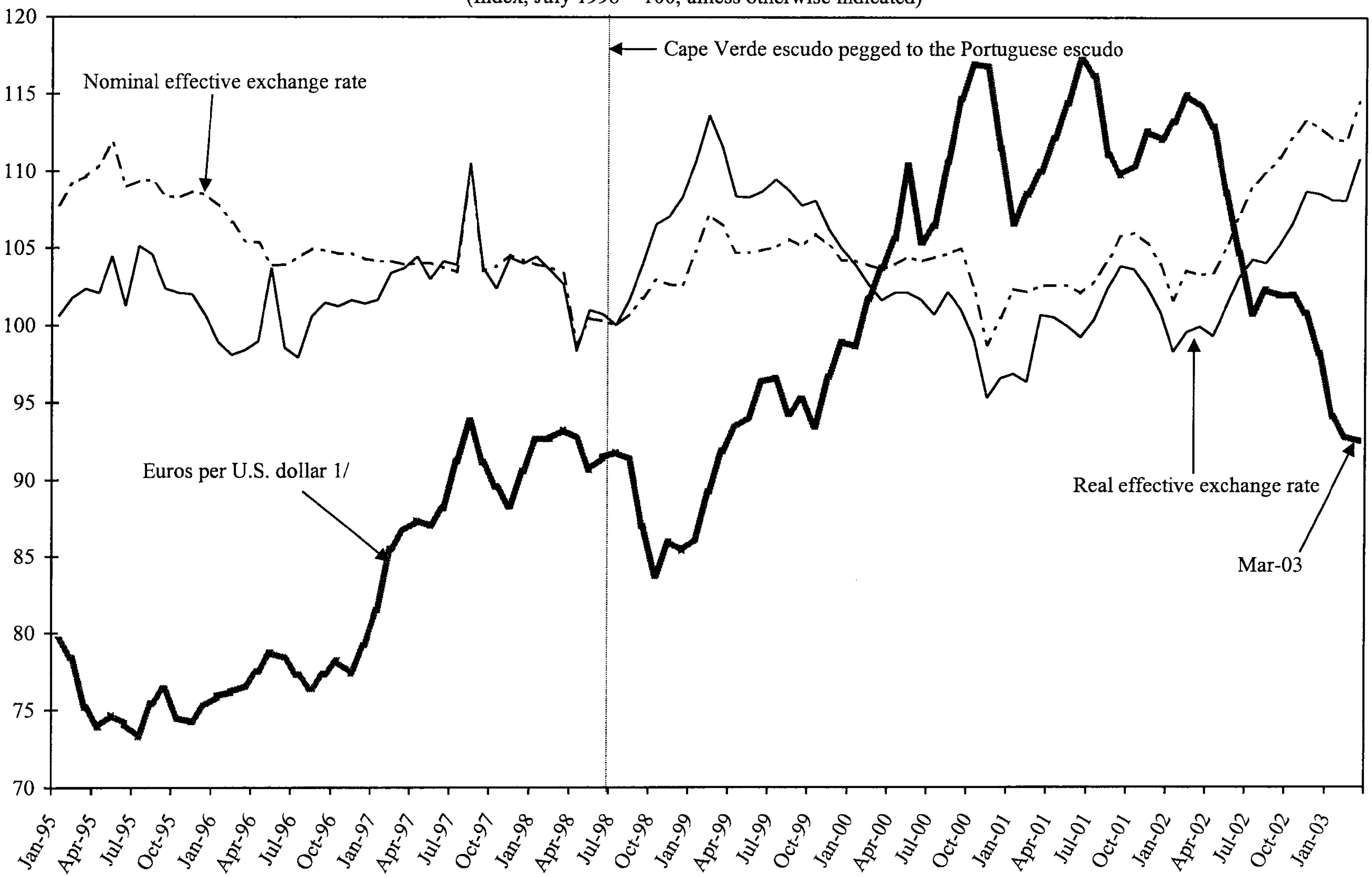


Sources: Cape Verdean authorities; and Fund staff estimates and projections.

1/ Includes domestic capital participation and net lending.

Figure 2. Cape Verde: Real and Nominal Effective Exchange Rates, January 1995–March 2003

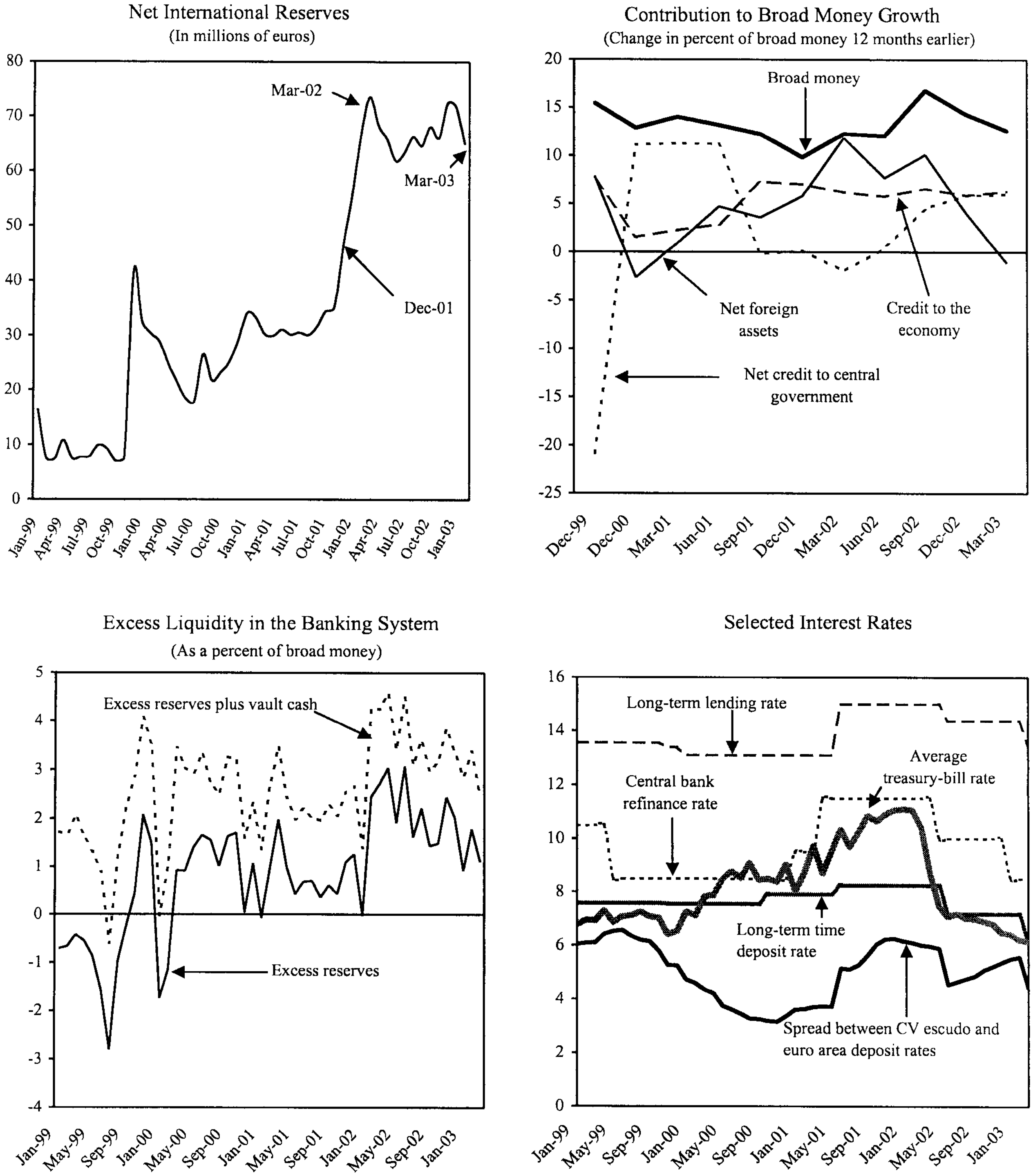
(Index, July 1998 = 100, unless otherwise indicated)



Source: International Monetary Fund, Information Notice System (INS).

1/ Based on INS data series.

Figure 3. Cape Verde: Monetary Indicators, January 1999–March 2003
(In percent, unless otherwise indicated)



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

Table 1. Cape Verde: Selected Economic and Financial Indicators, 2000–05

	2000	2001	2002 Program 1/	2002 Actual	2003 Projection 1/	2003 Revised Projections	2004 Revised Projections	2005 Revised Projections
	(Annual percentage change)							
National income and prices								
Real GDP	6.6	3.8	4.6	4.6	5.0	5.0	5.0	5.0
Real GDP (per capita)	4.7	2.0	2.3	2.8	2.7	3.1	3.1	3.0
Consumer price index (annual average)	-2.4	3.8	1.7	1.8	2.3	3.0	2.0	2.0
Consumer price index (end of period)	-1.0	4.6	2.0	3.0	2.3	2.2	2.0	2.0
External sector								
Exports (in euros) 2/	...	17.5	4.6	10.5	6.5	9.7	11.5	11.7
Imports (in euros) 2/	...	10.6	5.6	13.7	4.5	8.2	6.5	6.2
Real effective exchange rate (annual average)	-7.4	-0.2	-0.1	2.6	...	...	...	...
Terms of trade (minus = deterioration)	-2.8	1.0	0.0	-1.6	-0.1	-0.4	1.2	1.0
Government budget								
Total revenue (excluding grants)	3.5	12.1	12.3	16.0	7.6	11.1	6.7	9.8
Total expenditure	19.5	-25.4	5.6	12.1	6.4	5.7	3.2	3.0
Recurrent and extraordinary expenditure	48.4	-31.2	0.5	2.9	8.9	8.2	7.0	5.7
Capital expenditure	-8.3	-9.6	-2.7	27.8	11.3	-4.8	2.4	0.3
	(Annual change in percent of beginning-of-period broad money, unless otherwise indicated)							
Money and credit 3/								
Net domestic assets	15.5	4.0	10.5	10.5	6.3	6.9	5.4	5.0
Of which: net claims on the central government	11.1	0.1	6.0	5.9	0.0	0.9	-0.8	-1.4
credit to the economy	1.6	7.1	6.4	5.9	6.3	6.0	6.2	6.4
Broad money	12.9	9.8	13.2	14.3	7.6	7.8	8.2	7.8
Income velocity (GDP/M2)	1.62	1.55	1.46	1.47	1.46	1.43	1.43	1.43
Discount rate 4/	9.5	11.5	10.0	10.0	...	...	...	...
	(In percent of GDP)							
Saving-investment balance								
Gross domestic investment	20.6	19.0	19.8	21.6	21.2	21.7	21.6	21.4
Public	6.4	5.4	4.4	6.5	4.6	5.7	5.4	5.0
Private	14.2	13.6	15.4	15.2	16.6	16.0	16.2	16.3
Gross national savings	10.0	8.6	9.3	10.4	10.4	11.2	10.5	11.3
Of which: public sector	-7.0	5.6	6.6	10.8	5.2	8.8	8.1	8.9
External current account (including official transfers)	-10.6	-10.3	-10.6	-11.2	-10.7	-10.6	-11.0	-10.1
Government budget								
Total revenue	20.8	21.9	23.6	23.8	23.6	24.5	24.2	24.7
Total grants	6.1	6.1	6.0	8.7	4.4	7.3	5.8	5.4
Total expenditure	46.7	32.7	31.6	34.5	31.3	33.8	32.2	30.8
Overall balance (including grants)	-19.8	-4.8	-2.0	-1.9	-3.3	-2.0	-2.2	-0.8
Domestic bank financing	8.2	0.1	3.9	3.7	0.0	0.6	-0.6	-0.9
Total public debt 5/	93.4	94.8	92.3	84.3	88.8	80.0	76.2	68.9
External public debt 6/	61.4	64.9	63.9	52.9	62.3	51.0	50.3	45.8
Domestic public debt 7/	32.0	30.0	28.4	31.4	26.5	29.0	25.9	23.1
External current account (excluding official transfers)	-14.7	-14.2	-14.7	-17.0	-13.8	-17.8	-16.8	-15.4
Overall balance of payments	-7.2	2.8	0.7	3.7	-3.3	0.4	-1.1	0.1
	(In millions of U.S. dollars, unless otherwise specified)							
External current account (including official transfers)	-58.2	-56.9	-68.2	-69.2	-74.4	-75.7	-85.4	-84.0
Gross international reserves (end of period)	28.2	41.9	58.0	77.1	67.6	83.4	99.7	115.1
Gross international reserves (in months of imports of goods and services)	1.0	1.5	1.7	2.1	1.9	2.1	2.3	2.5
External debt service (in percent of exports of goods and nonfactor services)	10.8	29.2	17.0	15.5	13.7	12.6	11.8	11.0
Memorandum items:	(In units specified)							
Nominal GDP (in billions of Cape Verde escudos)	63.6	67.8	71.1	72.2	76.2	77.9	84.2	90.8
Exchange rate (Cape Verde escudos per U.S. dollar)								
Period average	115.9	123.2	...	117.3	...	...	...	...
End period	118.8	125.0	...	108.8	...	...	...	...

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

1/ As contained in the December 9, 2002 staff report (EBS/02/211).

2/ Exports and imports of goods and nonfactor services.

3/ Reflects revised presentation consistent with the Bank of Cape Verde.

4/ Central bank lending rate; in percent.

5/ Including verified stock of domestic and external arrears.

6/ Projection numbers include financing gap.

7/ Excluding the claims on the offshore Trust Fund. Program and 2003 projection numbers exclude domestic arrears.

