September 2004
IMF Country Report No. 04/304

Cape Verde: Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Cape Verde

In the context of the fourth review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility and request for waiver of performance criteria with Cape Verde, the following documents have been released and are included in this package:

- the staff report for the fourth review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **May 7, 2004,** with the officials of Cape Verde on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on August 6, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **August 26, 2004** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its August 27, 2004 discussion** of the staff report that completed the review and request.

- a statement by the Executive Director for Cape Verde.

The documents listed below have been or will be separately released.

Joint Staff Assessment of the Poverty Reduction Strategy Paper Preparation Status Report
Poverty Reduction Strategy Paper—Preparation Status Report
Letters of Intent sent to the IMF by the authorities of Cape Verde*
Memorandum of Economic and Financial Policies by the authorities of Cape Verde*
Technical Memorandum of Understanding*
*May also be included in the Staff Report

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

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

CAPE VERDE

Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria

Prepared by the African Department

(In consultation with other Departments)

Approved by Menachem Katz and Mark Plant

August 6, 2004

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 (www.imf.org). Four loans totaling SDR 4.92 million have been disbursed, and another SDR 1.23 million becomes available at the completion of this review.

Developments. Economic performance in 2003 was good. Real GDP grew by 5.3 percent and prices by 1.2 percent, reflecting strength in agriculture and tourism. Official inflows were lower than expected, resulting in (i) lower public investment and a smaller-than-expected fiscal deficit (3.3 percent of GDP, including grants); (ii) a smaller-than-expected external current account deficit; and (iii) a small decline in international reserves. Although transmission lags from the tightening of monetary policy in October 2003 resulted in the nonobservance of the performance criteria pertaining to net international reserves and net domestic assets of the central bank at end-December, developments through April 2004 mark a return to the program path.

Letter of intent and memorandum on economic and financial policies. The authorities reaffirm their commitment to the fiscal and monetary restraint needed to sustain the peg to the euro, as well as to measures to strengthen antipoverty programs and enhance international competitiveness. They request three waivers of performance criteria.

Discussions. During April 22–May 7, 2004, the staff team met with Prime Minister José Maria Neves, Finance Minister João Serra, Governor Olavo Correira of the Bank of Cape Verde, and other officials and private sector representatives.

Staff. The team included Messrs. Rogers (Head), Camard, Cuc, Mehado, and Ould-Abdallah (Reserch Assistant), and Ms. Montero (Administrative Assistant) (All AFR).

Contents Page

I. Introduction

1. **On April 10, 2002, the Executive Board 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 (www.imf.org).** On the same occasion, the Executive Board approved Cape Verde's interim poverty reduction strategy paper (I-PRSP) (www.imf.org), as did IDA shortly afterward. The first review under the PRGF arrangement was concluded on December 16, 2002, together with the 2002 Article IV consultation. The second review was concluded on June 25, 2003, at which time Executive Directors concluded that Cape Verde's PRSP preparation status report provided a sound basis for Fund concessional assistance. The third review was completed on December 19, 2003.

2. **In the letter (Appendix III), and its attached supplementary memorandum of economic and financial policies (MEFP), the government of Cape Verde requests the completion of the fourth PRGF review and waivers for the nonobservance of two quantitative performance criteria for end-December 2003 and one continuous performance criterion.** The supplementary MEFP reviews progress made during 2003 and sets forth policies to be implemented through the end of 2004. Progress will be monitored by quantitative performance criteria for end-June and end-December 2004, as well as structural performance criteria and benchmarks through December 2004. A fifth disbursement of SDR 1.23 million is being requested, conditional on the completion of the fourth review.

II. Program Implementation in 2003

3. **Economic performance in 2003 was better than programmed in many respects: real GDP growth was higher, inflation was lower, the fiscal and external current account deficits were smaller (both including and excluding official grants), and the terms of trade were stronger.** However, monetary policy was somewhat looser than programmed, resulting in a weaker balance of payments than envisaged. As a result, the performance criteria pertaining to net international reserves and net domestic assets of the Bank of Cape Verde (BCV) were not observed. All other structural performance criteria for December were observed, and the value- added tax (VAT) and tariff reform were implemented in January 2004 as scheduled.[1]

Key Indicators

(In percent, unless otherwise indicated)

	2002	2003	2004
Real growth	4.9	5.3	5.5
Inflation	1.9	1.2	1.0
M2 growth	14.3	8.6	7.9
Private credit growth	12.0	15.2	10.1
Net credit to government/GDP	3.6	1.1	0.3
Revenue/GDP	22.4	21.6	22.5
Expenditure/GDP	33.4	30.3	32.3
Fiscal deficit/GDP	-2.6	-3.3	-4.3
Current account/GDP	-12.0	-8.9	-9.0
Reserves/Imports (months)	2.0	1.8	2.0

[1] VAT collections in the first quarter of 2004 totaled 1.2 percent of GDP, against an annual target of 4.9 percent of GDP. This is indicative of a fairly successful launch.

4. **Stronger economic growth reflected the continued rapid growth in tourism and a rebound in agriculture following drought conditions in 2002.** Inflation, which peaked at 4½ percent in early 2003 as a result of drought, declined sharply late in the year following an excellent harvest (Table 1 and Figure 1). The exchange rate peg to the euro also helped contain inflation. Low inflation, in turn, has helped to preserve international competitiveness. While the maintenance of the peg remains dependent on continued high levels of aid and remittances, confidence in it is such that there has been no need for the central bank to use its authority to restrict capital outflows.

5. **The central government ran an overall deficit (including grants) of 3.3 percent of GDP, against 4.1 percent of GDP in the program** (Table 2). Total revenue was broadly in line with the program, with lower tax revenues largely offset by higher non-tax revenues. The latter development reflected better financial outturns in publicly-owned enterprises. Total expenditure was lower than programmed, primarily because of a more modest implementation rate for the public investment program.

6. **Monetary conditions were looser than programmed**. By the time reserve requirements were raised in late October 2003, banks had already made lending commitments through the end of the year. Despite unusually high levels of activity in the interbank market, the most aggressive lenders still needed to draw heavily from the discount window at the end of the year, almost entirely offsetting the effect of the October tightening. As a result, credit to the economy expanded by 15 percent during the year, compared with a programmed 12 percent, putting pressure on the balance of payments (Table 3). Consequently, the performance criteria for end-December 2003 on net domestic assets and net international reserves of the central bank were not observed.

7. **Progress on structural reforms, which had been robust through most of 2003, was more mixed in the run-up to municipal elections, though a number of delayed actions have since been taken**.[2] The government has made progress with the reform of public utility Electra and state-owned airline TACV, which together had losses equal to 2.5 percent of GDP in 2002. The government made slower progress in a few other areas. Despite progress in clearing arrears with some public service enterprises (MEFP, paragraph 6), a comprehensive assessment of the stock of verified domestic arrears has not been completed. In addition, the review of tax exemptions has been delayed because of difficulties in obtaining the necessary technical assistance. More recently, however, the government has taken important steps to accelerate regulatory reform and to reinvigorate the privatization program (Box 1; and MEFP, paragraph 5).

---

[2] Ahead of the municipal elections, Finance Minister Carlos Burgo unexpectedly resigned, and his portfolio was assumed by Prime Minister José Maria Neves. After the elections, the Prime Minister formed a new cabinet, appointing former State Secretary for Finance João Serra as the new Minister of Finance. The next parliamentary elections are due in early 2006.

Box 1. Status of the Privatization Program

Cape Verde's privatization program commenced in the early 1990s, with the government committing itself to privatizing most of its close to 50 poorly-performing state-owned enterprises. By 1998, the number of SOEs was reduced to about 30. More than 40 new, fully-private companies were created from the fragmentation of some SOEs into separate companies and the corporatization of state-run assets which were then divested. In 1999-2000, with the support of the World Bank, major enterprises such as Cape Verde Telecom, Electra, and the major state-owned commercial banks were privatized. Following that, the pace of privatization slowed, and only a small number of enterprises have been privatized or liquidated since then.

The government has recently committed to completing the privatization program by the end of 2005. In addition to building up the necessary regulatory capacity, this will primarily entail execution of new action plans to privatize six enterprises:

- **Arca Verde,** which provides maritime transport services for passengers and goods over eighteen regular inter-island routes, has been formally in liquidation since 1998, but has remained in operation pending the entry of alternative service providers. The process for awarding minimum service contracts for uneconomic routes is underway, and the disposal of the four remaining vessels is expected to be finalized by the end of this year.

- National airline **TACV** continues to experience losses in its operations, albeit at much reduced levels from 2002. While management of the company has improved, the government is moving forward with privatization plans: a request for bids has recently been issued for a management contract to restructure the company and prepare it for privatization.

- The fish freezing and storage facility **Interbase**, which serves the commercial fishing fleet, is receiving a government subsidy to cover its very large electricity bills. A first attempt to privatize the company failed. The second attempt yielded three bidders acceptable to the government, and their proposals are now under evaluation. The process is expected to be completed in the coming months.

