LAPSE OF TIME

EBS/20/11
Correction 3

March 20, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Cabo Verde—First Review Under the Policy Coordination Instrument and Request for Modification of Targets**

Board Action:	The attached correction to EBS/20/11 (2/26/20) has been provided by the staff:
Factual Errors Not Affecting the Presentation of Staff's Analysis or Views	**Page 6**
Questions:	Ms. Kabedi-Mbuyi, AFR (ext. 36387)

they created the SPIGF with an initial capital of €90 million, and an Emergency Fund totaling €10 million, intended to provide rapid first response to weather-related and other exogenous shocks. Since there are liabilities backed by resources in the offshore account, the creation of the SPIGF, as currently planned, would increase public gross debt by 5.7 percent of GDP and may raise debt service obligations, with implications for debt sustainability.[1] The authorities will prepare a strategy on the operationalization of the SPIGF, which is a new reform target, in consultation with staff (see below).

Box 1. The Sovereign Private Investment Guarantee Fund – Background

Background. In the late 90's, Cabo Verde faced a domestic debt overhang. At end-1997, the stock of domestic debt stood at US$186 million (about 46 percent of GDP), reflecting excessive domestic financing of fiscal deficits, and contingent liabilities from restructured SOEs and banks. To reduce the public debt burden, the government put in place a debt reduction operation funded with donors' financial support and proceeds from privatization. The operation covered a stock of domestic debt totaling CVE 11.35 billion, held by the central bank, BCV (CVE 4.6 billion); a commercial bank, BCA (CVE 6.4 billion); the pension fund, INPS (CVE 328 million); and the insurance company, Garantia (CVE 22 million).

The offshore Trust Fund (TF). Although there was funding for the debt reduction operation, rather than repaying directly the creditors, the authorities decided to set up a scheme under which: (i) resources mobilized for the operation were placed in an offshore TF, created by law in August 1998, and managed by a central bank in Europe and; (ii) an institution (Fiduciaria International) was created to swap the old stock of domestic debt with twenty-year bonds called *Titulos Consolidados de Mobilizacão Financeira- TCMFs*. Bonds holders earned dividends proportional to their shares, paid directly by the TF manager. The main reason for adopting this approach was to avoid a sudden and large injection of liquidity in the banking system through cash payments associated with the debt reduction.

The TCMFs were not repaid as planned. Under the 1998 law creating the TF, the TCMFs had to be repaid during the 20-year maturity period, using budgetary resources, as the fiscal position improved. However, the TCMFs were eventually not repaid as planned and they all matured in 2018. Consequently, in December 2018, the government issued a Decree calling for the repayment of TCMFs worth less than CVE 300 million, and the replacement of the remaining stock with new bonds to be repaid in 20 years in equal annual instalments, at an interest rate of up to 3 percent; or exchanged between bond holders on conditions to be agreed between parties. On this basis, TCMFs held by Garantia were redeemed in January 2019; and INPS repurchased BCA bonds. As a result, at end-December 2019, TCMFs totaled CVE 11.33 billion (equivalent to €102.7 million) and were held by the BCV (CVE 4.6 billion) and INPS (CVE 6.7 b~~m~~illion).

The planned use of the Trust Fund. As of end-2019, the offshore account had €106 million; and the corresponding liabilities amounted to €102.7 million (5.7 percent of GDP). The authorities plan to use the resources in the offshore account to set up the SPIGF (€90 million) that will be invested and used to provide guarantees to capital-intensive private investment projects; and an Emergency Fund (€10 million) for rapid response to natural disasters. The balance would be allocated to the government budget (€6 million). Under this plan, the SPIGF will issue a bond to the Treasury, and the Treasury will issue bonds at 3 percent interest rate to replace the TCMFs, with debt service paid by the Treasury. The final modalities of the TCMFs replacement and parameters related to the new bonds will be clarified in the strategy currently under preparation. The authorities stressed that one important aspect in this regard would be to avoid a mismatch between assets and liabilities.

[1] The TCMFs were originally not included in the stock of domestic public debt, which would explain an increase in gross debt with the issuance of bonds replacing them.