Table 2. Cape Verde: Annual Fiscal Operations of the Central Government, 2000-05

	2000	2001	2002		2003	2003	2004	2005
			Program 1/	Actual	Projection 1/	Revised Projections		
	(In billions of Cape Verde escudos, unless otherwise indicated)							
Revenue, grants, and net lending	17.14	18.94	21.02	23.52	21.36	24.77	25.27	27.26
Domestic revenue	13.24	14.83	16.76	17.21	18.02	19.12	20.39	22.38
Tax revenue 2/	11.76	12.99	14.70	15.14	15.53	16.50	17.56	19.31
Nontax revenue	1.48	1.54	1.52	1.85	1.62	1.75	2.03	2.34
Domestic capital participation	0.00	0.01	0.32	0.00	0.35	0.35	0.37	0.40
Net lending	0.00	0.29	0.22	0.22	0.53	0.53	0.43	0.33
External grants	3.90	4.11	4.26	6.32	3.34	5.65	4.88	4.88
Capital grants	3.90	4.11	2.40	5.16	3.34	4.88	4.88	4.88
Budget support	0.00	0.00	1.86	1.16	0.00	0.77	0.00	0.00
Total expenditure	29.73	22.19	22.43	24.88	23.87	26.30	27.16	27.97
Recurrent expenditure	17.17	14.86	14.84	15.29	16.17	16.55	17.71	18.72
Primary current expenditure	15.78	13.36	12.67	13.31	14.04	14.42	15.45	16.53
Wages and salaries	6.41	6.58	6.52	7.09	7.47	7.66	8.25	8.88
Goods and services	0.47	0.57	0.67	0.60	0.78	0.60	0.64	0.69
Transfers and subsidies	6.84	5.72	4.93	4.89	4.71	5.42	5.78	6.14
Other expenditures	2.06	0.50	0.55	0.73	1.09	0.74	0.78	0.82
Domestic interest payments	0.82	0.94	1.27	1.44	1.51	1.51	1.66	1.62
External interest payments	0.56	0.57	0.90	0.55	0.62	0.62	0.59	0.58
Extraordinary expenditures	4.46	0.00	1.30	0.22	0.70	0.85	0.33	0.10
Social emergency measures	0.03	0.00	0.20	0.00	0.10	0.10	0.10	0.10
Restructuring costs	4.43	0.00	1.10	0.22	0.60	0.75	0.23	0.00
Capital expenditure	8.10	7.32	6.29	9.36	7.00	8.91	9.12	9.15
Foreign financed	6.78	6.19	4.99	8.64	5.50	7.32	7.32	7.32
Domestically financed	1.32	1.13	1.30	0.72	1.50	1.59	1.80	1.83
Overall balance, including grants 3/	-12.58	-3.24	-1.41	-1.36	-2.51	-1.54	-1.88	-0.71
Financing	12.67	2.99	2.15	1.40	-0.50	1.54	-0.47	-0.67
Foreign (net)	3.23	2.11	1.92	1.19	0.20	1.59	0.30	0.17
Total drawings	2.43	7.56	4.68	4.17	2.71	4.10	2.99	2.99
Balance of payments, budget	0.00	5.09	2.10	1.37	0.55	1.66	0.55	0.55
Project loans	2.43	2.46	2.58	2.81	2.16	2.44	2.44	2.44
Amortization	-1.32	-5.44	-2.76	-2.98	-2.51	-2.52	-2.69	-2.82
Bridge loans and Portuguese credit facility	0.00	-2.28	-0.55	-0.55	-0.73	-0.55	-0.55	-0.55
Other	-1.32	-3.16	-2.21	-2.43	-1.78	-1.97	-2.14	-2.27
Of which: clearance of previously rescheduled arrears	0.00	-1.86	...	-0.81	...	-0.38	0.00	0.00
Change in arrears 4/	2.13	-1.86	-1.62	-0.97	-0.81	-0.80	0.00	0.00
Rescheduling/cancellation of arrears 4/	0.00	1.86	1.62	0.97	0.81	0.80	0.00	0.00
Domestic (net)	9.43	0.88	0.23	0.21	-0.70	-0.05	-0.78	-0.84
Banking system	5.22	0.05	2.76	2.69	0.00	0.48	-0.48	-0.84
Nonbanks	2.09	1.34	0.02	1.46	0.00	0.39	0.00	0.00
Domestic arrears 2/	2.13	-0.51	-2.55	-3.94	-0.70	-0.91	-0.30	0.00
Net errors and omissions	-0.08	0.25	-1.10	-0.04	0.00	0.00	0.00	0.00
Financing gap	0.00	0.00	0.37	0.00	3.01	0.00	2.36	1.38
Identified possible financing	...	...	...	...	...	...	1.69	0.82
Netherlands	...	...	...	...	...	...	0.33	0.00
European Union	...	...	...	...	...	...	0.55	0.00
World Bank	...	...	...	...	...	...	0.82	0.82
Residual financing gap	...	...	...	...	...	...	0.67	0.56
Memorandum items:								
Overall balance, excluding grants 5/	-16.49	-7.35	-5.68	-7.67	-5.85	-7.19	-6.77	-5.59
Primary current balance 6/	-2.55	1.48	4.08	3.89	3.98	4.69	4.94	5.86
Primary balance 7/	-15.10	-5.85	-3.51	-5.69	-3.72	-5.06	-4.51	-3.40
Domestic balance 8/	-9.15	-0.59	0.21	1.51	0.28	0.76	1.15	2.31
Excluding extraordinary expenditures	-4.69	-0.59	1.51	1.73	0.98	1.60	1.48	2.41
Net external flows 9/	7.14	6.22	6.55	7.51	6.55	7.24	7.54	6.43
Social expenditures	...	7.44	...	7.41	...	...	...	...
Education (current expenditure)	...	3.52	...	3.61	...	...	...	...
Education (capital expenditure)	...	2.24	...	1.97	...	...	...	...
Health (current expenditure)	...	1.32	...	1.30	...	...	...	...
Health (capital expenditure)	...	0.35	...	0.53	...	...	...	...
Social expenditures (as percent of total expenditure)	...	33.5	...	29.8	...	...	...	...

Table 2. Cape Verde: Annual Fiscal Operations of the Central Government, 2000-05 (concluded)

	2000	2001	2002		2003	2003	2004	2005
			Program 1/	Actual	Projection 1/	Revised Projections		
	(In percent of GDP; unless otherwise indicated)							
Revenue, grants, and net lending	26.9	27.9	29.6	32.6	28.0	31.8	30.0	30.0
Domestic revenue	20.8	21.9	23.6	23.8	23.6	24.5	24.2	24.7
Tax revenue 2/	18.5	19.1	20.7	21.0	20.4	21.2	20.8	21.3
Nontax revenue	2.3	2.3	2.1	2.6	2.1	2.2	2.4	2.6
Domestic capital participation	0.0	0.0	0.5	0.0	0.5	0.4	0.4	0.4
Net lending	0.0	0.4	0.3	0.3	0.7	0.7	0.5	0.4
External grants	6.1	6.1	6.0	8.7	4.4	7.3	5.8	5.4
Capital grants	6.1	6.1	3.4	7.1	4.4	6.3	5.8	5.4
Budget support	0.0	0.0	2.6	1.6	0.0	1.0	0.0	0.0
Total expenditure	46.7	32.7	31.6	34.5	31.3	33.8	32.2	30.8
Recurrent expenditure	27.0	21.9	20.9	21.2	21.2	21.3	21.0	20.6
Primary current expenditure	24.8	19.7	17.8	18.4	18.4	18.5	18.3	18.2
Wages and salaries	10.1	9.7	9.2	9.8	9.8	9.8	9.8	9.8
Goods and services	0.7	0.8	0.9	0.8	1.0	0.8	0.8	0.8
Transfers and subsidies	10.7	8.4	6.9	6.8	6.2	7.0	6.9	6.8
Other expenditures	3.2	0.7	0.8	1.0	1.4	0.9	0.9	0.9
Domestic interest payments	1.3	1.4	1.8	2.0	2.0	1.9	2.0	1.8
External interest payments	0.9	0.8	1.3	0.8	0.8	0.8	0.7	0.6
Extraordinary expenditures	7.0	0.0	1.8	0.3	0.9	1.1	0.4	0.1
Social emergency measures	0.0	0.0	0.3	0.0	0.1	0.1	0.1	0.1
Restructuring costs	7.0	0.0	1.5	0.3	0.8	1.0	0.3	0.0
Capital expenditure	12.7	10.8	8.9	13.0	9.2	11.4	10.8	10.1
Foreign financed	10.6	9.1	7.0	12.0	7.2	9.4	8.7	8.1
Domestically financed	2.1	1.7	1.8	1.0	2.0	2.0	2.1	2.0
Overall balance, including grants 3/	-19.8	-4.8	-2.0	-1.9	-3.3	-2.0	-2.2	-0.8
Financing	19.9	4.4	3.0	1.9	-0.7	2.0	-0.6	-0.7
Foreign (net)	5.1	3.1	2.7	1.7	0.3	2.0	0.4	0.2
Total drawings	3.8	11.1	6.6	5.8	3.6	5.3	3.6	3.3
Balance of payments, budget	0.0	7.5	2.9	1.9	0.7	2.1	0.7	0.6
Project loans	3.8	3.6	3.6	3.9	2.8	3.1	2.9	2.7
Amortization	-2.1	-8.0	-3.9	-4.1	-3.3	-3.2	-3.2	-3.1
Bridge loans and Portuguese credit facility	0.0	-3.4	-0.8	-0.8	-1.0	-0.7	-0.7	-0.6
Other	-2.1	-4.7	-3.1	-3.4	-2.3	-2.5	-2.5	-2.5
Of which: clearance of previously rescheduled arrears	0.0	-2.7	...	-1.1	...	-0.5	0.0	0.0
Change in arrears 4/	3.3	-2.7	-2.3	-1.3	-1.1	-1.0	0.0	0.0
Rescheduling/cancellation of arrears 4/	0.0	2.7	2.3	1.3	1.1	1.0	0.0	0.0
Domestic (net)	14.8	1.3	0.3	0.3	-0.9	-0.1	-0.9	-0.9
Banking system	8.2	0.1	3.9	3.7	0.0	0.6	-0.6	-0.9
Nonbanks	3.3	2.0	0.0	2.0	0.0	0.5	0.0	0.0
Domestic arrears 2/	3.3	-0.8	-3.6	-5.5	-0.9	-1.2	-0.4	0.0
Net errors and omissions	-0.1	0.4	-1.6	-0.1	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.5	0.0	3.9	0.0	2.8	1.5
Identified possible financing	...	...	...	...	...	...	2.0	0.9
Netherlands	...	...	...	...	...	...	0.4	0.0
European Union	...	...	...	...	...	...	0.7	0.0
African Development Bank	...	...	...	...	...	...	0.0	0.0
World Bank	...	...	...	...	...	...	1.0	0.9
Residual financing gap	...	...	...	...	...	...	0.8	0.6
Memorandum items:								
Overall balance, excluding grants 5/	-25.9	-10.8	-8.0	-10.6	-7.7	-9.2	-8.0	-6.2
Primary current balance 6/	-4.0	2.2	5.7	5.4	5.2	6.0	5.9	6.5
Primary balance 7/	-23.7	-8.6	-4.9	-7.9	-4.9	-6.5	-5.4	-3.7
Domestic balance 8/	-14.4	-0.9	0.3	2.1	0.4	1.0	1.4	2.5
Excluding extraordinary expenditures	-7.4	-0.9	2.1	2.4	1.3	2.1	1.8	2.7
Net external flows 9/	11.2	9.2	9.2	10.4	8.6	9.3	9.0	7.1
Social expenditures	...	11.0	...	10.3	...	...	...	...
Education (current expenditure)	...	5.2	...	5.0	...	...	...	...
Education (capital expenditure)	...	3.3	...	2.7	...	...	...	...
Health (current expenditure)	...	1.9	...	1.8	...	...	...	...
Health (capital expenditure)	...	0.5	...	0.7	...	...	...	...

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

1/ As contained in the December 9, 2002 staff report (EBS/02/211).
2/ 2003 includes exceptional revenues of CVEsc 474 million from old tax debt that will be used to clear arrears of the same amount with a domestic oil company.
3/ "Overall balance, including grants" = revenue including grants - total expenditure.
4/ External arrears flows in 2002 differ slightly from change in arrears stocks (Table 5) because of exchange rate valuation effects.
5/ "Overall balance, excluding grants" = revenue excluding grants - total expenditure.
6/ "Primary current balance" = domestic revenue - primary current expenditure.
7/ "Primary balance" = domestic revenue - total expenditure + domestic and external interest payments.
8/ "Domestic balance" = domestic revenue - recurrent expenditure + external interest payments - extraordinary expenditures - domestically financed capital expenditure.
9/ Excluding external interest payments, and including financing gap.