- **ENAPOR** operates nine ports around the country. Although the Government secured the services of Booz-Allen & Hamilton to develop a privatization strategy for ENAPOR in 1999, the effort was not completed because the regulatory environment was judged inadequate. However, an implementation schedule has now been agreed, and the two major ports should be privatized, and the secondary ports concessioned, by mid-2005.

- Dockyard **CABNAVE** is expected to attract substantial investor interest. A contract has been signed with a consultant to prepare the company for privatization.

- Privatization of pharmaceutical maker and distributor **EMPROFAC** depends heavily on a regulatory framework for the pharmaceutical sector. A new regulatory agency (ARFA) is being established, and the pre-privatization process is expected to be launched shortly.

8. The ceiling on nonconcessional debt was raised to US$10 million during the third PRGF review to allow for two loans by the OPEC Fund for International Development to finance a school and a health center.[3] The first of these loans, for US$5 million, was signed in early February 2004. Negotiations on the second loan were concluded in May. By that time, the amount of the loan was raised from US$5 million to US$6 million to accommodate additional costs, including the impact of the depreciation of the U.S. dollar against the euro. At the time of the third review, the terms of the loan would have resulted in a grant element of 35 percent, but by the time the loan had been signed, the grant element had fallen to 34 percent as a result of the downward revision in the commercial interest reference rates on which the calculation is based. The program limit was therefore exceeded by $1 million.

9. In addition, the authorities have negotiated (but not yet signed) a loan from ECOWAS for an amount equivalent to about US$7 million to help finance the new international airport in Praia (MEFP, paragraph 14). Although the authorities intend drawing the loan in dollars, it is officially denominated in SDRs and, applying the commercial interest reference rate for SDRs, the grant element of the loan would be 31 percent – i.e. it would be nonconcessional.[4] Given the importance of the airport project for Cape Verde's growth and development strategy, the strong commercial viability of this project, and its positive impact on the future financial performance of TACV, the staff supports the authorities' request that the continuous performance criterion for the ceiling on nonconcessional debt be raised to accommodate this loan (MEFP Table 3). The loan would have minimal impact on Cape Verde's external vulnerability, with the NPV of debt to exports ratio remaining comfortably below 150 percent and declining.

III. Report on the Discussions

10. The discussions focused on (i) the elements of the macroeconomic policy framework for 2004; (ii) specific fiscal and monetary policies to achieve the international reserve accumulation target for 2004 without interrupting poverty reduction efforts; (iii) the implementation of structural reforms to strengthen public service enterprises and enhance international competitiveness; and (iv) progress in preparing the poverty reduction strategy paper (PRSP).

A. The Macroeconomic Policy Framework for 2004

11. **The discussions on the macroeconomic framework for 2004 focused on the need to ensure that fiscal and monetary policies were consistent with an increase in international reserve coverage and adequate growth in credit to the private sector**. Particularly as the rapid credit expansion in 2003 provided some scope for limiting growth in 2004, the mission and authorities agreed that the credibility of the exchange rate peg depended on a demonstrable

---

[3] See page 9 of Country report No. 03/402 (12/3/03).

[4] The loan is for 20 years with a 5 year grace period and interest rate of 3 percent. If the U.S. dollar commercial interest reference rate were applied, the grant element of the loan would be 36 percent – i.e. it would be concessional.

improvement in reserve coverage, especially in light of the loss of reserves in 2003. At the same time, both the authorities and the mission recognized that increasing international reserve cover by more than the 0.2 months of imports agreed at the time of the third PRGF review would require a substantial fiscal effort. This would make it difficult for the authorities to implement their poverty reduction strategy and other programs, notably a strengthening of domestic security and a reduction in the stock of domestic arrears.

12. **Against this background, the macroeconomic framework for 2004 is broadly in line with the one agreed at the time of the third PRGF review.** Real GDP is projected to grow by 5 ½ percent in 2004, driven primarily by an increase in tourism, and 12-month inflation is projected to be on the order of 2 percent. With money demand rising in line with nominal GDP, bank credit to the government will be limited to 0.3 percent of GDP in order to support an increase in reserve coverage by 0.2 months and adequate credit to the economy. The program is fully financed for 2004.

Box 2. Structural Conditionality

Status and coverage of structural conditionality under the PRGF-supported program

Beginning with the second review under the PRGF arrangement, structural conditionality has been limited to deepening fiscal transparency, strengthening the tax system, and improving the regulatory environment, including through measures restricting unbudgeted subsidies to public service enterprises. (For current coverage, see MEFP Table 4; for status of earlier measures, see MEFP, Table 2; and Country report 03/402 (12/31/03), Appendix IV, Attachment I, Table 2.)

Structural Areas Covered by World Bank lending and conditionality

The World Bank is pursuing reform of public service enterprises in greater depth, as well as improvements in related areas, through a Privatization & Regulation Project and a Growth & Competitiveness Project. A Poverty Reduction Support Credit is being prepared, but the associated conditionality has not yet been established.

Other relevant structural reforms not included in the current program

The tariff system continues to provide substantial protection for domestic industry, even after the January 2004 reforms. The authorities, who are now in negotiations to join the WTO, expect to introduce another round of tariff reforms in the next few years.

B. Fiscal Policy for 2004

13. **The 2004 budget passed by the National Assembly is in line with understandings reached during discussions for the third review.** It strikes a balance between the authorities' desire to move ahead with priority spending and the need to ensure that fiscal policy supports the

targeted increase in net international reserves and adequate growth in credit to the private sector. Domestic revenue is now projected to rise to 22 ½ percent of GDP, notably higher than programmed. The better outlook for revenues reflects the one-off collection of tax arrears (amounting to 0.9 percent of GDP) and higher dividends from public enterprises (0.7 percent of GDP), especially from the state-owned airport authority. Total expenditures are targeted to increase to 32 percent of GDP, as envisaged during the third review. Recurrent outlays will rise, primarily to support the hiring and training of more teachers, doctors, and security personnel. Capital expenditures will also rise, reflecting increased spending on schools, health facilities and roads. The overall fiscal deficit (excluding grants) would be more than covered by net external financing (including grants amounting to 5 ½ percent of GDP). This would permit a reduction in the government's domestic financial liabilities, including a substantial amount of old arrears.

14. **The mission reiterated its view that the recent trend in recurrent expenditures could not be sustained in the medium term without significantly higher levels of donor budget support or domestic revenue**. The major factor behind the increase in expenditures is the rapidly growing wage bill, which reflects the hiring and training of teachers (and, to a lesser extent, doctors and security personnel). The authorities agreed with this assessment and reaffirmed their commitment to ensuring that the pace of implementing their poverty reduction strategy remained fully consistent with continued macroeconomic stability. They noted that the recent increase in the number of teachers was a necessary component of the government's decision, effective 2001, to raise the minimum number of years of compulsory education from four to six. They indicated that the hiring needed to accommodate the influx of students was largely complete and that the growth in the wage bill would slow substantially in 2005.

15. **Regarding fiscal reforms, the authorities indicated that they were focusing on the remaining implementation issues from the January introduction of the VAT**. FAD is continuing to provide technical assistance, and the authorities have indicated that they will be stepping up efforts in the areas of compliance and taxpayer relations. These efforts will serve as structural benchmarks for the program (MEFP, paragraph 9). Officials of the Ministry of Finance noted that technical difficulties with the revenue- and expenditure-tracking system are making it difficult to compile quarterly accounts of fiscal operations to report to the National Assembly. They did indicate, however, that they will make every effort to begin doing so by end-June 2004. The authorities intend to complete a comprehensive assessment of tax exemptions by end-September, subject to obtaining appropriate technical assistance, with a view to reducing their number in the 2005 budget.

C. Monetary Policy for 2004

16. **The discussions on monetary policy centered on the expected impact going forward of the October 2003 increase in reserve requirements on international reserve accumulation, and on the scope for lowering reserve requirements over the medium term.** While expressing a desire to see interest rates fall over the medium term, the monetary authorities reaffirmed their commitment to orient policy toward the accumulation of international reserves. Officials in both the central bank and government recognized that this orientation is indispensable to sustaining the peg and improving market confidence. These officials noted that structural

reforms in credit markets could be more effective in lowering lending rates at this juncture than monetary policy, a view shared by the mission (MEFP, paragraph 12). The central bank agreed that the current tighter stance of policy should continue until there were clear signs of a sustainable upward trend in international reserves.

17. **The implementation of monetary policy is hampered by the lack of competition in the banking system**. With few auction participants and the central bank barred by law from purchasing government securities for its own account, interest rates on government securities are very sensitive to short-term liquidity conditions. Indeed, there is concern at the central bank to ensure that a lowering of reserve requirements (or remuneration of required reserves) translates into reduced loan-deposit spreads rather than higher bank profits. The BCV has requested technical assistance from the Fund to assist in the development of more robust instruments of monetary policy and in the development of the strategy for a transition to lower reserve requirements.

18. **Developments in the first four months of 2004 suggest a return to the program path for credit and reserve accumulation despite the technical impediments to monetary management.** Credit to the economy grew at an annual rate of only 6.4 percent in the first quarter, reflecting balance sheet adjustment by the commercial banks, and international reserves rose. The margin between the program target for reserves (after adjustment) and the outturn fell from €3.5 million at end-December to less than €0.5 million at end-March, and substantial foreign exchange inflows were reported during April.

19. **For 2004 as a whole**, **broad money is projected to increase by about 8 percent, in line with nominal GDP**. Net bank credit to government will be limited to ¼ percent of GDP, while credit to the economy would grow by about 10 percent, reflecting a return to the program path following the adjustment in the first quarter.[5] This stance is expected to yield an increase in gross international reserves of at least €14 million, raising reserve coverage to 2.0 months of imports of goods and services.

D. Structural Reforms

20. **The discussions on structural reforms focused on simplifying the complex financial relationships between the government and the main public service enterprises.** The efficient functioning of and competitive pricing by these enterprises are a critical part of the environment for private sector development, and the avoidance of excessive subsidy payments is critical to maintaining macroeconomic stability. The discussions therefore covered the areas of privatization, regulation, and arrears (Box 2; and MEFP, paragraph 14). A key element of the government's effort to regularize its financial relations with Electra (the water and power company) is the adoption of an automatic and transparent mechanism by the Economic

[5] It implies an annualized growth rate of 12 percent for the final three quarters of the year. This was the targeted growth rate for 2003-04 under the program prior to last year's slippages.

Regulatory Agency (ARE) for adjusting electricity and water tariffs in response to changes in costs. Its establishment would be a structural performance criterion for end-December 2004.

21. **The mission also discussed measures to strengthen bank supervision**. The system of monthly offsite bank examinations continues to work well. Two of the three offshore banks had onsite examinations in 2003, and an onsite examination of the largest commercial bank was recently completed, though the latter was limited in scope to examining the bank's reserves and loan-loss provisions. While there is currently no regulation setting limits on open foreign exchange positions at commercial banks, the central bank continues to monitor developments closely, and a draft regulation has been prepared with the aim of implementation by the end of the year. A number of micro credit institutions have been created in Cape Verde, but as yet they are not taking deposits.

E. Program Monitoring

22. The proposed quantitative and structural performance criteria and indicative targets through June 2004 are specified in Tables 3 and 4 of the MEFP (Appendix III, Attachment I). The definitions of relevant terms and the specification of reporting requirements are contained in the amended technical memorandum of understanding (TMU, Appendix III, Attachment II). The staff expects to hold discussions on the fifth review by October 2004. The fifth review will focus on the budget for 2005, on the implications for economic policies of the PRSP, and on structural reforms to enhance international competitiveness and private sector development.

F. The PRSP Process and the Medium-Term Framework

23. **The government expects to finalize its PRSP during the third quarter of 2004**. The mission was provided with a draft PRSP, which includes an ambitious action plan for broad consultation and revision prior to finalization. As the PRSP has not been finalized within one year of the last preparation status report (PSR), the authorities have prepared a second PSR for consideration by the Executive Boards of the Fund and the World Bank. The authorities had not yet constructed a detailed macroeconomic framework and medium-term expenditure framework for the PRSP at the time of the discussions, but the mission and the authorities agreed that the basic parameters of the framework set forth in the previous MEFP remained broadly appropriate.[6] That framework projected real GDP growth on the order of 5–7 percent; inflation of 2-3 percent; and an increase in gross international reserves to the equivalent of 2½–3 months of imports of goods and services. Broad money is projected to grow in line with nominal GDP, and credit to the economy somewhat more rapidly. The fiscal deficits projected for the medium term would be consistent with declining external and domestic debt burdens.

[6] Discussions between the authorities and the staff over objectives and methodologies for the medium-term framework are ongoing. Given the robustness of the recent DSA (EBS/03/192, December 4, 2003, Appendix III) and the advanced state of PRSP preparation, the mission did not discuss details of a medium-term framework with the authorities, but will incorporate the PRSP framework in staff projections in the context of the fifth review.

24. **The authorities expect to focus on securing financial support through the medium term once they have completed the PRSP.** The mission reiterated the importance of the PRSP as the mechanism for setting forth clear strategies for education and health care and identifying the budget support necessary to implement the strategies within the macroeconomic framework set out in the document.

IV. Staff Appraisal

25. **Over the past year, the government has remained consistently focused on maintaining macroeconomic stability**. The staff commends the authorities for returning the economy to the program path following the slippages of early 2003. The nonobservance of two quantitative performance criteria for end-December 2003, while unfortunate, stems primarily from technical factors, as does the nonobservance of the continuous performance criterion on the contracting of nonconcessional debt.

26. **The strong performance of the economy is a reflection of a generally sound policy framework**. Economic growth remains robust, inflation remains low, international reserves are rising, and progress is being made in establishing the conditions for rapid economic growth in the future.

27. **The staff believes the authorities' proposed policy mix for 2004 to be appropriate for the maintenance of these favorable conditions**. The authorities are to be commended for recognizing that conditions are not yet in place for a lowering of interest rates, but that adherence to the program is essential to eventual rate cuts. The very promising launch of the VAT, undertaken in the heat of an election campaign, should be followed up with progress in developing taxpayer assistance programs and in enforcement. Measures to enhance fiscal transparency would also, in the staff's view, be highly beneficial.

28. **The staff welcomes the government's determination to regain the momentum that was lost in some areas of structural reform during the recent election campaign**. The new action plans of the privatization unit, notably for TACV, should be pursued with vigor. In this regard, progress in developing the regulatory environment is also essential. While a good start has been made in regularizing financial relations with Electra, much more needs to be done, and a lasting solution will require the adoption of an electricity tariff-setting mechanism by the Economic Regulatory Agency.

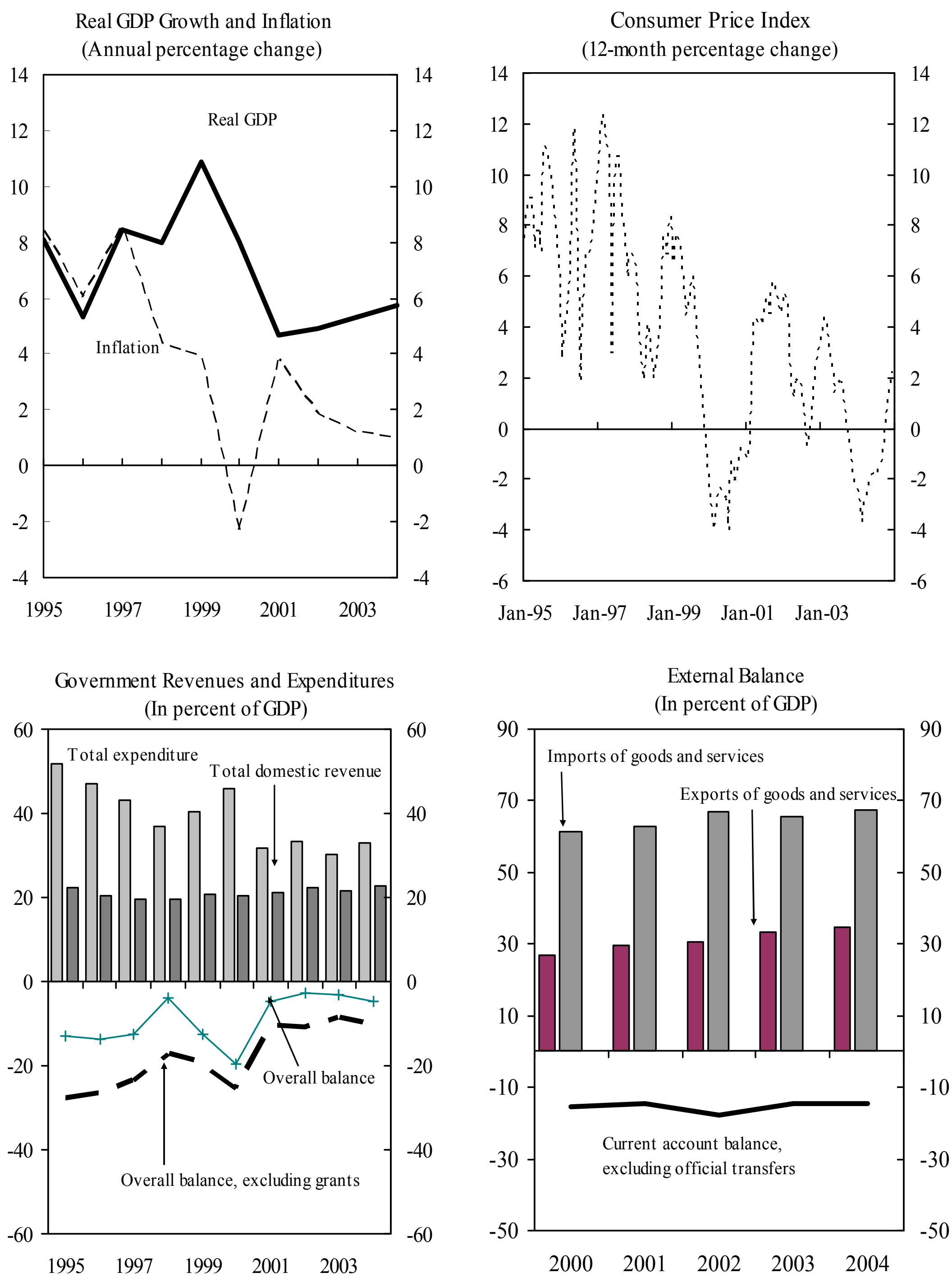
29. **Despite the favorable outlook, the staff recommends continued vigilance against potential risks.** Given the limited effectiveness of indirect monetary instruments, early attention needs to be paid to any signs of renewed rapid credit growth. Also, in preparing the 2005 budget, the staff urges the authorities to resist pressures for higher spending ahead of the January 2006 parliamentary elections, but rather to focus on reducing tax exemptions, in order to avoid a repetition of past election-year reverses.