Table 3. Cape Verde: Monetary Survey, 2000–05

	2000	2001	2002					2003			2003	2004	2005
			Mar.	Jun.	Sep.	Dec.		Mar.	Jun.	Sep.	Dec.	Dec.	Dec.
						Prog.	Actual	Actual	Proj.	Proj.	Revised Projections		
	(In millions of Cape Verde escudos, unless otherwise specified)												
Net foreign assets	7,139	9,557	12,077	10,784	11,706	10,761	11,331	11,563	11,425	11,881	11,820	13,402	15,081
Foreign assets	9,244	11,489	14,066	13,366	14,004	13,059	13,841	14,088	13,987	14,599	14,694	16,645	18,508
Of which: foreign reserves	3,349	5,238	8,185	7,070	7,375	6,385	8,391	8,440	8,440	9,090	9,079	10,844	12,518
Foreign liabilities	-2,104	-1,932	-1,989	-2,581	-2,298	-2,298	-2,511	-2,525	-2,562	-2,718	-2,874	-3,243	-3,427
Net domestic assets	34,561	36,239	35,734	37,627	38,942	41,065	41,027	42,288	42,473	43,578	44,641	47,676	50,737
Net domestic credit	41,184	44,093	44,179	45,930	47,937	49,947	49,914	50,240	50,752	52,168	53,528	56,564	59,625
Net claims on general government	21,702	21,665	21,336	22,596	23,588	24,584	24,789	24,402	24,614	24,967	25,268	24,790	23,948
Claims on the Trust Fund (TCMFs)	10,600	10,600	10,600	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	11,625	11,676	11,319	12,401	13,436	14,432	14,362	14,190	14,323	14,608	14,841	14,363	13,521
Credit to central government	13,082	13,356	14,543	14,868	16,257	16,367	16,546	17,071	16,972	17,025	17,025	16,547	15,706
Deposits of central government	-1,457	-1,680	-3,223	-2,466	-2,821	-1,935	-2,185	-2,882	-2,649	-2,417	-2,185	-2,185	-2,185
Of which: project deposits	-211	-331	-1,652	-811	-941	-350	-397	-917	-744	-570	-397	-397	-397
Net claims on local government	-57	3	-102	-10	5	5	13	6	15	14	13	13	13
Net claims on other government agencies (INPS)	-466	-614	-482	-395	-453	-453	-186	-394	-324	-255	-186	-186	-186
Credit to the economy	19,483	22,428	22,843	23,334	24,349	25,363	25,126	25,838	26,138	27,201	28,261	31,774	35,677
Credit to public enterprises	156	215	262	252	240	223	230	218	269	261	251	274	300
Credit to private sector	19,327	22,206	22,575	23,076	24,103	25,134	24,890	25,615	25,863	26,935	28,004	31,495	35,372
Claims on nonbank financial institutions	0	7	7	6	6	6	6	5	6	6	6	6	6
Other items (net)	-6,624	-7,854	-8,445	-8,304	-8,995	-8,882	-8,887	-7,952	-8,278	-8,590	-8,887	-8,888	-8,888
Broad money (M2)	41,700	45,796	47,810	48,411	50,648	51,826	52,358	53,851	53,898	55,459	56,461	61,077	65,818
Narrow money (M1)	20,131	20,759	20,932	20,693	21,478	22,563	22,621	22,602	22,574	23,178	23,547	24,556	25,475
Currency in circulation	6,458	6,703	6,020	5,856	5,668	6,478	6,459	5,897	5,882	6,031	6,118	6,008	5,816
Demand deposits	13,673	14,056	14,911	14,838	15,810	16,084	16,162	16,706	16,692	17,147	17,429	18,548	19,658
Quasi money	19,371	22,931	24,547	25,740	26,996	27,045	27,636	28,709	28,908	29,925	30,648	34,071	37,702
Time deposits	18,081	21,802	23,074	24,142	25,312	25,844	25,857	26,989	27,188	28,154	28,730	31,995	35,466
Other quasi-monetary deposits	1,290	1,130	1,472	1,598	1,684	1,201	1,779	1,719	1,721	1,771	1,918	2,075	2,236
Foreign currency deposits	2,198	2,106	2,332	1,978	2,174	2,219	2,101	2,540	2,416	2,356	2,266	2,451	2,641
	(Change in percent of broad money 12 months earlier)												
Net foreign assets	-2.6	5.8	11.9	7.7	10.1	2.6	3.9	-1.1	1.3	0.3	0.9	2.8	2.7
Net domestic assets	15.5	4.0	0.4	4.4	6.7	10.5	10.5	13.7	10.0	9.2	6.9	5.4	5.0
Net domestic credit	22.5	7.0	3.9	6.7	11.4	12.8	12.7	12.7	10.0	8.4	6.9	5.4	5.0
Net claims on the central government	11.1	0.1	-1.9	0.4	4.6	6.0	5.9	6.0	4.0	2.3	0.9	-0.8	-1.4
Credit to the economy	1.6	7.1	6.2	5.8	6.6	6.4	5.9	6.3	5.8	5.6	6.0	6.2	6.4
Other items (net)	-7.0	-2.9	-3.5	-2.3	-4.7	-2.2	-2.3	1.0	0.1	0.8	0.0	0.0	0.0
Broad money	12.9	9.8	12.3	12.1	16.8	13.2	14.3	12.6	11.3	9.5	7.8	8.2	7.8
Narrow money	4.7	1.5	2.1	1.7	6.1	3.9	4.1	3.5	3.9	3.4	1.8	1.8	1.5
Currency outside banks	1.2	0.6	0.6	0.5	0.3	-0.5	-0.5	-0.3	0.1	0.7	-0.7	-0.2	-0.3
Demand deposits	3.5	0.9	1.5	1.2	5.7	4.4	4.6	3.8	3.8	2.6	2.4	2.0	1.8
Time and savings deposits	7.4	8.9	9.8	10.5	10.5	8.8	8.9	8.2	6.3	5.6	5.5	5.8	5.7
Foreign currency deposits	0.2	-0.2	-0.4	-1.0	-0.5	0.2	0.0	0.4	0.9	0.4	0.3	0.3	0.3
	(In units as indicated)												
Selected monetary indicators													
Emigrant deposits (in millions of Cape Verde escudos)	12,477	15,585	16,517	17,150	18,290	19,192	19,042	20,111	20,426	21,323	22,019	24,431	26,985
Excess reserves /total deposits (in percent)	1.3	1.4	4.8	3.0	2.8	1.9	1.7	4.1	3.2	2.3	1.4	1.4	1.4
Money multilplier (M2 / M0)	3.08	3.14	3.00	3.19	3.27	3.29	3.22	3.19	3.24	3.30	3.37	3.45	3.55

Table 3. Cape Verde: Monetary Survey, 2000–05 (continued)

	2000	2001	2002					2003			2003	2004	2005
			Mar.	Jun.	Sep.	Dec.		Mar.	Jun.	Sep.	Dec.	Dec.	Dec.
						Prog.	Actual	Actual	Proj.	Proj.	Revised Projections		
	(In millions of Cape Verde escudos, unless otherwise specified)												
Bank of Cape Verde													
Net foreign assets	4,053	5,945	8,881	7,525	7,812	6,822	8,632	8,675	8,635	9,126	8,956	10,353	11,842
Of which: net international reserves	3,221	5,100	8,110	6,819	7,124	6,134	7,984	8,093	8,033	8,501	8,308	9,704	11,193
Foreign assets	4,212	6,115	8,988	7,808	8,095	7,105	9,135	9,116	9,139	9,812	9,823	11,589	13,262
International reserves	3,349	5,238	8,185	7,070	7,375	6,385	8,391	8,440	8,440	9,090	9,079	10,844	12,518
Nonreserve assets	864	877	803	738	720	720	744	675	698	721	744	744	744
Foreign liabilities	-160	-170	-107	-283	-283	-283	-503	-441	-503	-685	-867	-1,236	-1,420
Short-term foreign liabilities	-128	-138	-76	-251	-251	-251	-407	-347	-407	-589	-771	-1,140	-1,324
Medium- and long-term foreign liabilities	-32	-32	-32	-32	-32	-32	-96	-94	-96	-96	-96	-96	-96
Net domestic assets	9,499	8,635	7,032	7,632	7,695	8,935	7,605	8,203	7,994	7,675	7,814	7,331	6,719
Net domestic credit	10,867	9,976	8,816	8,984	9,622	10,293	9,728	9,666	9,678	9,578	9,937	9,454	8,842
TCMFs	4,167	4,167	4,167	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	4,444	4,183	3,374	3,538	4,179	4,325	4,103	4,246	3,727	3,627	4,312	3,829	3,217
Credit to central government	5,043	4,857	5,400	4,685	5,597	4,857	5,302	5,754	5,131	4,929	5,511	5,028	4,416
Deposits of central government	-598	-675	-2,026	-1,147	-1,418	-532	-1,199	-1,508	-1,405	-1,302	-1,199	-1,199	-1,199
Of which: project accounts	-211	-331	-1,652	-811	-941	*-350*	-397	-917	-744	-570	-397	-397	-397
Of which: foreign currency deposits	-272	-256	-263	-236	-376	*-120*	-330	-473	-425	-378	-330	-330	-330
Credit to the economy	1,157	1,189	1,193	1,198	1,201	1,201	1,184	1,186	1,184	1,184	1,184	1,184	1,184
Credit to public enterprises	82	82	77	77	72	72	72	72	72	72	72	72	72
Credit to private sector	1,075	1,106	1,116	1,121	1,129	1,129	1,112	1,114	1,112	1,112	1,112	1,112	1,112
Claims on nonbank financial institutions	0	0	0	0	0	0	0	0	0	0	0	0	0
Credit to commercial banks	1,099	438	82	82	75	600	275	67	600	600	275	275	275
Other items (net)	-1,368	-1,341	-1,784	-1,353	-1,926	-1,358	-2,123	-1,464	-1,684	-1,904	-2,123	-2,123	-2,123
Assets	2,276	2,616	2,922	2,622	2,641	2,641	2,346	2,411	2,389	2,368	2,346	2,346	2,346
Liabilities	3,644	3,957	4,706	3,975	4,567	3,999	4,469	3,875	4,073	4,271	4,469	4,469	4,469
Reserve money (M0)	13,552	14,581	15,913	15,157	15,508	15,757	16,237	16,877	16,629	16,801	16,770	17,684	18,561
Currency outside banks	6,458	6,703	6,020	5,856	5,668	6,478	6,459	5,897	5,882	6,031	6,118	6,008	5,816
Cash in vaults	597	650	734	722	854	658	1,013	753	901	1,035	1,164	1,273	1,387
Deposits of commercial banks	6,496	7,227	9,158	8,579	8,985	8,621	8,764	10,213	9,832	9,720	9,486	10,401	11,356
Deposits of other financial institutions	1	1	1	1	1	1	1	15	15	15	1	1	1
	(Twelve-month percentage change)												
Reserve money	15.8	7.6	17.0	12.1	15.7	8.1	11.4	6.1	9.7	8.3	3.3	5.4	5.0
Net foreign assets	-20.7	14.0	34.9	25.0	26.6	6.0	18.4	-1.3	7.3	8.5	2.0	8.3	8.4
Net domestic assets	36.5	-6.4	-17.9	-12.9	-10.9	2.1	-7.1	7.4	2.4	-0.1	1.3	-2.9	-3.5
Net domestic credit	36.9	-6.6	-18.0	-14.9	-7.6	2.2	-1.7	5.3	4.6	-0.3	1.3	-2.9	-3.5
Claims on the government	-5.0	-1.9	-12.6	-13.4	-5.0	1.0	-0.5	5.5	1.2	-3.6	1.3	-2.9	-3.5
Credit to the economy	-0.3	0.2	0.3	0.3	0.1	0.1	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0
Credit to banks	6.6	-4.9	-5.7	-1.7	-2.7	1.1	-1.1	-0.1	3.4	3.4	0.0	0.0	0.0
Other items (net)	-0.4	0.2	0.1	2.0	-3.4	-0.1	-5.4	2.0	-2.2	0.1	0.0	0.0	0.0

Table 3. Cape Verde: Monetary Survey, 2000–05 (concluded)