30. **The forthcoming PRSP promises to be a useful tool in the authorities' efforts to raise growth beyond the 5 – 5 ½ percent range and to make further headway in the effort to reduce poverty**. The staff calls on the authorities to complete the document at the earliest date

consistent with maintaining quality. The PRSP will give the authorities the opportunity to set clear and attainable goals for public education and health and to cost and prioritize their programs. In this context, the staff urges the authorities to ensure that the implementation of their poverty reduction strategy, with special regard to the wage bill, is compatible with continued macroeconomic stability.

31. **On the strength of the policies being pursued by the authorities, as well as their track record of policy implementation, the staff recommends the completion of the fourth review under the PRGF arrangement**. It also supports the authorities' request for waivers for the nonobservance of two performance criteria for end-December, as the corrective measures taken have now had the intended effect, and for the nonobservance of the performance criterion limiting the contracting of nonconcessional debt.

Figure 1. Cape Verde: Selected Economic Indicators, 1995–2004 [1]

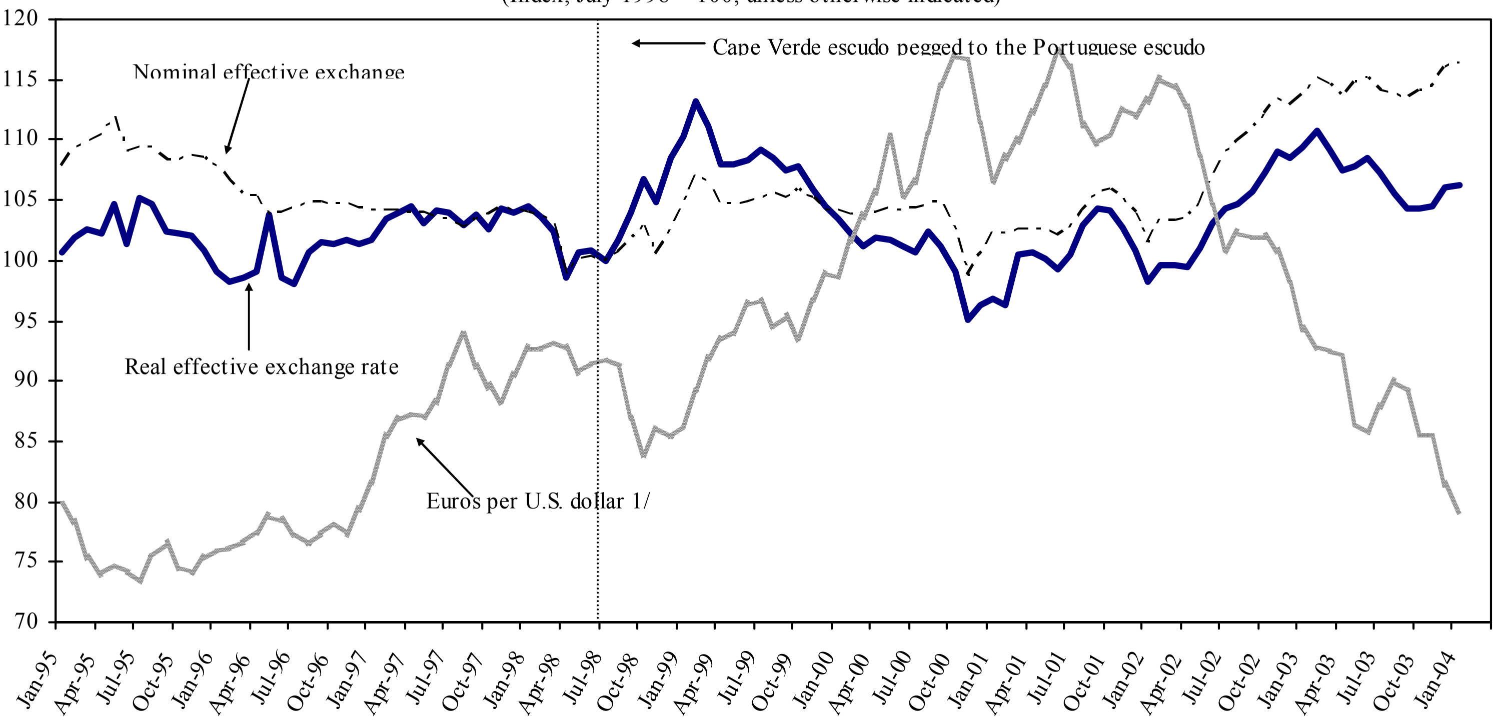


Sources: Cape Verdean authorities; and Fund staff estimates and projections.

1/ Data for 2004 are projections.

Figure 2. Cape Verde: Real and Nominal Effective Exchange Rates, January 1995–April 2004

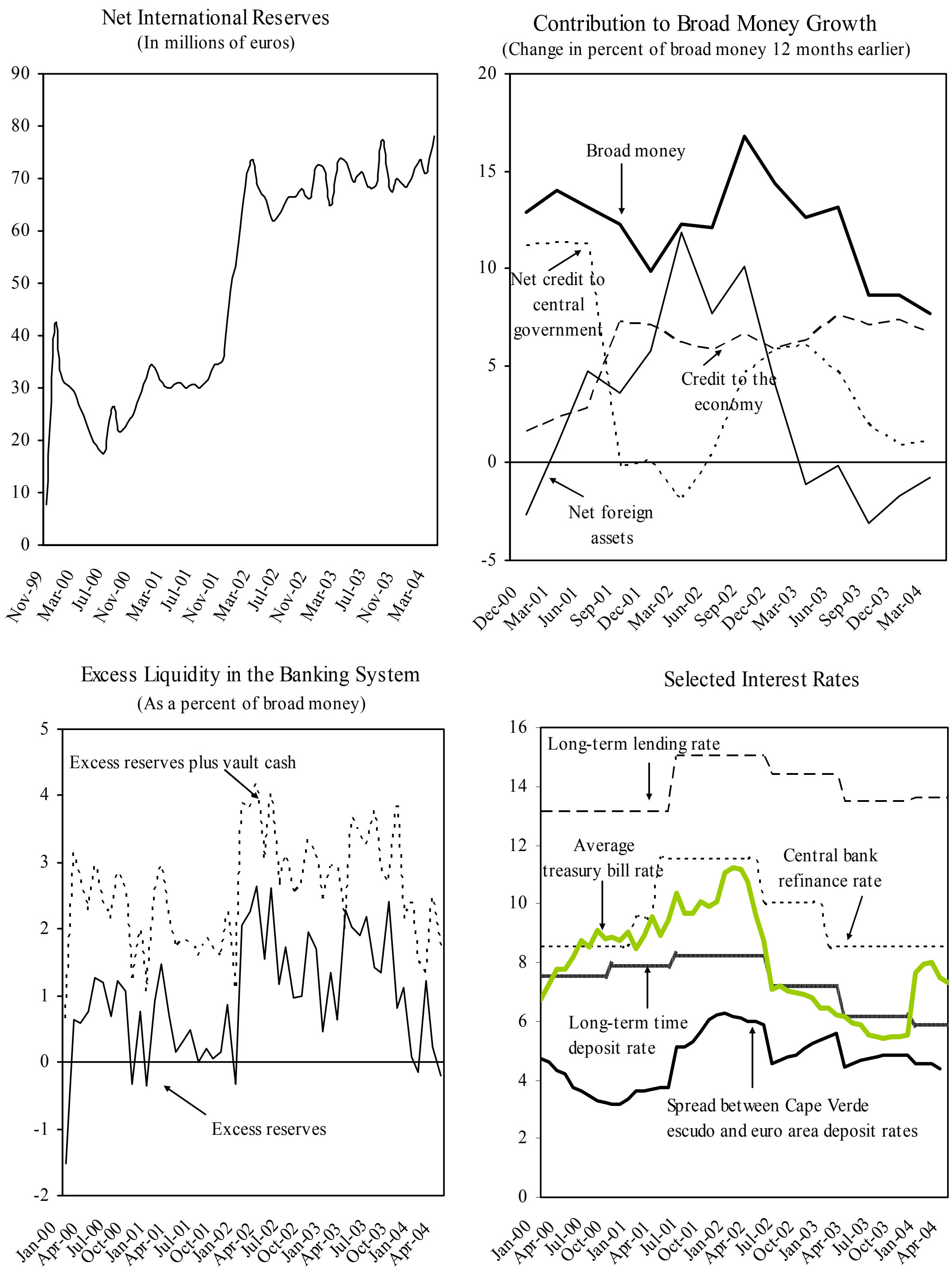
(Index, July 1998 = 100, unless otherwise indicated)



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

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

Figure 3. Cape Verde: Monetary Indicators, January 2000–April 2004
(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, 2001–04

	2001	2002	2003 Program 1/	2003 Prel.	2004 Program 1/	2004 Rev. Proj.
			(Annual percentage change)			
National income and prices						
Real GDP	4.7	4.9	5.0	5.3	5.0	5.5
Real GDP (per capita)	2.8	3.1	3.1	3.4	3.1	3.6
Consumer price index (annual average)	3.8	1.9	2.3	1.2	2.0	1.0
Consumer price index (end of period)	4.6	3.0	2.0	-2.3	2.0	2.0
External sector						
Exports (in euros) 2/	17.5	10.5	4.1	18.6	9.0	9.8
Imports (in euros) 2/	10.6	13.8	5.2	7.2	6.1	8.3
Real effective exchange rate (annual average)	0.2	2.6	...	3.4	...	...
Terms of trade (minus = deterioration)	0.7	-0.9	2.0	2.3	1.1	1.2
Government budget						
Total revenue (excluding grants)	12.1	12.3	2.2	5.1	4.6	12.1
Total expenditure	-25.4	12.2	6.7	-1.2	6.2	14.9
Recurrent and extraordinary expenditure	-31.2	3.0	8.6	6.4	9.9	13.8
Capital expenditure	-9.6	27.8	-0.4	-18.0	4.5	26.8
			(Annual change in percent of beginning-of-period broad money, unless otherwise indicated)			
Money and credit						
Net domestic assets	4.0	10.5	7.5	10.3	6.2	5.6
Of which: net claims on the central government	0.1	5.9	1.6	0.9	0.0	0.5
credit to the economy	7.1	5.9	6.1	7.3	6.2	5.1
Broad money (M2)	9.8	14.3	7.8	8.6	8.2	7.9
Domestic broad money (M2X)	3.4	10.3	…	4.2	…	4.4
Income velocity (GDP/M2)	1.59	1.52	1.49	1.49	1.49	1.48
Discount rate 3/	11.5	10.0	...	8.5	...	...
			(In percent of GDP)			
Saving-investment balance						
Gross domestic investment	18.4	21.5	19.8	18.2	19.6	18.2
Public	5.3	6.3	5.7	4.7	5.6	5.6
Private	13.1	15.3	14.0	13.5	14.1	12.6
Gross national savings	7.6	9.6	9.4	9.3	9.2	9.2
Of which: public sector	5.4	9.7	6.7	5.5	5.2	6.6
External current account (including official transfers)	-10.8	-12.0	-10.3	-8.9	-10.5	-9.0
Government budget						
Total revenue	21.3	22.4	21.7	21.6	21.0	22.5
Total grants	5.9	8.5	7.0	5.4	5.6	5.6
Total expenditure	31.8	33.4	32.7	30.3	32.2	32.3
Overall balance (including grants)	-4.7	-2.6	-4.1	-3.3	-5.6	-4.3
Domestic bank financing	0.1	3.6	1.0	1.1	0.0	0.3
Total public debt 4/	92.4	85.6	81.6	72.0	80.2	72.2
External public debt 5/	63.2	55.2	53.5	42.9	53.8	45.4
Domestic public debt 6/	29.2	30.4	28.1	29.1	26.4	26.8
External current account (excluding official transfers)	-14.6	-17.6	-17.3	-14.3	-16.1	-14.6
Overall balance of payments (incl. identified financing)	2.7	3.6	0.8	-0.1	0.5	1.4
			(In millions of U.S. dollars, unless otherwise indicated)			
External current account (Million euros, including official transfers)	-68.4	-80.9	-76.1	-65.8	-83.3	-71.2
Gross international reserves (Million euros, end of period)	47.5	76.1	86.2	74.1	99.4	88.2
Gross international reserves (in months of imports of goods and services)	1.4	2.0	2.2	1.8	2.4	2.0
External debt service (in percent of exports of goods and nonfactor services)	29.2	15.6	11.5	9.7	12.4	11.1
Memorandum items:			(In units specified)			
Nominal GDP (in billions of Cape Verde escudos)	69.7	74.4	81.2	81.2	87.5	87.4
Exchange rate (Cape Verde escudos per U.S. dollar)						
Period average	123.2	117.2	...	97.7	...	...
End period	125.1	105.1	...	87.3	...	...

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

1/ As contained in the December 4, 2003 staff report (EBS/03/162).
2/ Exports and imports of goods and nonfactor services.
3/ Central bank lending rate; in percent.
4/ Including verified stock of domestic and external arrears.
5/ Projection numbers include financing gap.
6/ Excluding the claims on the offshore Trust Fund.

Table 2. Cape Verde: Annual Fiscal Operations of the Central Government, 2001-04

	2000	2001	2002	2003		2004	
				Program 1/	Prel.	Program 1/	Rev. Proj.
	(In billions of Cape Verde escudos, unless otherwise indicated)						
Revenue, grants, and net lending	17.14	18.94	22.98	23.24	21.91	23.27	24.52
Domestic revenue	13.24	14.83	16.66	17.59	17.51	18.39	19.63
Tax revenue 2/	11.76	12.99	14.68	15.71	15.46	16.55	17.18
Income and profit taxes	3.91	4.79	5.13	5.54	5.30	6.08	6.34
Consumption taxes	1.89	2.10	2.47	2.50	2.50	2.69	5.99
Taxes on goods and services	1.89	2.10	2.47	...	2.50	...	1.67
Value-added tax	0.00	0.00	0.00	...	0.00	...	4.32
International trade taxes 2/	4.81	5.34	6.13	6.79	6.76	6.83	3.88
Other taxes	1.16	0.76	0.95	0.87	0.90	0.94	0.97
Nontax revenue	1.48	1.54	1.76	1.33	1.51	1.58	2.19
Net lending	0.00	0.29	0.22	0.55	0.54	0.26	0.26
External grants	3.90	4.11	6.32	5.65	4.40	4.88	4.88
Capital grants	3.90	4.11	5.16	4.88	3.63	4.88	4.88
Budget support	0.00	0.00	1.16	0.77	0.77	0.00	0.00
Total expenditure	29.73	22.19	24.89	26.56	24.58	28.22	28.25
Recurrent expenditure 3/	17.17	14.86	15.31	16.62	16.28	18.26	18.52
Primary recurrent expenditure	15.78	13.36	13.31	14.53	14.28	16.09	16.44
Wages and salaries	6.41	6.58	7.09	8.48	9.36	9.28	10.77
Goods and services	0.47	0.57	0.60	1.54	1.32	1.66	1.66
Transfers and subsidies	6.84	5.72	4.89	3.90	2.84	4.35	3.21
Other expenditures	2.06	0.50	0.73	0.60	0.77	0.81	0.81
Domestic interest payments	0.82	0.94	1.44	1.51	1.48	1.59	1.48
External interest payments	0.56	0.57	0.56	0.58	0.52	0.57	0.59
Extraordinary expenditures	4.46	0.00	0.22	0.63	0.63	0.23	0.00
Capital expenditure	8.10	7.32	9.36	9.32	7.67	9.73	9.73
Foreign financed	6.78	6.19	8.64	8.50	6.91	8.71	8.71
Domestically financed	1.32	1.13	0.72	0.82	0.76	1.02	1.02
Overall balance, including grants 4/	-12.58	-3.24	-1.91	-3.32	-2.68	-4.94	-3.74
Financing	12.97	2.99	1.37	3.32	2.48	2.07	1.22
Foreign (net)	3.38	2.11	1.15	3.15	1.45	1.76	1.69
Total drawings	2.43	7.56	4.14	5.28	3.55	4.38	4.38
Balance of payments, budget	0.00	5.09	1.34	1.66	1.34	0.55	0.55
Project loans	2.43	2.46	2.81	3.62	2.21	3.83	3.83
Amortization	-1.32	-5.44	-2.99	-2.13	-2.10	-2.62	-2.69
Domestic (net)	9.58	0.88	0.22	0.17	1.04	0.31	-0.47
Banking system	5.22	0.05	2.69	0.82	0.93	0.01	0.30
Nonbanks	2.09	1.34	1.46	0.39	0.68	0.30	0.30
Of which : Privatization revenues	1.68	0.06	0.00	0.00	0.00	0.00	0.00
Domestic arrears 2/	2.28	-0.51	-3.94	-1.03	-0.58	0.00	-1.06
Net errors and omissions	-0.38	0.25	0.55	0.00	0.19	0.00	0.00
Financing gap	0.00	0.00	0.00	0.00	0.00	2.87	2.51
Identified possible financing	...	...	...	...	...	2.24	2.51
Netherlands	...	...	...	...	...	0.33	0.33
European Union	...	...	...	...	...	0.66	0.61
African Development Bank	...	...	...	...	...	0.33	0.26
World Bank	...	...	...	...	...	0.92	1.31
Residual financing gap	...	...	...	...	...	0.63	0.00
Memorandum items:							
Domestic expenditures 5/		15.42	15.70	17.48	17.16	18.93	18.94
Domestic balance 6/		-0.59	0.96	0.11	0.35	-0.54	0.69
Primary domestic balance 7/		0.34	2.40	1.62	1.83	1.05	2.17
Primary recurrent domestic balance 8/		1.46	3.35	3.07	3.23	2.30	3.19
Overall balance, excluding grants 9/	-16.49	-7.35	-8.23	-8.97	-7.08	-9.82	-8.62
Net external flows 10/	7.29	6.22	7.47	8.80	5.85	9.51	9.09
External debt service (in percent of domestic revenue)	14.22	40.53	21.32	15.41	14.95	17.35	16.72
Tax and non-tax arrears 11/		...	...	...	0.46	...	0.80