	2000	2001	2002					2003			2003	2004	2005
			Mar.	Jun.	Sep.	Dec.		Mar.	Jun.	Sep.	Dec.	Dec.	Dec.
						Prog.	Actual	Actual	Proj.	Proj.	Revised Projections		
	(In millions of Cape Verde escudos, unless otherwise specified)												
Commercial banks													
Net foreign assets	3,086	3,612	3,196	3,259	3,893	3,939	2,699	2,888	2,790	2,755	2,863	3,049	3,239
Foreign assets	5,031	5,374	5,077	5,558	5,909	5,954	4,706	4,972	4,848	4,788	4,871	5,056	5,246
Foreign liabilities	-1,945	-1,762	-1,882	-2,299	-2,015	-2,015	-2,007	-2,084	-2,058	-2,033	-2,007	-2,007	-2,007
Net domestic assets	32,155	35,481	38,593	39,295	41,086	41,408	43,199	45,051	45,227	46,673	47,478	52,021	56,763
Net domestic credit	37,410	41,993	45,255	46,246	48,154	48,933	49,962	51,540	51,807	53,345	54,242	58,784	63,527
Net claims on general government	13,091	13,316	13,794	14,892	15,242	16,092	16,519	15,989	16,720	17,173	16,789	16,794	16,565
TCMFs	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433
Other government deposits (INPS)	-466	-614	-482	-395	-453	-453	-186	-394	-324	-255	-186	-186	-186
Net claims on central government	7,180	7,493	7,945	8,863	9,257	10,107	10,259	9,943	10,596	10,981	10,529	10,534	10,304
Loans and overdrafts	5,056	5,483	5,549	6,471	6,649	7,500	6,704	6,762	7,200	7,370	6,704	6,704	6,704
Holding of government securities	2,983	3,015	3,594	3,712	4,010	4,010	4,540	4,556	4,640	4,725	4,810	4,815	4,586
Deposits of central government	-859	-1,005	-1,198	-1,319	-1,403	-1,403	-985	-1,374	-1,245	-1,115	-985	-985	-985
Net claims on local government	-57	3	-102	-10	5	5	13	6	15	14	13	13	13
Claims on local government	289	261	268	265	266	265	266	256	266	266	266	266	266
Deposits of local government	-347	-258	-370	-275	-261	-260	-254	-250	-251	-252	-254	-254	-254
Credit to the economy	18,326	21,239	21,651	22,136	23,148	24,162	23,941	24,652	24,954	26,017	27,076	30,590	34,493
Credit to public enterprises	73	133	185	175	168	151	158	146	197	188	178	202	227
Credit to private sector	18,252	21,099	21,459	21,955	22,974	24,005	23,778	24,501	24,751	25,823	26,892	30,383	34,260
Claims on nonbank financial institutions	0	7	7	6	6	6	6	5	6	6	6	6	6
Net claims on the Bank of Cape Verde	5,994	7,438	9,810	9,219	9,765	8,678	9,502	10,899	10,133	10,155	10,376	11,400	12,469
Total reserves	7,093	7,877	9,891	9,301	9,839	9,278	9,777	10,966	10,733	10,755	10,650	11,675	12,743
Vault cash	597	650	734	722	854	658	1,013	753	901	1,035	1,164	1,273	1,387
Deposits with central bank	6,496	7,227	9,158	8,579	8,985	8,621	8,764	10,213	9,832	9,720	9,486	10,401	11,356
Required reserves	6,043	6,699	7,153	7,302	7,715	7,782	8,005	8,266	8,315	8,605	8,805	9,656	10,544
Excess reserves	454	528	2,004	1,277	1,270	839	759	1,947	1,517	1,115	681	745	812
Credit from the Bank of Cape Verde	-1,099	-438	-82	-82	-75	-600	-275	-67	600	600	-275	-275	-275
Other items (net)	-5,256	-6,513	-6,661	-6,951	-7,068	-7,525	-6,763	-6,488	-6,580	-6,672	-6,763	-6,763	-6,763
Deposit liabilities to nonbank residents	35,241	39,092	41,789	42,554	44,979	45,347	45,898	47,940	48,017	49,428	50,341	55,069	60,002
Local currency deposits	33,043	36,987	39,450	40,576	42,806	43,128	43,796	45,399	45,601	47,073	48,076	52,618	57,361
Demand deposits	13,672	14,056	14,898	14,836	15,809	16,083	16,161	16,691	16,692	17,147	17,428	18,548	19,658
Of which: emigrant deposits	1,387	1,765	1,786	1,836	1,994	2,092	2,133	2,117	2,196	2,340	2,466	2,736	3,022
Quasi money	19,371	22,931	24,552	25,740	26,996	27,045	27,636	28,709	28,908	29,925	30,648	34,071	37,702
Time deposits	18,081	21,802	23,080	24,142	25,312	25,844	25,857	26,989	27,188	28,154	28,730	31,995	35,466
Of which: emigrant deposits	10,015	12,672	13,589	14,225	15,162	15,910	15,817	16,785	17,021	17,741	18,291	20,294	22,416
Other quasi-monetary deposits	1,290	1,130	1,472	1,598	1,684	1,201	1,779	1,719	1,721	1,771	1,918	2,075	2,236
Foreign currency deposits	2,198	2,106	2,339	1,978	2,174	2,219	2,101	2,540	2,416	2,356	2,266	2,451	2,641
Of which: emigrant deposits	1,075	1,148	1,142	1,089	1,134	1,190	1,092	1,210	1,209	1,243	1,263	1,401	1,547
Memorandum items:													
Emigrant deposits (as ratio to total deposits)	0.30	0.34	0.35	0.35	0.36	0.37	0.36	0.37	0.38	0.38	0.39	0.40	0.41
Other deposits (as ratio to total deposits)	0.70	0.66	0.65	0.65	0.64	0.63	0.64	0.63	0.62	0.62	0.61	0.60	0.59
Composition of emigrant deposits	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Local currency	0.91	0.93	0.93	0.94	0.94	0.94	0.94	0.94	0.94	0.94	0.94	0.94	0.94
Demand	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.11
Time	0.80	0.81	0.82	0.83	0.83	0.83	0.83	0.83	0.83	0.83	0.83	0.83	0.83
Foreign currency	0.09	0.07	0.07	0.06	0.06	0.06	0.06	0.06	0.06	0.06	0.06	0.06	0.06

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

Table 4. Cape Verde: Balance of Payments, 2000–05

	2000	2001	2002		2003	2003	2004	2005
			Program 1/	Actual	Projection 1/	Revised Projections		
	(In millions of Cape Verde escudos, unless otherwise indicated)							
Current account balance	-6,746	-7,016	-7,505	-8,115	-8,181	-8,234	-9,287	-9,140
Trade balance	-22,438	-23,958	-27,573	-27,648	-28,640	-29,740	-31,102	-32,387
Exports (f.o.b.)	4,598	4,577	4,957	4,902	-5,353	5,423	6,036	6,701
Imports (f.o.b.)	-27,036	-28,535	-32,529	-32,549	-33,933	-35,163	-37,138	-39,088
Services (net)	890	1,312	3,054	1,242	3,440	1,504	2,291	3,306
Credit	12,904	15,981	16,554	17,808	17,547	19,485	21,732	24,302
Of which: tourism	4,821	6,539	...	7,509	...	8,306	9,558	11,051
Debit	-12,014	-14,668	-13,500	-16,565	-14,108	-17,982	-19,441	-20,997
Factor income (net)	-1,366	-753	-814	-1,191	-779	-1,267	-1,381	-1,547
Credit	607	830	...	787	...	714	787	969
Debit	-1,973	-1,583	...	-1,978	...	-1,981	-2,168	-2,516
Of which: scheduled interest payments	-558	-568	-901	-546	-623	-620	-595	-581
Current transfers (net)	16,167	16,382	17,828	19,482	17,798	21,269	20,904	21,488
Official	2,614	2,601	2,963	4,159	2,339	5,651	4,882	4,882
Private	13,554	13,781	14,865	15,323	15,459	15,618	16,022	16,606
Capital and financial account (net)	5,438	7,413	8,014	10,556	5,654	8,559	8,325	9,249
Capital transfers	1,342	3,004	1,590	1,058	2,040	900	1,035	1,202
Government	42	0	...	244	...	0	0	0
Private	1,300	3,004	...	814	...	900	1,035	1,202
Direct investment (net)	3,888	983	800	1,718	1,269	2,400	2,760	3,312
Portfolio investment	-13	180	0	0	0	0	0	0
Government	-1,279	2,113	1,919	1,192	199	1,585	303	171
Trust fund	-2,384	0	0	0	0	0	0	0
Net official flows	1,106	2,113	1,919	1,192	199	1,585	303	171
Disbursements	2,430	7,557	4,679	4,172	2,712	4,102	2,992	2,992
Amortization	-1,325	-5,444	-2,760	-2,980	-2,513	-2,517	-2,689	-2,821
Of which: clearance of previously rescheduled arrears	0	-1,855	...	-813	...	-381	0	0
Other	0	0	0	0	0	0	0	0
Other capital	1,500	1,132	3,706	6,587	2,148	3,673	4,226	4,564
Commercial banks	-1,452	-525	-327	913	-169	-165	-185	-190
Emigrant deposit flows	2,417	3,108	3,607	3,457	2,016	2,978	2,412	2,555
Commercial credit (net)	576	-663	426	2,577	301	960	2,000	2,200
Other	-41	-788	0	-359	0	-100	0	0
Net errors and omissions	-3,243	1,496	0	246	0	0	0	0
Overall balance	-4,550	1,892	509	2,687	-2,526	324	-963	109
Financing	4,550	-1,892	-877	-2,687	-483	-324	-1,397	-1,489
Change in net foreign assets of central bank (-=increase)	2,423	-1,892	-877	-2,687	-483	-324	-1,397	-1,489
Of which: change in net international reserves	1,369	-1,879	-1,037	-2,884	482	-324	-1,397	-1,489
Of which: IMF (net)	0	0	183	354	567	364	369	185
Exceptional financing	2,127	0	0	0	0	0	0	0
Change in government arrears (+=increase) 2/	2,127	-1,855	-1,620	-968	0	-802	0	0
Rescheduling/cancellation of arrears 2/	0	1,855	1,620	968	0	802	0	0
Financing gap	0	0	368	0	3,009	0	2,359	1,380
Memorandum items:								
Current account (including official transfers) 3/	-10.6	-10.3	-10.6	-11.2	-10.7	-10.6	-11.0	-10.1
Current account (excluding official transfers) 3/	-14.7	-14.2	-14.7	-17.0	-13.8	-17.8	-16.8	-15.4
Overall balance 3/	-7.2	2.8	0.7	3.7	-3.3	0.4	-1.1	0.1
Gross international reserves	3,349	5,238	6,385	8,391	7,434	9,079	10,844	12,518
In months of imports of goods and nonfactor services	1.0	1.5	1.7	2.1	1.9	2.1	2.3	2.5
External public debt (including arrears)	39,088	44,000	...	38,208	...	39,685	39,988	40,159
Including financing gap	...	...	...	...	...	...	42,347	41,539

Table 4. Cape Verde: Balance of Payments, 2000–05 (concluded)

	2000	2001	2002 Program 1/	2002 Actual	2003 Projection 1/	2003 Revised Projections	2004 Revised Projections	2005 Revised Projections
	(In millions of euros, unless otherwise indicated)							
Current account balance	-61.2	-63.6	-68.0	-73.6	-74.2	-74.7	-84.2	-82.9
Trade balance	-203.4	-217.2	-250.0	-250.7	-259.7	-269.6	-282.0	-293.6
Exports (f.o.b.)	41.7	41.5	44.9	44.4	-48.5	49.2	54.7	60.8
Imports (f.o.b.)	-245.1	-258.7	-294.9	-295.1	-307.6	-318.8	-336.7	-354.4
Services (net)	8.1	11.9	27.7	11.3	31.2	13.6	20.8	30.0
Credit	117.0	144.9	150.1	161.4	159.1	176.7	197.0	220.3
Of which: tourism	43.7	59.3	...	68.1	...	75.3	86.7	100.2
Debit	-108.9	-133.0	-122.4	-150.2	-127.9	-163.0	-176.3	-190.4
Factor income (net)	-12.4	-6.8	-7.4	-10.8	-7.1	-11.5	-12.5	-14.0
Credit	5.5	7.5	...	7.1	...	6.5	7.1	8.8
Debit	-17.9	-14.4	...	-17.9	...	-18.0	-19.7	-22.8
Of which: scheduled interest payments	-5.1	-5.1	-8.2	-5.0	-5.6	-5.6	-5.4	-5.3
Current transfers (net)	146.6	148.5	161.6	176.6	161.4	192.8	189.5	194.8
Official	23.7	23.6	26.9	37.7	21.2	51.2	44.3	44.3
Private	122.9	124.9	134.8	138.9	140.2	141.6	145.3	150.5
Capital and financial account (net)	49.3	67.2	72.7	95.7	51.3	77.6	75.5	83.9
Capital transfers	12.2	27.2	14.4	9.6	18.5	8.2	9.4	10.9
Government	0.4	0.0	...	2.2	...	0.0	0.0	0.0
Private	11.8	27.2	...	7.4	...	8.2	9.4	10.9
Direct investment (net)	35.3	8.9	7.3	15.6	11.5	21.8	25.0	30.0
Portfolio investment	-0.1	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Government	-11.6	19.2	17.4	10.8	1.8	14.4	2.8	1.5
Trust fund	-21.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net official flows	10.0	19.2	17.4	10.8	1.8	14.4	2.8	1.5
Disbursements	22.0	68.5	42.4	37.8	24.6	37.2	27.1	27.1
Amortization	-12.0	-49.4	-25.0	-27.0	-22.8	-22.8	-24.4	-25.6
Of which: clearance of previously rescheduled arrears	0.0	-16.8	...	-7.4	...	-3.5	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other capital	13.6	10.3	33.6	59.7	19.5	33.3	38.3	41.4
Commercial banks	-13.2	-4.8	-3.0	8.3	-1.5	-1.5	-1.7	-1.7
Emigrant deposit flows	21.9	28.2	32.7	31.3	18.3	27.0	21.9	23.2
Commercial credit (net)	5.2	-6.0	3.9	23.4	2.7	8.7	18.1	19.9
Other	-0.4	-7.1	0.0	-3.3	0.0	-0.9	0.0	0.0
Net errors and omissions	-29.4	13.6	0.0	2.2	0.0	0.0	0.0	0.0
Overall balance	-41.3	17.2	4.6	24.4	-22.9	2.9	-8.7	1.0
Financing	41.3	-17.2	-8.0	-24.4	-4.4	-2.9	-12.7	-13.5
Change in net foreign assets of central bank (-=increase)	22.0	-17.2	-8.0	-24.4	-4.4	-2.9	-12.7	-13.5
Of which: change in net international reserves	12.4	-17.0	-9.4	-26.1	4.4	-2.9	-12.7	-13.5
Of which: IMF (net)	0.0	0.0	1.7	3.2	5.1	3.3	3.3	1.7
Exceptional financing	19.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in government arrears (+=increase) 2/	19.3	-16.8	-14.7	-8.8	0.0	-7.3	0.0	0.0
Rescheduling/cancellation of arrears 2/	0.0	16.8	14.7	8.8	0.0	7.3	0.0	0.0
Financing gap	0.0	0.0	3.3	0.0	27.3	0.0	21.4	12.5
Memorandum items:								
Current account (including official transfers) 3/	-10.6	-10.3	-10.6	-11.2	-10.7	-10.6	-11.0	-10.1
Current account (excluding official transfers) 3/	-14.7	-14.2	-14.7	-17.0	-13.8	-17.8	-16.8	-15.4
Overall balance 3/	-7.2	2.8	0.7	3.7	-3.3	0.4	-1.1	0.1
Gross international reserves	30.4	47.5	57.9	76.1	67.4	82.3	98.3	113.5
In months of imports of goods and nonfactor services	1.0	1.5	1.7	2.1	1.9	2.1	2.3	2.5
External public debt (including arrears)	354.4	398.9	...	346.4	...	359.8	362.5	364.1
Including financing gap	...	...	...	...	...	...	383.9	376.6

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

1/ As contained in the December 9, 2002 staff report (EBS/02/211).