Table 2. Cape Verde: Annual Fiscal Operations of the Central Government, 2001-04 (Concluded)

	2001	2002	2003		2004	
			Program 1/	Prel.	Program 1/	Rev. Proj.
	(In percent of GDP, unless otherwise indicated)					
Revenue, grants, and net lending	27.2	30.9	28.6	27.0	26.6	28.1
Domestic revenue	21.3	22.4	21.7	21.6	21.0	22.5
Tax revenue 2/	18.6	19.7	19.3	19.0	18.9	19.7
Income and profit taxes	6.9	6.9	6.8	6.5	7.0	7.3
Consumption taxes	3.0	3.3	3.1	3.1	3.1	6.9
Taxes on goods and services	3.0	3.3	0.0	3.1	0.0	1.9
Value-added tax	0.0	0.0	0.0	0.0	0.0	4.9
International trade taxes 2/	7.7	8.2	8.4	8.3	7.8	4.4
Other taxes	1.1	1.3	1.1	1.1	1.1	1.1
Nontax revenue	2.2	2.4	1.6	1.9	1.8	2.5
Net lending	0.4	0.3	0.7	0.7	0.3	0.3
External grants	5.9	8.5	7.0	5.4	5.6	5.6
Capital grants	5.9	6.9	6.0	4.5	5.6	5.6
Budget support	0.0	1.6	0.9	0.9	0.0	0.0
Total expenditure	31.8	33.4	32.7	30.3	32.2	32.3
Recurrent expenditure 3/	21.3	20.6	20.5	20.0	20.9	21.2
Primary recurrent expenditure	19.2	17.9	17.9	17.6	18.4	18.8
Wages and salaries	9.4	9.5	10.4	11.5	10.6	12.3
Goods and services	0.8	0.8	1.9	1.6	1.9	1.9
Transfers and subsidies	8.2	6.6	4.8	3.5	5.0	3.7
Other expenditures	0.7	1.0	0.7	0.9	0.9	0.9
Domestic interest payments	1.3	1.9	1.9	1.8	1.8	1.7
External interest payments	0.8	0.7	0.7	0.6	0.7	0.7
Extraordinary expenditures	0.0	0.3	0.8	0.8	0.3	0.0
Capital expenditure	10.5	12.6	11.5	9.4	11.1	11.1
Foreign financed	8.9	11.6	10.5	8.5	10.0	10.0
Domestically financed	1.6	1.0	1.0	0.9	1.2	1.2
Overall balance, including grants 4//	-4.7	-2.6	-4.1	-3.3	-5.6	-4.3
Financing	4.3	1.8	4.1	3.1	2.4	1.4
Foreign (net)	3.0	1.5	3.9	1.8	2.0	1.9
Total drawings	10.8	5.6	6.5	4.4	5.0	5.0
Amortization	-7.8	-4.0	-2.6	-2.6	-3.0	-3.1
Domestic (net)	1.3	0.3	0.2	1.3	0.4	-0.5
Banking system	0.1	3.6	1.0	1.1	0.0	0.3
Nonbanks	1.9	2.0	0.5	0.8	0.3	0.3
Of which : Privatization revenues	0.1	0.0	0.0	0.0	0.0	0.0
Domestic arrears 2/	-0.7	-5.3	-1.3	-0.7	0.0	-1.2
Net errors and omissions	0.4	0.7	0.0	0.2	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	3.3	2.9
Identified possible financing	...	...	...	...	2.6	2.9
Netherlands	...	...	...	...	0.4	0.4
European Union	...	...	...	...	0.8	0.7
African Development Bank	...	...	...	...	0.4	0.3
World Bank	...	...	...	...	1.1	1.5
Residual financing gap	...	...	...	...	0.7	0.0
Memorandum items:						
Domestic expenditures 5/	22.1	21.1	21.5	21.1	21.6	21.7
Domestic balance 6/	-0.9	1.3	0.1	0.4	-0.6	0.8
Primary domestic balance 7/	0.5	3.2	2.0	2.3	1.2	2.5
Primary recurrent domestic balance 8/	2.1	4.5	3.8	4.0	2.6	3.6
Overall balance, excluding grants 9/	-10.5	-11.1	-11.0	-8.7	-11.2	-9.9
Net external flows 10/	8.9	10.0	10.8	7.2	10.9	10.4
External debt service (in percent of domestic revenue)	40.5	21.3	15.4	14.9	17.3	16.7
Tax and non-tax arrears 11/	...	...	...	0.6	...	0.9

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

1/ As contained in the December 4, 2003 staff report (EBS/03/162).
2/ 2003 includes exceptional revenues of CVEsc 455 million from old tax debt that were used to clear arrears of the same amount.
3/ As a result of repeated changes in budget classification, subitems are not consistent across columns.
4/ "Overall balance, including grants" = revenue including grants - total expenditure.
5/ "Domestic expenditure" = total expenditure - external interest - foreign financed capital expenditure.
6/ "Domestic balance" = domestic revenue - domestic capital participation - domestic expenditure
7/ "Primary domestic balance"= domestic revenue - domestic capital participation - domestic expenditure + domestic interest payments
8/ "Primary recurrent domestic balance"= domestic revenue - domestic capital participation - primary current expenditure
9/ "Overall balance, excluding grants" = revenue excluding grants - total expenditure.
10/ Excluding external interest payments, and including financing gap.
11/ 2004 includes tax and non-tax arrears of CVEsc 803 million to clear arrears with Shell, Telecom, and construction companies.

Table 3. Cape Verde: Monetary Survey, 2002-04

	2002	2003		2004				
	Dec.	December		March	June		Sep.	Dec.
	Actual	Program	Actual	Actual	Prog.	Rev. Proj.	Rev. Proj.	Rev. Proj.
	(In millions of Cape Verde escudos, unless otherwise specified)							
Net foreign assets	11,331	11,489	10,456	11,170	12,325	11,706	11,490	11,793
Foreign assets	13,841	14,708	13,434	14,138	15,643	14,933	14,767	15,289
Of which: foreign reserves	8,391	9,507	8,173	8,479	10,441	9,273	9,108	9,730
Foreign liabilities	-2,511	-3,219	-2,978	-2,968	-3,318	-3,227	-3,278	-3,496
Net domestic assets	41,027	44,972	46,428	46,800	46,987	48,003	49,115	49,608
Net domestic credit	49,916	53,844	54,504	54,910	55,725	56,113	57,225	57,684
Net claims on general government	24,790	25,533	25,562	25,516	25,929	26,335	26,216	25,830
Claims on the Trust Fund (TCMFs)	10,600	10,600	11,038	11,038	10,600	11,038	11,038	11,038
Net claims on the central government	14,368	15,185	14,859	14,839	15,581	15,659	15,539	15,154
Credit to central government	16,546	17,379	17,097	17,113	17,775	17,932	17,813	17,456
Deposits of central government	-2,178	-2,194	-2,238	-2,273	-2,194	-2,273	-2,273	-2,301
Of which: project deposits	-397	...	-393	-351	...	-351	-351	-351
Net claims on local government	8	115	67	80	115	80	80	80
Net claims on other government agencies (INPS)	-186	-367	-402	-442	-367	-442	-442	-442
Credit to the economy	25,126	28,311	28,943	29,394	29,796	29,778	31,009	31,854
Credit to public enterprises	230	193	180	167	193	167	167	191
Credit to private sector	24,890	28,113	28,726	29,191	29,598	29,574	30,806	31,626
Claims on nonbank financial institutions	6	4	37	36	4	36	36	37
Other items (net)	-8,889	-8,871	-8,076	-8,110	-8,737	-8,110	-8,110	-8,076
Broad money (M2)	52,358	56,461	56,884	57,971	59,312	59,710	60,605	61,401
Narrow money (M1)	22,621	22,998	22,989	22,104	23,589	22,301	22,237	23,894
Currency outside banks	6,459	5,695	6,516	5,925	5,985	5,971	5,757	6,754
Demand deposits	16,162	17,304	16,474	16,180	17,604	16,330	16,480	17,140
Quasi money	27,636	30,803	31,662	33,378	32,954	34,639	35,547	35,097
Time deposits	25,857	28,995	29,983	30,842	...	...	...	33,285
Other quasi-monetary deposits	1,779	1,808	1,679	2,536	...	...	...	1,813
Foreign currency deposits	2,101	2,660	2,232	2,488	2,770	2,770	2,821	2,410
	(Change in percent of broad money 12 months earlier)							
Net foreign assets	3.9	0.3	-1.7	-0.7	3.0	1.8	2.5	2.4
Net domestic assets	10.5	7.5	10.3	8.4	5.3	7.2	7.7	5.6
Net domestic credit	12.7	7.5	8.8	8.6	7.0	7.7	8.2	5.6
Net claims on the central government	5.9	1.6	0.9	1.2	1.7	1.9	2.0	0.5
Credit to the economy	5.9	6.1	7.3	6.6	5.1	5.1	5.6	5.1
Credit to public enterprises	0.0	-0.1	-0.1	-0.1	0.0	-0.1	0.0	0.0
Credit to private sector	5.9	6.2	7.3	6.6	5.1	5.1	5.6	5.1
Valuation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items (net)	-2.3	0.0	1.6	-0.2	-1.7	-0.5	-0.5	0.0
Broad money	14.3	7.8	8.6	7.7	8.3	9.0	10.2	8.0
Selected monetary indicators								
Income velocity of money	1.52		1.49	...	...	...	...	1.48
Emigrant deposits	19,042	21,424	22,153	22,676	...	23,276	24,300	25,140
Excess reserves /total deposits (in percent)	0.5	0.4	0.1	0.3	0.4	0.4	0.4	0.1
Money multilplier (M2 / M0)	3.22	3.38	3.29	3.38	3.38	3.25	3.34	3.34
Credit to the economy (percentage change)	12.0	12.7	15.2	13.8	14.0	10.3	11.0	10.1

Table 3. Cape Verde: Monetary Survey, 2001-04 (continued)

	2002	2003		2004				
	Dec.	December		March	June		Sep.	Dec.
	Actual	Program	Actual	Actual	Prog.	Rev. Proj.	Rev. Proj.	Rev. Proj.
	(In millions of Cape Verde escudos, unless otherwise specified)							
Bank of Cape Verde								
Net foreign assets	8,632	9,311	8,088	8,391	10,245	9,185	9,020	9,298
Of which: net international reserves	7,984	8,736	7,528	7,834	9,508	8,465	8,300	8,741
Foreign assets	9,135	10,178	8,818	9,135	11,112	9,929	9,764	10,386
Foreign liabilities	-503	-867	-730	-744	-867	-744	-744	-1,088
Net domestic assets	7,605	7,386	9,201	8,763	7,294	9,201	9,101	9,080
Net domestic credit	9,728	9,604	10,652	10,204	9,377	10,641	10,541	10,532
Trust Fund claims	4,167	4,167	4,605	4,605	4,167	4,605	4,605	4,605
Net claims on central government	4,103	4,182	4,425	4,239	3,956	4,676	4,576	3,449
Credit to central government	5,302	4,927	5,373	5,157	4,701	5,594	5,494	4,395
Deposits of central government	-1,199	-745	-947	-918	-745	-918	-918	-946
Of which: project accounts	-397	...	-393	-351	...	-351	-351	-351
Of which: foreign currency deposits	-330	...	-456	-469	...	-469	-469	-469
Claims on local government	0	0	0	0	0	0	0	0
Credit to the economy	1,184	1,188	1,212	1,208	1,188	1,208	1,208	1,212
Credit to public enterprises	72	72	72	72	72	72	72	72
Credit to private sector	1,112	1,116	1,107	1,103	1,116	1,103	1,103	1,107
Claims on nonbank financial institutions	0	0	33	33	0	33	33	33
Credit to commercial banks	275	67	410	152	67	152	152	1,266
Valuation	0	0	0	0	0	0	0	0
Other items (net)	-2,123	-2,218	-1,452	-1,440	-2,084	-1,440	-1,440	-1,452
Assets	2,345	...	2,396	2,418	...	...	...	2,396
Liabilities	4,468	...	3,848	3,859	...	...	...	3,848
Reserve money (M0)	16,237	16,697	17,289	17,154	17,539	18,386	18,120	18,379
Currency outside banks	6,459	5,695	6,516	5,925	5,985	5,971	5,757	6,754
Cash in vaults	1,013	773	808	828	805	1,591	1,319	820
Deposits of commercial banks	8,764	10,225	9,964	10,400	10,745	10,823	11,044	10,804
Deposits of private sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0
Deposits of other financial institutions	1	4	0	1	4	1	1	0
Gross international reserves (mn. Euros)	76.1	86.2	74.1	76.9	94.7	84.1	82.6	88.2
Net international reserves (mn. Euros)	72.4	79.2	68.2	71.0	86.2	76.7	75.2	79.2
Reserve money (12-month change in percent)	11.4	2.8	6.5	1.6	2.9	7.9	6.3	6.3

Table 3. Cape Verde: Monetary Survey, 2002-04 (concluded)

	2002	2003		2004				
	Dec.	December		March	June		Sep.	Dec.
	Actual	Program	Actual	Actual	Prog.	Rev. Proj.	Rev. Proj.	Rev. Proj.
	(In millions of Cape Verde escudos, unless otherwise specified)							
Commercial banks								
Net foreign assets	2,699	2,178	2,368	2,780	2,079	2,521	2,470	2,495
Foreign assets	4,706	4,530	4,616	5,004	4,530	5,004	5,004	4,903
Foreign liabilities	-2,007	-2,352	-2,248	-2,224	-2,451	-2,483	-2,534	-2,408
Of which: Nonresident deposits	-1,650	-1,970	-1,811	-1,811	-2,069	-2,069	-2,120	-1,992
Net domestic assets	43,199	48,588	48,000	49,265	51,248	51,217	52,378	52,152
Net domestic credit	49,964	55,242	54,625	55,934	57,902	57,887	59,047	58,776
Net claims on general government	16,521	17,184	16,531	16,672	17,807	17,054	17,035	17,777
Trust Fund claims	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433
Other government deposits (INPS)	-186	-367	-402	-442	-367	-442	-442	-442
Net claims on central government	10,265	11,003	10,433	10,600	11,626	10,982	10,963	11,705
Loans and overdrafts	6,704	7,313	7,302	7,381	7,313	7,381	7,381	7,381
Holding of government securities	4,540	5,139	4,423	4,575	5,762	4,957	4,938	5,680
Deposits of central government	-979	-1,449	-1,291	-1,355	-1,449	-1,355	-1,355	-1,355
Net claims on local government	8	115	67	80	115	80	80	80
Claims on local government	266	261	239	231	261	231	231	231
Deposits of local government	-259	-146	-172	-151	-146	-151	-151	-151
Credit to the economy	23,941	27,123	27,731	28,186	28,608	28,570	29,801	30,641
Credit to public enterprises	158	121	108	95	121	95	95	118
Credit to private sector	23,778	26,998	27,619	28,088	28,483	28,472	29,703	30,519
Claims on nonbank financial institutions	6	4	4	3	4	3	3	4
Net claims on the Bank of Cape Verde	9,502	10,931	10,363	11,076	11,483	12,263	12,211	10,358
Total reserves	9,777	10,998	10,772	11,228	11,550	12,415	12,363	11,624
Vault cash	1,013	773	808	828	805	1,591	1,319	820
Deposits with central bank	8,764	10,225	9,964	10,400	10,745	10,823	11,044	10,804
Required reserves	8,518	10,020	9,924	10,259	10,525	10,603	10,824	10,761
Excess reserves	246	205	40	141	220	220	220	43
Credit from the Bank of Cape Verde	-275	-67	-410	-152	-67	-152	-152	-1,266
Other items (net)	-6,765	-6,653	-6,625	-6,669	-6,653	-6,669	-6,669	-6,625
Deposit liabilities to nonbank residents	45,898	50,766	50,368	52,045	53,328	53,739	54,848	54,647
Local currency deposits	43,796	48,107	48,135	49,557	50,558	50,969	52,027	52,237
Demand deposits	16,161	17,304	16,473	16,179	17,604	16,330	16,480	17,140
Of which: emigrant deposits	2,133	2,293	2,202	2,174	...	...	...	2,499
Quasi money	27,636	30,803	31,662	33,378	35,724	37,409	38,368	35,097
Time deposits	25,857	28,995	29,983	30,842	...	...	...	33,285
Of which: emigrant deposits	15,817	17,974	18,918	19,472	...	...	...	21,469
Other quasi-monetary deposits	1,779	1,808	1,679	2,536	...	...	...	1,813
Foreign currency deposits	2,101	2,660	2,232	2,488	2,770	2,770	2,821	2,410
Of which: emigrant deposits	1,092	1,157	1,033	1,030	...	1,030	1,030	1,172
Memorandum items:								
Emigrant deposits (as ratio to total deposits)	0.36	0.38	0.39	0.39	...	...	...	0.41
Other deposits (as ratio to total deposits)	0.64	0.62	0.61	0.61	...	...	...	0.59
Composition of emigrant deposits	1.00	1.00	1.00	1.00	...	...	...	1.00
Local currency	0.94	0.95	0.95	0.95	...	...	...	0.95
Demand	0.11	0.11	0.10	0.10	...	...	...	0.10
Time	0.83	0.84	0.85	0.86	...	...	...	0.85
Foreign currency	0.06	0.05	0.05	0.05	...	...	...	0.05