2/ Arrears flows in 2002 differ slightly from change in arrears stocks (Table 5) because of exchange rate valuation effects.

3/ In percent of GDP.

Table 5. Cape Verde: External Debt Arrears by Creditors, 1999-2002
(In thousands of U.S. dollars, unless otherwise indicated)

	End-December 1999			End-December 2000			End-December 2001			End-December 2002		
	On principal	On interest	Total	On principal	On interest	Total	On principal	On interest	Total	On principal	On interest	Total
Multilateral 1/	1,505	205	1,710	2,403	686	3,089	2,903	804	3,706	0	0	0
AfDF	0	20	20	0	17	17	0	0	0	0	0	0
BADEA	0	0	0	813	0	813	406	413	819	0	0	0
EIB	1,050	0	1,050	734	225	959	893	129	1,022	0	0	0
IFAD	0	128	128	91	44	135	0	0	0	0	0	0
OPEC	0	57	57	388	291	679	1,166	262	1,428	0	0	0
NDF	0	0	0	0	9	9	0	0	0	0	0	0
NTF	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	0	0	0	0	0	0	0	0	0
Bilateral	1,627	439	2,066	22,768	1,947	24,715	8,184	2,578	10,763	6,238	1,307	7,545
Government 2/	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
Germany - Kreditanstalt für Wiederaufbau	...	...	...	0	0	0	0	0	0	0	0	0
China	...	...	...	...	...	...	0	0	0	0	0	0
Agencies	1,602	0	1,602	8,027	1,639	9,666	7,037	1,786	8,823	6,238	1,307	7,545
CACEX (Brazil)	0	0	0	757	167	924	1,006	185	1,191	0	0	0
ICO (Spain) 3/ 4/	0	0	0	6,070	1,277	7,347	5,431	1,138	6,568	6,238	1,307	7,545
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	11,087	3,384	14,471	6,238	1,307	7,545
(in millions of Cape Verde escudos)	337	69	406	2,989	313	3,302	1,386	423	1,808	679	142	821

Source: Ministry of Finance.

1/ AfDF = 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.

2/ Excludes Russia, as the debt stock is still disputed and discussions between the two parties are ongoing.

3/ Cape Verde is negotiationg with ICO on the terms of the arrears rescheduling. An arrangement is expected by the end of 2003.

4/ Arrears to ICO were unchanged in 2002 in Cape Verde escudos. The change in U.S. dollars reflects the exchange rate appreciation.

Table 6. Cape Verde: External Public Debt Outstanding, 1999–2002
(In millions of U.S. dollars; end of period)

	1999	2000	2001	2002
Multilateral 1/	210.8	226.9	252.2	258.1
AfDF	71.6	77.9	86.2	90.5
IDA	86.8	101.9	110.1	116.1
IMF	0.0	0.0	0.0	3.3
BADEA	14.9	12.5	20.6	20.3
AfDB	6.8	1.3	1.3	0.5
EIB	10.4	9.0	8.1	5.5
OPEC	4.7	7.3	7.7	5.9
IFAD	10.1	10.2	8.9	7.9
Saudi Fund	0.7	0.0	0.3	0.4
NDF	2.3	2.3	2.9	2.2
NTF	2.7	4.5	6.2	5.4
Bilateral	84.6	74.4	75.9	73.0
Government	61.6	55.5	56.0	53.2
China	13.4	13.4	0.0	0.0
Kuwait	9.1	2.5	4.4	3.4
Portugal	18.4	24.2	41.3	40.7
South Africa	7.2	3.8	0.0	0.0
Abu Dhabi	0.2	0.2	0.2	0.1
Germany	13.4	11.4	10.1	9.1
Export credit agencies	23.0	18.9	19.9	19.8
Caisse Général des Dépôts	4.7	3.9	4.7	6.5
ICO (Spain)	6.8	6.7	6.6	7.5
CACEX (Brazil)	2.7	2.2	2.4	2.4
SOMEC (Portugal)	8.7	6.2	6.3	3.4
Private companies	...	...	8.2	12.3
Banco Espirito Santo	...	...	7.5	11.6
MSF (Portugal)	...	...	0.7	0.7
Total 2/	295.4	301.3	336.3	343.3

Source: Cape Verdean authorities.

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

2/ Excluding external arrears.

Table 7. Cape Verde: Fund Position During the Period of the PRGF Arrangement, 2002–05

	Outstanding on Dec. 31, 2001	2002 June	2002 Dec.	2003 June	2003 Dec.	2004 June	2004 Dec.	2005 June
				(In millions of SDRs)				
Disbursements		1.23	1.23	1.23	1.23	1.23	1.23	1.26
Of which: Poverty Reduction and Growth Facility		1.23	1.23	1.23	1.23	1.23	1.23	1.26
Repurchases/repayments		0.00	0.00	0.00	0.00	0.00	0.00	0.00
Ordinary resources		0.00	0.00	0.00	0.00	0.00	0.00	0.00
PRGF		0.00	0.00	0.00	0.00	0.00	0.00	0.00
Charges and interests		0.01	0.01	0.02	0.02	0.02	0.03	0.03
Ordinary resources		0.00	0.00	0.00	0.00	0.00	0.00	0.00
PRGF		0.00	0.01	0.01	0.01	0.02	0.02	0.02
SDR charges		0.01	0.01	0.01	0.01	0.01	0.01	0.01
Total Fund credit outstanding (end of period)	0.00	1.23	2.46	3.69	4.92	6.15	7.38	8.64
Ordinary resources	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
PRGF	0.00	1.23	2.46	3.69	4.92	6.15	7.38	8.64
				(In percent of quota, unless otherwise specified)				
Total Fund credit outstanding (end of period)	0.0	12.8	25.6	38.4	51.3	64.1	76.9	90.0
PRGF disbursements		12.8	12.8	12.8	12.8	12.8	12.8	13.1
Repurchases/repayments		0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interests		0.1	0.1	0.2	0.2	0.3	0.3	0.3
Debt service (in percent of exports of goods and nonfactor services)		...	0.02	...	0.03	...	0.04	...

Sources: International Monetary Fund, Finance Department; and staff projections.

Table 8. Cape Verde: Proposed Schedule of Disbursement Under the PRGF Arrangement, 2002–05

Amount	Available Date	Conditions Necessary for Disbursement 1/
SDR 1.23 million	April 4, 2002	Executive Board approval of the three-year annual arrangement.
SDR 1.23 million	December 16, 2002	Observance of the performance criteria for June 30, 2002 and completion of the first review under the arrangement.
SDR 1.23 million	June 30, 2003	Observance of the performance criteria for December 31, 2002 and completion of the second review under the arrangement.
SDR 1.23 million	December 20, 2003	Observance of the performance criteria for June 30, 2003 and completion of the third review under the arrangement.
SDR 1.23 million	June 30, 2004	Observance of the performance criteria for December 31, 2003 and completion of the fourth review under the arrangement.
SDR 1.23 million	December 20, 2004	Observance of the performance criteria for June 30, 2004 and completion of the fifth review under the arrangement.
SDR 1.26 million	June 30, 2005	Observance of the performance criteria for December 31, 2004 and completion of the sixth review under the arrangement.

Source: International Monetary Fund.

1/ Other than the generally applicable conditions under the Poverty Reduction and Growth Facility (PRGF) arrangement.

Cape Verde: Relations with the Fund
(As of May 31, 2003)

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

II. **General Resources Account**:	SDR million	%Quota
Quota	9.60	100.0
Fund holdings of currency	9.60	99.96
Reserve position in Fund	0.00	0.02

III. **SDR Department**:	SDR million	%Allocation
Net cumulative allocation	0.62	100.0
Holdings	0.00	0.65

IV. **Outstanding Purchases and Loans**:	SDR million	% Quota
Poverty Reduction and Growth PRGF arrangements	2.46	25.62

V. **Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	Apr 10, 2002	Apr 09, 2005	8.64	2.46
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):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	0.00	0.00	0.00	0.00	0.12
Charges/interest	0.02	0.04	0.05	0.06	0.06
Total	0.02	0.04	0.05	0.06	0.18

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, Bank of Cape Verde (BCV) is subject to an assessment with respect to the PRGF arrangement, which was approved on April 10, 2002 and is scheduled to expire on April 09, 2005. A safeguards assessment of the BCV was completed on December 9, 2002.

The assessment identified certain vulnerabilities in the reporting, internal control and audit area, and made appropriate recommendations, as reported in EBS/02/211.

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**:

Discussions of 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 Executive Board concluded the discussions of the Article IV consultations and completed the first review under the PRGF on December 16, 2002 (EBS/02/211; and SUR/02/137). The previous Article IV consultation discussions were held in Praia during the period March 3-16, 2001. The Executive Board approved its conclusion on June 15, 2001 (SM/01/145; 5/11/01). It is expected that the next Article IV consultation with Cape Verde will be held on the 24-month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

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 Verde 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 2004. In November 2000, an MAE technical assistance mission advised the authorities on the desirability of establishing a strongly anchored exchange rate regime.

XI. **Resident Representative:** 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. A PRSP is under preparation.

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 by supporting the government's design and implementation of its Interim poverty reduction strategy, and forthcoming PRSP. Specifically, 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 strategy of private sector-led growth, which aims at broadening the basis of private sector participation in Cape Verde's economy and enhancing private sector competitiveness. Components of the strategy include: improving the investment climate; modernizing the business laws and enforcing 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 financial sector.

World Bank Group Activities & Assessment of Country Policies

IDA Portfolio

4. The current World Bank portfolio gives a high priority to capacity building in the social, public and infrastructure sectors, and the careful introduction of market-based incentives for private sector development. Moreover, the Bank supports the administration's comparatively strong ability and willingness to enact its development plans, and has recently shifted its support towards a direct financing of the budget on the basis of agreed reforms. These central themes have also been identified in the country's I-PRSP as key pillars on which to base the future of the country's development strategy.

5. In strengthening the country's physical infrastructure, the Transport and Infrastructure Project has supported the large-scale contracting of road works to local construction enterprises. 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. The Privatization Project is developing local capacity to design and implement reforms in the public enterprise sector, monitor performance, and build private sector capacity through training. The Public Sector Reform Project, which closed in December 2002, helped to modernize the public sector.

6. Two projects that were approved in fiscal year 1999 in the social sectors are still active. 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 Education Sector Project supports 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.

Assessment of Country Policies

7. The authorities of Cape Verde and development partners, including the Bank, have undertaken a substantial body of analytic work over the past two years to assess key social, structural, and sectoral development policies and identify policy and institutional reform priorities for poverty reduction. Regarding strategic policy-making, the Bank has provided advice on the I-PRSP and sector strategies.

8. In the area of public sector management, the authorities have sought partners' advice on strengthening the administration's capabilities. In that connection, the Bank is producing a study on the role of the state, leading a study of the pension system, participating in a Country Financial Accountability Assessment (along with the Netherlands and the European Union), supporting important statistical work (such as a household survey), and a multi-sectoral public expenditure review effort.

9. In addition to advisory services, the Bank is supporting its shift toward direct support of the administration with structural adjustment credits. A structural adjustment operation was approved in December 2001 and a supplemental was approved in December 2002. The associated credits support the government's stabilization program and help 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.

10. As of April 30, 2003, IDA had extended 19 credits to Cape Verde, amounting to about US$182.4 million equivalent, of which about US$150.4 million equivalent has been disbursed. Eleven credits have closed, and the current portfolio includes eight active projects with associated credit amounts of about US$81.6 million equivalent, with an undisbursed balance of about US$29.8 million. A growth and competitiveness project was approved on May 13, 2003 and is not yet effective.

IFC and MIGA activities

11. 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. MIGA has also participated in an advisory capacity to the development of an investment facilitation program in 2002 and 2003.

World Bank Partnership Outlook

12. The Bank's future plans comprise a Competitiveness and Growth Project, which was approved on May 13, 2003, and is not yet effective. It medium-term approach will selectively identify some of its programs for focused assistance and advice. Financial support is expected to take the form of a Poverty Reduction Support Credit (PRSC), which would provide budgetary support on the basis of an agreed reform program. The World Bank, IFC, and MIGA will continue to coordinate their respective roles to support development activities in Cape Verde.

World Bank-Fund collaboration in specific areas

13. 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; and (iii) 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.

14. Questions may be referred to Mr. John McIntire (tel.: 221-849-5011), Ms. Mary Barton-Dock (tel.: 1-202-473-0876), or Jean van Houtte (tel.: 1-202-473-0156).

Relations with the World Bank Group

Statement of IDA Operations

(As of April 30, 2003; in millions of U.S. dollars)

Credit No.	Projects	Principal Amount	Disbursed	Undisbur-sed	Approved Date	Closing Date
	11 credits closed	*100.8*	*97.6*	*0.1*		
35871	SAC Supplemental	4.0	4.3	0.0	19-Dec-02	30-Jun-03
36290	HIV/AIDS	9.0	0.8	9.2	28-Mar-02	31-Dec-06
35870	Structural Adjustment Loan	15.0	15.2	0	13-Dec-01	31-Dec-02
24661	Transport Infrastructure Suppl.	5.0	1.6	3.8	30-Jan-01	31-Dec-03
32230	Education &Training Consolidation	6.0	4.4	1.5	25-May-99	30-Jun-03
31210	Privatization Technical Assistance	9.0	7.5	1.6	21-Jul-98	31-Dec-03
32050	Energy/Water	17.5	6.6	10.2	11-May-99	30-Jun-04
32240	Social Sector Development	16.1	12.3	3.5	25-May-99	31-Aug-03
	Total active projects	81.6	52.8	29.8		
	Active and closed projects	182.4	150.4	29.9		

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

Statement of IFC Investments

(In millions of U.S. dollars)

			Original Gross Commitments				Disbursed			
FY Approv.	Company	Type of business	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Participation
1992	Growela 1/	Shoe manu-facturing	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

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. A technical assistance assessment 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 while notable improvements had been made in many aspects of Cape Verde's statistical systems, significant deficiencies remain due to a shortage of financial and human resources.

Cape Verde has indicated its intention to participate in the General Data Dissemination System (GDDS) and has nominated a GDDS coordinator. Cape Verde participated in the GDDS workshop that was held in Lisbon in October 2002 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 provided 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 (INE). 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. Final national accounts estimates through 1997 have been prepared with the assistance of the STA statistical advisor and the French government. National accounts estimates for 1996 and 1997 were finalized at end-2001.Work on data for 1998-99 started in late 2000 and was 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 INE as an autonomous institution to replace the former General Directorate of Statistics. However, much work 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 INE 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 was 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.[1] The management of government expenditures has been improved with the consolidation of most accounts previously held with commercial banks at the central bank level. In addition, government agencies' reporting, as well as the coordination among the treasury, the budget directorates, and the central bank, has also been improved, with the Ministry of Economic Coordination (MEC) 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 MEC. 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 the *Government Finance Statistics Yearbook (GFSY).*

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[1] 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. In particular: (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

A technical assistance mission visited Praia in 1999 and 2002 as a result of which a number of improvements were made. For instance, the BCV is currently able to compile balance of payments statistics on a quarterly basis. Moreover, 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 during official contacts. However, in spite of these improvements, the overall quality of the BOP estimates continues to be deficient (as indicated by the significant size of net errors and omissions published in IFS). The first step in a plan for improving the quality of BOP estimates would focus on a thorough review of the procedures followed in deriving total exports and imports of goods and services.

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*. The mission revised the operation and preliminary results of the new system of quarterly enterprise surveys to 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. In spite of thesc improvements, 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 in August 2002 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.

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 MEC is able to provide a breakdown by creditors for debt and arrears.

Cape Verde: Core Statistical Indicators
(As of May 23, 2003)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of latest observation	01/31/03	12/31/02	12/31/02	12/31/02	12/31/02	01/31/03	12/31/02	09/30/02	Q3 2002	09/30/02	2001	12/31/01
Date received	01/03	01/03	01/03	01/03	01/03	01/03	01/03	01/03	01/03	01/03	01/03	01/03
Frequency of data	M	M	M	M	M	M	M	Q	Q	Q	A	A
Frequency of reporting	M	M	M	M	M	M	V	V	V	V	V	V
Source of update	CB	CB	CB	CB	CB	CB	INE	CB	CB	MEC	INE	CB
Mode of reporting	C	C	C	C	C	C	C	M	M	M	M	M
Confidentiality	C	B	B	B	B	C	C	C	C	B	C	B
Frequency of publication	M	M	M	M	M	M	M	SA	A	A	V	V

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

Cape Verde: Selected Social and Demographic Indicators 1/

	Cape Verde	Sub-Saharan Africa 2/
Population		
Population (in thousands)	440	642,812
Annual rate of growth (1996-2000)	2.3	2.8
Density (persons per thousand hectares)	1,090	272
Population characteristics		
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
Health		
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
Access to improved water source		
Percent of population	70	55
Urban	76	82
Rural	26	41
Education		
Adult illiteracy (percent)	25	40
Male	16	31
Female	33	47
Primary school enrollment (net)	96	...
Pupils-teacher ratio (primary schools; 1999)	29	40
Labor force		
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.

June 9, 2003

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

Dear Mr. Köhler:

On December 16, 2002, the Executive Board of the IMF concluded the first review of the three-year arrangement for Cape Verde under the Poverty Reduction and Growth Facility (PRGF), approved on April 10, 2002, in the amount of SDR 8.64 million.

The attached memorandum on economic and financial policies (MEFP) reviews the achievements made during the first year of the program and sets out the objectives and policies the government of Cape Verde is pursuing during 2003.

Cape Verde's economic performance in 2002 was generally positive. Macroeconomic policies have been deliberate, and progress has been made in key structural areas. All quantitative and structural performance criteria for end-December 2002 and end-January 2003 were met. The government believes that its policies for 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 second review under the PRGF arrangement.

The government considers the measures and policies set forth in the attached memorandum appropriate for achieving 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 will conduct with the Fund the third and fourth reviews under the PRGF arrangement, the third not later than end-December 2003 and the fourth by end-June 2004.

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

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

CAPE VERDE

MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES FOR 2003

I. INTRODUCTION

1. Cape Verde's medium-term economic program is being supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) covering the period 2002-04. This memorandum sets forth the economic and financial policies of the government of Cape Verde for 2003, as well as the broad economic objectives for 2003-05. To guide its policies for poverty reduction and growth, the government prepared an interim poverty reduction strategy paper (PRSP), which was approved by the Boards of the IMF and World Bank in April 2002. The government has completed its PRSP preparation status report and is working to complete the full PRSP by the end of 2003.

II. PERFORMANCE UNDER THE 2002 PRGF-SUPPORTED PROGRAM

2. Economic and financial performance continued to improve in 2002, and the PRGF-supported program is on track. Real GDP growth recovered to about 4 ½ percent, fueled by rising private and public investment, average inflation fell to 1.8 percent, and the overall balance of payments was in surplus. All quantitative performance criteria for end-December 2002 were met, some by large margins. The government implemented an automatic oil price adjustment mechanism (OPAM) on January 1, 2003, thereby meeting the structural performance criterion under the program (Attachment I, Tables 1 and 2).

3. The fiscal deficit (excluding grants) declined moderately from 10.8 percent of GDP in 2001 to 10.6 percent in 2002. Domestic revenue increased to 23.8 percent of GDP, reflecting strong international trade taxes and the collection of tax arrears. Total expenditure increased to 34.5 percent of GDP, primarily because of higher capital expenditures, but also because of the promotion of existing civil servants and the recruitment of new teachers and tax officers late in the year. The deficit was financed by net external flows amounting to 10.4 percent of GDP (including grants of 8.7 percent of GDP). Including grants, the fiscal deficit fell from 4.8 percent of GDP in 2001 to 1.9 percent, a moderately larger adjustment than programmed, and the primary recurrent surplus increased to 5.4 percent of GDP. The government was able to limit domestic borrowing to 0.2 percent of GDP. The reduction in domestic borrowing, including the large cash settlement of domestic arrears, helped to bring down the average interest rate on treasury bills from 11 percent at the end of 2001 to 6 ½ percent at the end of 2002.

4. Despite the modest improvement in the fiscal deficit, the external current account deficit (excluding official transfers) increased from 14.2 percent of GDP in 2001 to 17.0 percent in 2002, reflecting strong growth of imports of capital goods associated with the increase in private domestic investment. The larger current account deficit was more than covered by net official and private capital inflows, and the overall balance of payments

registered a large surplus for the second consecutive year. As a result, international reserve coverage increased from 1.5 months of imports in 2001 to 2.1 months in 2002.

5. Against the background of continued fiscal consolidation, low inflation, and a strong overall balance of payments, the Bank of Cape Verde (BCV) began to ease monetary policy in mid-2002 by lowering its lending rate with a view to gradually reducing domestic interest rates, mindful that the primary objective of monetary policy remains to ensure that international reserves continue to rise. The rate of growth of broad money increased from 9.8 percent in December 2001 (on a 12-month basis) to 14.3 percent in December 2002, primarily because of an increase in government recourse to domestic bank credit to finance the cash settlement of old domestic arrears.

6. Progress with structural reforms during 2002 was mixed. The new organic central bank law, the value-added tax (VAT) law, and the new customs tariff schedule were unanimously approved by the National Assembly in June. However, because of a lengthy review process, additional legislation necessary for the implementation of the VAT was not approved until April 2003, and there have been technical delays in disbursements of donor support. Consequently, the government has revised the target date for implementing the VAT, as described below. The government liquidated two large loss-making public enterprises: EMPA (food import and distribution) and TRANSCOR (municipal transport). Retrenchment payments associated with the liquidation of EMPA, which had been programmed to commence late in 2002, began in early 2003. Substantial income losses were realized in two important companies: Electra (the minority government-owned electricity and water monopoly) and the TACV (the wholly government-owned national airline). The government has already taken action to stem these losses in 2003.

III. Program for 2003-04

A. The Poverty Reduction Strategy for the Medium-Term Program

7. The government first introduced Cape Verde's poverty reduction strategy in the context of the 1997-2000 National Poverty Alleviation Plan (NPAP) and the National Development Plan (NDP). The vision set forth in the NPAP was updated in the Grandes Opcoes de Plano (GOP), a strategic medium-term framework for economic and social development and poverty reduction approved by the National Assembly in December 2001. The government's strategic priorities for reducing poverty, as derived from the GOP, are (i) the promotion of good governance; (ii) support for private sector-led economic growth and a broadening of the productive base; (iii) the enhancement of human capital; (iv) the implementation of a comprehensive policy to reduce poverty; and (v) the balanced development of infrastructure across the Cape Verde archipelago. Based on the principles outlined in the GOP, a new NDP covering the period 2002-05 was approved by the government in April 2003.

8. Now that the interim PRSP has been issued and the NDP updated and approved, the stage has been set to finalize Cape Verde's poverty reduction strategy paper (PRSP), which is

replacing the NPAP as the government's poverty reduction strategy document. The government has prepared a PRSP preparation status report, highlighting achievements to date and actions to be taken. Key milestones already reached include the completion of the household income and expenditure survey, the 2000 census, and the public expenditure reviews. These studies will provide important inputs into the analysis of the nature, origins, and extent of poverty and the prioritization of public expenditures, with a view to meeting the most urgent needs of the poor. The government is developing its capacity, with donor support, to explore alternative medium- and long-term macroeconomic frameworks, which will improve the analysis of the linkages between growth and poverty and provide inputs into the costing of the government's antipoverty programs. The final poverty diagnostic report based on the household survey and census is scheduled for October 2003, with the final PRSP to be ready by the end of the year.

B. Medium-Term Macroeconomic Objectives and Strategy

9. The key elements of the government's economic strategy remain to (i) pursue fiscal consolidation in order to free up financial resources for the private sector, alleviate pressure on the external current account, and facilitate a gradual reduction in domestic interest rates without undermining the balance of payments; (ii) redirect public expenditures toward health, education, security, and the development of infrastructure; (iii) implement monetary policy consistent with a further increase in international reserves; and (iv) implement structural reforms to enhance private sector competitiveness and promote private sector-led economic growth in order to reduce unemployment and poverty.

10. The key macroeconomic objectives for 2003-05 are to (i) achieve a rate of economic growth on the order of 5–7 percent; (ii) limit inflation to 2–3 percent, (iii) increase gross international reserves to the equivalent of 2 ½–3 months of imports of goods and services by 2005; and (iii) limit the fiscal deficit (including grants) to about 2 ½ percent of GDP. Broad money growth on the order of 8-10 percent a year and growth in credit to the economy on the order of 11-14 percent would be consistent with these objectives. Meeting these economic and financial targets will require the continued technical and financial support of donors, including additional budget support.

IV. The Program for 2003

11. The government's 2003 macroeconomic framework is based on (i) an increase in real GDP growth to 5 percent; (ii) end-period inflation of 2.2 percent; and (iii) a moderate increase in gross international reserves of €6 million, which will be sufficient to maintain import coverage at about 2.1 months.

A. Fiscal Policy

12. The government will continue to pursue fiscal consolidation while increasing expenditures in key social areas. Domestic revenue is projected to rise by 11 percent to CVEsc 19.1 billion (24.5 percent of GDP), reflecting the continued collection of tax arrears, the elimination of the excise exemption on diesel fuel consumed by Electra, and the

continued buoyancy of trade taxes. Total expenditure is programmed to rise by 6 percent to CVEsc 26.3 billion (33.8 percent of GDP). Against this background, the fiscal deficit (excluding grants) is programmed to fall to CVEsc 7.2 billion (9.2 percent of GDP). The deficit will be fully financed from net external flows, and the government will be able to reduce its net domestic indebtedness by about 0.1 percent of GDP.

13. Recurrent expenditures are programmed to increase by about 9.4 percent to CVEsc 16.7 billion. The wage bill will increase by 8 percent to reflect a 2.5 percent wage increase, the progression through grade for existing teachers (which has been frozen for nearly ten years), and the hiring of additional teachers, medical doctors, and tax inspectors. Transfers and subsidies are programmed to rise by nearly 15 percent, reflecting the hiring of additional police, an increase in transfers to municipalities (which are linked to the central government's revenue of the previous year by law), an increase in provisions for the National Assembly, and a contingent provision for a temporary subsidy to Electra (amounting to CVEsc 310 million). This provision is being made to help offset accumulated losses arising, in part, because the government delayed raising electricity and water tariffs following the privatization of Electra, despite the sharp increases in fuel costs. This subsidy will be paid only if the external audit of Electra indicates it is necessary and only if Electra's management implements internal reforms as outlined below. Excluding this provision, recurrent expenditures are programmed to rise a more modest 7.4 percent. Extraordinary expenditures will more than triple to CVEsc 845 million (1 percent of GDP) in 2003, including CVEsc 745 million for retrenchment payments to former employees of EMPA and TRANSCOR. Capital expenditure is programmed to decline slightly from 2002 but will remain strong by historical standards, reflecting recent improvements in the implementation of donor-funded projects.

14. The government will implement the VAT and new customs tariffs on January 1, 2004. All necessary legislative action on the part of the National Assembly has been taken. To ensure that the new target date is met, the Council of Ministers will approve the VAT preregistration decree by end-June and amend the National Accounting Plan by end-September. The preregistration decree will specify who must register for the VAT, their reporting requirements, and the principles for the application of penalties in case of noncompliance. The new VAT law and customs tariffs will be included in the 2004 budget. Structural conditionality will apply to these actions, as described in Table 4 of this attachment. The government is taking other actions to strengthen revenue performance, expenditure management, and fiscal transparency. In this regard, it will complete a comprehensive review of tax exemptions by the end of September 2003, with a view to significantly reducing them over the medium term. A resident budget advisor has been appointed to help improve the budget process and expenditure management and reporting. The treasury will prepare a comprehensive assessment of the stock of verified domestic payments arrears as at end-2002. The government will begin submitting quarterly accounts of central government fiscal operations to the National Assembly by the end of June 2003. It will continue implementing the recommendations made in the donor-funded Country Financial Accountability Assessment, which will further enhance fiscal transparency, accountability, and the quality of expenditures.

B. Monetary and Financial Sector Policies

15. The BCV will pursue a monetary stance consistent with a modest increase in international reserves. If the balance of payments is sufficiently strong, then the BCV will consider easing monetary policy to induce a further, gradual decline in domestic interest rates. Strict adherence to the fiscal target for 2003 will be necessary to achieve these dual objectives. Broad money is projected to increase by about 8 percent, in line with nominal GDP. With credit to the economy growing by about 12 ½ percent and credit to the central government rising by 3 percent, the increase in international reserves will be sufficient to maintain international reserve coverage at 2.1 months of imports of goods and services.

16. The BCV has made notable progress in implementing its 2003 work plan to strengthen its operational and oversight responsibilities. On-site examinations were completed for the two new offshore banks, and the reports have been submitted to the BCV board of directors for approval. The banking supervision department of the BCV intends to complete on-site examinations of two of Cape Verde's four domestic banks and an insurance company this year. Off-site examinations have been computerized, which has enhanced the BCV's ability to analyze the soundness of the banking sector. The BCV will be seeking technical assistance to undertake a comprehensive review of Cape Verde's financial sector legislation, with a view to establishing a legislative framework conducive to financial development and diversification. The central bank will also begin working toward consolidating, revising, and strengthening the legislative framework governing the development and supervision of microfinance institutions.

17. In addition, the BCV will continue to implement the recommendations of the IMF's safeguards assessment report. The board of the BCV has issued a resolution specifying the deadlines for publishing the annual report and the audited financial statements. The BCV has also prepared and enacted a manual of guidelines for the proceedings of the internal audit function. The new organic central bank law, approved in 2002, mandates the adoption of International Accounting Standards (IAS), which will be fully applied in the 2003 audit of the BCV's operations. A new external auditor has been identified, and contract negotiations are expected to be concluded soon. The one remaining action necessary to comply with the safeguards assessment report recommendations is to bring the BCV's internal audit procedures in line with the IAS. The BCV has requested the technical assistance necessary for it to meet this objective in 2003.

C. External Sector

18. Achieving a sustainable external current account balance, in the context of Cape Verde's fixed-exchange rate regime and the gradual decline in domestic interest rates, will require continued fiscal consolidation, the enhancement of external competitiveness through structural reforms and the development of human resources, and the creation of an environment conducive to foreign investment. To this end, the government will continue to focus its public investment program on basic infrastructure, such as energy, water, roads, and telecommunications, and to reorient recurrent expenditures toward education, health, and

security. The government's growth and competitiveness project (2003-07), financed by the World Bank, will focus on improving the investment climate through tax reform, the alleviation of administrative barriers to investment, legal reform, private sector capacity building, and financial sector reform and development. In addition to policies emerging from the growth and competitiveness project, the government is promoting exports by developing export-oriented industrial parks and opening up new tourist destinations to foreign investors. These actions are already bearing fruit. In addition, Cape Verde's export sector will benefit from 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 the acquisition of air-traffic landing rights in the United States.

19. The improved outlook for exports notwithstanding, the external current account deficit (excluding official transfers) is projected to rise from 17 percent of GDP in 2002 to about 18 percent in 2003, reflecting a cautious outlook for private transfers. Net official and private capital flows are projected to be lower than in 2002, but still sufficient to permit a modest increase in international reserves.

20. The government has reached agreements regarding the clearance of external arrears with all its creditors, excepting Russia and Spain, with whom discussions are continuing. The government has improved its database on external debt stocks and payment obligations, which has enabled the government to keep current on all its external obligations. The government will contact the government of São Tomé and Príncipe regarding the modalities of Cape Verde's provision of debt relief under the Initiative for Heavily Indebted Poor Countries (HIPC Initiative).

D. Structural Reforms

21. In addition to the structural reforms discussed above, the government will pursue reforms in the public enterprises, including privatization, the regulatory environment, and pension reform.

22. With regard to Electra, the government raised electricity and water tariffs by 25 percent and 20 percent, respectively, on January 1, 2003. The positive impact of the tariff increases on Electra's income were partially offset by the elimination of the price subsidy on diesel fuel consumed by the utility. The government is undertaking a comprehensive external audit of Electra, with donor assistance, to ascertain Electra's financial condition and to recommend cost-saving measures. If the audit indicates the need, the government is prepared to provide Electra with a temporary subsidy to reduce its financial losses in 2003, subject to progress on the part of Electra's management in:

- improving bill collection;
- reducing technical losses;
- improving internal audit procedures;

- reducing the number of staff;
- improving maintenance of existing facilities; and
- restructuring debt.

In addition to the increase in tariff rates already effected, the government will do its part to improve Electra's financial condition by:

- continuing to pay all its bills to Electra on time;
- clearing all its verified arrears to Electra;
- moving quickly to establish the multisector regulatory agency to oversee the implementation of an automatic and transparent tariff adjustment mechanism; and
- determining if there are any legal obstacles that inhibit Electra's ability to collect payments from the private sector.

23. The government has appointed new management to the TACV, which is implementing measures to reduce losses, including the elimination of loss-making routes, the replacement of high-cost aircraft with more energy-efficient lease aircraft, and reductions in the number of staff. The government will monitor progress through periodic reports prepared by management. In addition, the government will initiate work on a comprehensive regulatory approach to the transport sector to ensure that high-cost interisland service by the TACV continues without undermining the TACV's financial performance. The government also appointed a new director of the privatization program earlier this year to improve government oversight of the public enterprises slated for privatization. The government will push ahead with preparing the TACV, the public fish-freezing company (INTERBASE), and the ship repair facility (CABNAVE/CABMAR) for privatization.

24. The National Assembly approved the general regulatory framework law in April 2003, and the government will establish and staff the multisector regulatory agency by September of this year. Among its other responsibilities, the new agency will implement the new oil price adjustment mechanism and an automatic and transparent electricity and water tariff adjustment mechanism. The government, with donor assistance, will begin developing a strategy for reforming the public pension scheme.

E. Statistical Issues and Capacity Building

25. The National Institute of Statistics (INE) will complete the steps necessary to bring its statistical systems in compliance with the General Data Dissemination System (GDDS) framework. It has adopted the GDDS as the country's statistical framework, appointed a country coordinator, and prepared the metadata. It will soon finish compiling demographic data. The INE now publishes a quarterly business confidence index and will publish the 1998-2000 national accounts before the end of 2003. It will also rebase the consumer price

index on the basis of the recently completed household income and expenditure survey. The INE will begin to develop annual household indicators and coordinate and integrate social data from the line ministries to strengthen Cape Verde's capacity to monitor the impact of its poverty reduction strategy. Cape Verde is receiving technical assistance in a number of other areas, including tax reform, expenditure management, and banking supervision, and is seeking additional technical assistance in the area of treasury operations, as well as continued assistance in the area of balance of payments statistics.

V. Program Monitoring

26. Program implementation through December 2003 will be monitored according to the performance criteria and benchmarks presented in Attachment I, Tables 2 and 4. The definitions of quantitative performance criteria and benchmarks and reporting requirements are contained in the attached technical memorandum of understanding (TMU). Paragraph 20 of the earlier TMU (EBS/02/54; 3/22/02) has been dropped, reflecting the introduction of the automatic petroleum pricing mechanism, which has obviated the need for reporting on petroleum imports and sales. The relevant sections of the TMU have also been amended to reflect the new adjusters for deviations in external debt service, nonproject donor support, and the cash payment of domestic arrears relative to the program assumptions.

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

	2001	Cumulative Flows from End-December 2001 2002											2003	
	Dec.	Mar.		Jun.			Sep.			Dec.			Mar.	Jun.
	Est.	Indicative benchmark	Actual	Perform. criteria	Perform. criteria (adjusted)	Actual	Indicative benchmark	Indicative benchmark (adjusted)	Actual	Perform. criteria	Perform. criteria (adjusted)	Actual	Indicative benchmark	Indicative benchmark
Quantitative benchmarks							(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	2.8	3.6	2.7	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	-0.9	0.3	1.1	-1.0	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	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	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	2.5	2.5	2.5	0.0	0.0
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one 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	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	9.4	-4.6	26.1	12.0	4.3
Memorandum items:														
							(In billions of Cape Verde escudos)							
Floor on the primary current fiscal balance (indicative target)	2.0	-0.2	1.9	0.3	...	2.6	2.9	...	3.9	3.5	...	3.9	4.0	4.9
Nonproject external financial assistence, including credit line (program assumption)	5.0	1.3	1.7	2.0	...	1.7	3.4	...	1.7	3.8	...	2.1	4.3	4.3

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 arrangments, 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 arrangments, 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: Quantitative Performance Criteria and Indicative Targets Under the Second Annual Program Supported by the PRGF Arrangement 1/ 2/

	2002	Cumulative Flows from End-December 2002			
		2003			
	Dec. Level	Mar. Estimate	Jun. Perform. criteria	Sep. Indicative target	Dec. Perform. criteria
Quantitative targets		(In billions of Cape Verde escudos)			
Ceiling on net domestic credit to the central government from the banking system 3/ 4/	14.4	-0.2	0.0	0.2	0.5
Ceiling on net domestic assets of the central bank 3/	7.6	0.6	0.4	0.1	0.2
Ceiling on the accumulation of new domestic payment arrears by the central government	1.1	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 5/	7.4	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/ 6/	0.0	0.0	0.0	0.0	0.0
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one one year owed or guaranteed by the central government 5/ 7/	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) 8/	72.4	1.0	0.4	4.7	2.9
Memorandum item:					
		(In billions of Cape Verde escudos)			
Floor on the primary current fiscal balance (indicative target)	3.9	0.9	2.2	3.4	4.7
Program assumptions					
Nonproject external financial assistence, including credit line (program assumption)	2.0	0.9	1.4	1.8	1.9
External debt service	3.5	0.7	1.2	1.8	3.1
Cash payments of domestic arrears	2.0	0.0	0.0	0.3	0.4

1/ Quantitative performance criteria and benchmarks are described in the technical memorandum of understanding (Attachment II).
2/ For purposes of calculating program adjusters, actual debt service payments and actual nonproject external financial assistance will be valued at current exchange rates.
3/ The ceiling will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.
4/ The ceiling on net domestic credit to the central government from the banking system will be adjusted downward by the shortfall in cash payments of domestic arrears relative to program assumptions.
5/ This performance criterion is on a continuous basis.
6/ 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 arrangments, the Portuguese credit line, and borrowings from the Fund.
7/ 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 arrangments, the Portuguese credit line, borrowings from the Fund, and normal import-related credits.
8/ The floor on net international reserves of the Bank of Cape Verde will be adjusted upward (downward) by the cumulative downward (upward) deviations in external debt service and downward (upward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to pogram assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.

Table 3. Cape Verde: Structural Performance Criteria and Benchmarks Under the First Annual Program (2002) Supported by the PRGF Arrangement

Measures	Test Dates	Status or Amended Test Dates
Prior action		
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	
Structural performance criteria		
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	Done
Structural performance benchmarks		
Inclusion of VAT and external tariff reform in 2003 budget	October 2002	October 2003; VAT implementation postponed until January 1, 2004
Establishment of external debt-management committee to oversee external debt strategy and ensure timely payments of debt service falling due	February 2002 (Done)	

Table 4. Cape Verde: Structural Performance Criteria and Benchmarks Under the Second Annual Program Supported by the PRGF Arrangement

Measures	Test Dates	Status or Amended Test Dates
Structural performance criteria		
Approval by the Council of Ministers of the VAT pre-registration decree	June 2003	
Structural performance benchmarks		
Approval by the Council of Ministers of the amended National Accounting Plan	September 2003	
Inclusion of VAT and external tariff reform in 2004 budget	October 2003	
Begin external audit of Electra	June 2003	
Approval by the Council of Ministers of the decree establishing the multi-sector regulatory agency	September 2003	

Table 5. Cape Verde: Structural Reform Objectives in 2002

Measures	Test Dates	Status
Fiscal and monetary		
Preparation of tax reform, including introduction of value-added tax (VAT) and external tariff reform on January 1, 2003	Continuous	Ongoing
Inclusion of VAT and external tariff reform in 2003 budget	October 2002	To be implemented October 2003
Strengthening of tax administration department of Ministry of Finance to implement VAT	Continuous	New tax inspectors hired
Review of tax exemption policy and preparation of action plan to reduce exemptions	September 2002	Preliminary review completed. Comprehensive report by September 2003
Strengthening of implementation of new tax collection system through commercial banks	Continuous	Ongoing
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	Continous	Budget advisor appointed
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
External sector		
Preparation for introduction of new streamlined tariff regime on January 1, 2002	Continuous	Ongoing
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
Structural and data issues		
Acceleration of domestic debt reduction operation, including hosting donors' conference during the first half of 2002	Continuous	Discussed at 2003 round table conference
With World Bank assistance, acceleration of program to liquidate the food import and distribution company (EMPA) and the municipal transport operator (TRANSCOR)	Continuous	Done
Introduction of automatic and transparent pricing mechanism for petroleum products	June 2002	Done
Development of improved information systems to track poverty and poverty programs of the government	December 2002	Ongoing
Improvement of the quality of key economic and financial sector data, including the real sector, balance of payments, and external debt statistics	Continuous	Improved balance of payments data

Cape Verde

Technical Memorandum of Understanding for the Second Annual Program Under the PRGF Arrangement

1. This memorandum sets out the understandings between the Cape Verdean authorities and the IMF staff regarding the definition of the quantitative performance criteria and indicative targets and reporting requirements under the second annual program supported by the Poverty Reduction and Growth Facility (PRGF) arrangement.

I. Quantitative Performance Criteria And Indicative Targets[1] [2]

A. Government Finances

2. Total government revenue is defined as the sum of all tax and nontax revenues, domestic capital participation, and net lending, cumulative since the start of the calendar year, excluding privatization proceeds and external grants. Tax revenue and nontax revenue are defined in accordance with the *Government Finance Statistics Manual (GFS)* 1986, Section IV.A.1.

3. The floor on the primary current fiscal balance cumulative from the beginning of calendar-year 2003 constitutes an indicative performance target. The primary current fiscal balance is defined as the difference between total government revenue (defined above in para. 1) and current primary expenditures on a commitment basis. Current primary expenditures equal total government expenditures on a commitment basis less interest obligations on external and domestic debt, capital expenditures, extraordinary expenditures on social emergency measures, and retrenchment payments made as a part of the public enterprise privatization and liquidation reform.

4. For the purposed of this memorandum, privatization proceeds will be understood to mean all monies received by the government from the sale or concessioning of a public company, organization, or facility to a private company or companies, organization(s), or individual(s), as well as any proceeds generated from the liquidation of a public company, less restructuring costs.

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[1] See Table 2 of the memorandum on economic and financial policies (MEFP).

[2] The data source used to evaluate the performance criteria on net domestic credit to the central government, net domestic assets of the central bank, and net international reserves will be the Cabo Verde—Panorama Bancario tables prepared monthly by the Bank of Cape Verde (BCV) Statistics and Research Department and forwarded electronically to the IMF African and Statistics Departments.

5. **Reporting requirements.** Data on the implementation of the budget compiled by the Ministry of Finance and Economic Planning will be provided on a quarterly basis, to be submitted not later than five weeks after the end of each quarter, including (i) government revenue by category, including external budget support grants; (ii) government expenditure, including primary current expenditure, domestic and external interest payments, and capital expenditure, including domestic capital expenditure and estimates of externally financed capital expenditure; (iii) the gross payment and gross accumulation of domestic payments arrears; (iv) external loan receipts and principal payments; (v) external arrears payments and accumulation; (vi) bank and nonbank financing; (vii) privatization receipts; and (viii) any other revenue, expenditure, or financing not included above.

B. Net Domestic Assets of the Central Bank

6. The ceiling on the cumulative change, from the beginning of calendar-year 2003, in net domestic assets of the Bank of Cape Verde (BCV) constitutes a performance criterion. Net domestic assets (NDA) of the BCV are defined as reserve money minus net foreign assets of the BCV, evaluated at the program exchange rates presented below. The program ceilings for NDA will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates. Reserve money comprises bank reserves and deposits of the monetary institutions and private sector with the central bank, as well as cash in circulation.

7. **Reporting requirements.** The preliminary monthly balance sheets of the BCV and the consolidated commercial banks will be transmitted on a monthly basis, with a maximum delay of five weeks. The definitive version of the monthly balance sheet of the BCV will be provided as soon as available.

C. Net Bank Credit to the Central Government

8. The ceiling on the cumulative change, from the beginning of calendar-year 2003, in net credit to the central government from the banking system constitutes a performance criterion. Net credit to the central government from the banking system (NCCG) is defined as the overall position of the main central government institutions vis-à-vis the banking system—that is, the stock of all outstanding claims on the central government (loans, advances, and all other government debt instruments, such as long-term government securities) held by the central bank and by commercial banks, less all deposits held by the central government with the central bank and with commercial banks, as they are reported monthly by the BCV to the IMF. The INPS (the social security agency) is not included in central government accounts. Net bank credit to the central government excludes claims on the Trust Fund (TCMFs).

9. Claims on the central government held by the central bank comprise the following items: (i) *crédito conta corrente OGE*; (ii) *Tesouro público protocolo*; (iii) *títulos governo*

central—obrigações nova serie; (iv) *créditos a regularizar m/n e m/e*; (v) *outros créditos ao governo*; and (vi) any other claims, or claims on the central government to be regularized, held by the central bank.

10. Deposits held by the central government with the central bank comprise the following items: (i) *depósitos do governo central—depósitos a ordem m/n*; (ii) *depósitos do governo central—depósitos a ordem m/e*; and (iii) *outros depositos do governo central.*

11. Claims on the central government held by the commercial banks comprise the following items: (i) *obrigações do Tesouro*; (ii) *bilhetes do Tesouro*; (iii) *protocolos*; (iv) *empréstimos*; (v) *outros títulos;* (vi) *outros créditos*; and (vii) any other claims, or claims on the central government to be regularized, held by the commercial banks.

12. Deposits held by the central government with the commercial banks comprise the following items: (i) *dep. governo central em m/n—D.G.T.*; (ii) *dep. governo central em m/n—serviços autónomos*; (iii) *dep. governo central em m/n—fundos autónomos*; (iv) *dep. governo central em m/n—projectos de investimentos*; (v) *dep. governo central em m/n—fundos de contrapartida*; (vi) *dep. governo central em m/n—institutos c/autonomia administ. e financeira excepto INPS*; (vii) *dep. governo central em m/e*; and (viii) *outros passivos com o governo.*

13. The program ceilings for the NCCG will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates. In addition, the ceilings for the NCCG will be adjusted downward by the shortfall in cash payments of domestic arrears relative to program assumptions.

14. **Reporting requirements.** The preliminary monthly balance sheets of the BCV and the consolidated commercial banks will be transmitted on a monthly basis, with a maximum delay of five weeks. The definitive version of the monthly balance sheet of the BCV will be provided as soon as available.

D. Ceiling on Nonconcessional External Debt Contracted or Guaranteed by the Central Government

15. Under the program, ceilings on medium- and long-term, as well as on short-term, nonconcessional external debt constitute performance criteria. These performance criteria are on a continuous basis. Nonconcessional external debt is defined as debt contracted or guaranteed by the central government with a grant element of less than 35 percent, calculated using currency-specific commercial interest reference rates (CIRRs) published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). Debt rescheduling and debt reorganization are excluded from the limits on nonconcessional external debt. There will be no new nonconcessional external debt contracted or guaranteed by the central government (excluding borrowing from the Fund) in

2003. The definition of short-term nonconcessional external debt excludes normal short-term (less than one year) import-related financing. The Portuguese government's precautionary credit line in support of the exchange rate peg is also excluded from the definition of nonconcessional external debt. In addition, the central government will not guarantee any external debt contracted by state enterprises and will maintain the policy of not guaranteeing private sector external debt. The performance criterion on medium- and long-term nonconcessional external indebtedness 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), 8/24/00) but also to commitments contracted or guaranteed for which value has not been received. With respect to the performance criterion on short-term nonconcessional external indebtedness, 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), 8/24/00).

16. **Reporting requirements.** The government of Cape Verde will consult with Fund staff before assuming any liabilities in circumstances where they are uncertain whether the instrument in question falls under the performance criterion. Details of all new external debt, including government guarantees, indicating terms of debt and creditors, will be provided on a quarterly basis within five weeks of the end of each quarter.

E. Net International Reserves of the Central Bank

17. The floor on the cumulative change, from the beginning of calendar-year 2003, in net international reserves (NIR) of the BCV constitutes a performance criterion under the program. The NIR of the BCV are defined as gross international reserves of the BCV net of its short-term external liabilities, calculated at the program exchange rates described below. Gross reserves of the BCV are those that are readily available (i.e., liquid and marketable and free of any pledges or encumberments), controlled by the BCV, and held for the purposes of meeting balance of payments needs and intervening in foreign exchange markets. They include gold, holdings of SDRs, the reserve position at the IMF, holdings of foreign exchange and traveler's checks, demand and short-term deposits at foreign banks abroad, fixed-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade securities. External liabilities of the BCV comprise liabilities to nonresidents contracted by the BCV with an original maturity of less than a year, any net off-balance-sheet position of the BCV (futures, forwards, swaps, or options) with either resident and nonresidents, any arrears on principal and interest to external creditors and suppliers, and purchases from the IMF. The program floors for the NIR will be adjusted upward (downward) by the cumulative downward (upward) deviations in external debt service and downward (upward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.

18. **Reporting requirements.** A table on the NIR prepared by the BCV will be transmitted on weekly basis, with a maximum delay of two weeks.

F. Nonaccumulation of New Domestic Payment Arrears

19. As part of the program, the government will not accumulate any new domestic payments arrears. This will be monitored through the monthly execution of the cash-flow plan and the corresponding release of budget appropriations. For programming purposes, a domestic payment obligation to suppliers is deemed to be in arrears if it has not been paid within the normal grace period of 60 days (30 days for government salaries and debt service) or such other period as has been contractually agreed with the supplier after the verified delivery of the concerned goods and services, unless the amount or the timing of the payment is subject to good faith negotiations between the government and the creditor. The outstanding stock of domestic payments arrears at end-December 2002 is estimated at CVEsc 1.1 billion.

20. **Reporting requirements.** The Ministry of Finance and Economic Planning, through the DGT, will submit on a quarterly basis a detailed table of the stock of domestic payments arrears, including the accumulation, payment, rescheduling and write-off of domestic payments arrears during the quarter. The data are to be provided within four weeks after the end of the quarter.

G. Nonaccumulation of External Arrears

21. As part of the program, the government will not accumulate any new external payments arrears on a continuous basis. This will be monitored through the monthly execution of the cash-flow plan and the corresponding release of budget appropriations.

22. External arrears are defined as total external debt-service obligations of the government that have not been paid by the time they are due, unless the definition of an arrear has been defined contractually between the government and creditor. External arrears exclude arrears on external debt, pending the conclusion of debt-rescheduling agreements. The outstanding stock of external arrears at end-December 2002 amounted to US$7.5 million.

23. **Reporting requirements.** Data on (i) debt-service payments and (ii) external arrears accumulation and payments will be transmitted on a quarterly basis by the Ministry of Finance and Economic Planning, within five weeks of the end of each quarter. In addition, the government will inform the Fund staff immediately of any accumulation of external arrears.

H. Program Exchange Rates and Nonproject Budgetary Support

24. Performance under the program will be assessed based on program exchange rates. The program exchange rates for this purpose are as follows: CVEsc 110.3 = €1; CVEsc 0.55 = Esc 1 (Portuguese escudos); and CVEsc 147.9 = SDR 1.

25. The 2003 program assumes (i) €5 million in nonproject budget support from the European Union in the first quarter; (ii) US$4 million in nonproject budget support from the

World Bank in the first quarter; (iii) US$6.2 million in nonproject budget support from the African Development Bank, comprising US$3.2 million in the third quarter and US$3 million in the fourth quarter; (iv) US$2 million from the Netherlands in the fourth quarter; and (v) the repayment of the outstanding Esc 200 million from the Portuguese credit facility drawn in 2002 and the drawing of Esc 1 billion from the Portuguese credit facility in the second quarter, of which 80 percent will be repaid in the fourth quarter.

II. Other Data Requirements for Program-Monitoring Purposes

26. Data on exports and imports, including volume and prices and compiled by the Director of Customs and the BCV, will be transmitted on a quarterly basis within five weeks after the end of each quarter. A preliminary quarterly balance of payments, compiled by the BCV, will be forwarded within five weeks after the end of each quarter.

27. The monthly disaggregated consumer price index for Cape Verde, compiled by the National Institute of Statistics (INE), will be transmitted monthly, within five weeks after the end of each month.

28. Documentation of all measures taken by the government to meet performance criteria or indicative benchmarks under the program will be transmitted to the Fund staff within one week after the day of implementation.