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

Table 4. Cape Verde: Balance of Payments, 2001–04
(In millions of euros, unless otherwise indicated)

	2001	2002	2003		2004	
			Program 1/	Est.	Program 1/	Proj.
Current account balance	-68.4	-80.9	-76.1	-65.8	-83.3	-71.2
Trade balance	-222.0	-256.4	-270.8	-257.3	-284.5	-276.6
Exports, f.o.b.	41.5	44.5	44.3	46.7	49.5	51.4
Imports, f.o.b.	-263.5	-300.9	-315.1	-304.0	-334.0	-328.0
Services (net)	11.9	11.3	10.8	18.1	14.8	21.0
Credit	144.9	161.4	170.1	197.5	184.2	216.8
Of which: tourism	59.3	68.1	70.4	74.0	77.1	82.8
Debit	-133.0	-150.2	-159.3	-179.4	-169.4	-195.8
Factor income (net)	-6.8	-12.4	-14.2	-12.1	-13.5	-13.0
Credit	7.5	7.1	6.3	13.7	7.0	11.4
Debit	-14.4	-19.5	-20.5	-25.8	-20.5	-24.5
Government interest	-5.1	-5.0	-5.2	-4.7	-5.2	-5.4
Interest by other sectors	-7.8	-8.1	-8.5	-18.8	-10.0	-12.4
Income on direct investment and other income	-1.4	-6.3	-6.8	-2.4	-5.3	-6.7
Current transfers (net)	148.5	176.6	198.2	185.5	199.9	197.4
Government	23.6	37.7	51.2	39.9	44.3	44.3
Other	124.9	138.9	147.0	145.6	155.7	153.1
Capital and financial account (net)	86.5	102.7	82.2	66.5	67.2	59.5
Capital transfers	27.2	9.6	8.8	18.8	10.2	9.3
Government	0.0	2.2	0.0	4.0	0.0	0.0
Other	27.2	7.4	8.8	14.8	10.2	9.3
Direct investment (net)	8.9	15.6	17.1	12.2	19.7	13.5
Portfolio investment	1.6	0.0	0.0	0.0	0.0	0.0
Government	19.2	10.4	28.5	9.1	15.9	15.3
Trust Fund	0.0	0.0	0.0	-4.0	0.0	0.0
Net official flows	19.2	10.4	28.5	13.1	15.9	15.3
Disbursements	68.5	37.6	47.9	32.2	39.7	39.7
Amortization	-49.4	-27.2	-19.3	-19.0	-23.8	-24.4
Other capital	29.6	67.1	27.7	26.4	21.4	21.3
Commercial banks	-1.0	9.8	4.7	4.4	-0.1	-1.2
Emigrant deposit flows	28.2	31.3	21.6	28.2	21.5	27.1
Commercial credit (net)	6.0	23.4	1.4	-5.5	0.0	0.0
Other	-3.5	2.6	0.0	-0.8	0.0	-4.6
Net errors and omissions	-1.0	2.5	0.0	-1.3	0.0	0.0
Overall balance	17.2	24.4	6.1	-0.6	-16.0	-11.8
Financing	-17.2	-24.4	-6.1	0.6	-10.0	-11.0
Flow in NFA of central bank (– =accumulation)	-17.2	-24.4	-6.1	0.6	-10.0	-11.0
Of which: change in net international reserves	-17.0	-26.1	-6.8	4.1	-10.0	-11.0
Of which: IMF (net)	0.0	3.2	3.8	2.6	3.2	3.1
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0
Change in government arrears (+=increase)	-16.8	0.0	-7.3	0.0	0.0	0.0
Rescheduling/cancellation of arrears	16.8	0.0	7.3	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	26.0	22.7
Identified possible financing	...	...	...	...	20.3	22.7
Residual financing gap	...	...	...	...	5.7	0.0
Memorandum items:						
Current account (including official transfers) 2/	-10.8	-12.0	-10.3	-8.9	-10.5	-9.0
Current account (excluding official transfers) 2/	-14.6	-17.6	-17.3	-14.3	-16.1	-14.6
Overall balance 2/	2.7	3.6	0.8	-0.1	-2.0	-1.5
Gross international reserves	47.5	76.1	86.2	74.1	99.4	88.2
In months of imports of goods and nonfactor services	1.4	2.0	2.2	1.8	2.4	2.0
External public debt	399.4	372.3	393.6	387.6	409.6	403.8
Assuming financing gap is filled	...	...	...	...	426.7	426.5

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

1/ As contained in the December 4, 2003 staff report (EBS/03/162).

2/ In percent of GDP.

Table 5. Cape Verde: External Public Debt Outstanding, 2000–03
(In millions of U.S. dollars, unless otherwise indicated; end of period)

	2000	2001	2002	2003
Multilateral	226.9	252.2	288.4	315.9
AfDF 1/	77.9	86.2	85.5	95.5
IDA	101.9	110.1	143.4	158.1
IMF	0.0	0.0	3.3	6.9
BADEA 1/	12.5	20.6	20.6	22.5
AfDB 1/	1.3	1.3	0.6	0.2
EIB 1/	9.0	8.1	7.0	8.7
OPEC 1/	7.3	7.7	10.7	11.2
IFAD 1/	10.2	8.9	9.1	9.9
Saudi Fund 1/	0.0	0.3	0.0	0.0
NDF 1/	2.3	2.9	2.7	2.9
NTF 1/	4.5	6.2	5.4	0.0
Bilateral	74.4	77.2	82.2	91.7
Government	55.5	56.0	67.7	70.3
China	13.4	0.0	0.0	0.0
Kuwait	2.5	4.4	2.9	3.7
Portugal	24.2	41.3	44.1	46.7
South Africa	3.8	0.0	0.0	0.0
Abu Dhabi	0.2	0.2	0.1	0.0
Germany	11.4	10.1	20.6	19.9
Export credit agencies	18.9	21.2	14.5	21.5
Caisse Général des Dépôts	3.9	4.7	7.0	8.3
ICO (Spain)	6.7	7.9	1.2	6.6
CACEX (Brazil)	2.2	2.4	2.4	2.6
SOMEC (Portugal)	6.2	6.3	3.9	4.0
Private companies	…	8.2	12.4	15.6
Banco Espirito Santo	…	7.5	11.8	15.6
MSF (Portugal)	…	0.7	0.7	0.0
Total (excluding arrears)	301.3	337.6	383.0	399.6
As percent of GDP	55.3	60.6	54.1	42.9
Stock of external debt arrears	22.8	14.5	7.5	0.0
Total (including arrears)	324.1	352.1	390.5	399.6
As percent of GDP	59.5	63.2	55.2	42.9
Total (including arrears and financing gap)	324.1	352.1	390.5	399.6
As percent of GDP	59.5	63.2	55.2	42.9
In millions of Cape Verde escudos	38,412	44,052	41,064	34,886

Source: Ministry of Finance and Planning.

1/ AfDF = African Development Fund; BADEA = Arab Bank for Economic Development for Africa; for 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; and NTF = Nigeria Trust Fund.

Table 6. Cape Verde: Vulnerability Indicators, 1998–2004

	1998	1999	2000	2001	2002	2003	2004 Proj.
			(In units indicated)				
Real effective exchange rate (annual percentage change) 1/	-0.5	5.3	-7.4	0.2	2.6	3.4	...
Nominal effective exchange rate (annual percentage change) 1/	-2.2	3.7	-1.9	0.2	4.0	6.3	...
Nominal Cape Verde escudos-U.S. dollar rate (annual percentage change) 2/	5.3	5.4	15.6	3.0	-4.9	-16.6	...
Domestic credit growth (annual percentage change)	5.6	11.3	25.2	7.1	13.2	9.2	3.7
Overall fiscal balance, including grants (in percent of GDP)	-3.9	-12.5	-19.5	-4.7	-2.6	-3.3	-4.4
Public debt (in percent of GDP)	81.8	86.1	107.5	107.6	99.8	87.7	87.4
Domestic debt, including claims on the offshore trust fund (in percent of GDP)	36.9	32.9	48.0	44.4	44.7	42.2	38.7
Domestic debt, excluding claims on the offshore trust fund (in percent of GDP)	36.9	21.9	31.6	29.2	30.4	29.1	26.6
External debt (in percent of GDP)	44.9	53.2	59.5	63.2	55.2	45.5	48.7
Scheduled external debt service relative to gross international reserves (in percent)	167.7	87.8	56.2	114.8	42.3	32.0	33.7
Scheduled external debt service relative to fiscal domestic revenues (in percent)	13.0	32.1	14.2	40.5	21.3	14.9	16.7
Gross international reserves (in months of imports of goods and nonfactor services)	0.3	1.5	1.0	1.4	2.0	1.8	2.0
Broad money relative to official reserves (in percent)	4,081.0	789.7	1,245.3	874.3	624.0	696.0	619.2
Broad money relative to net foreign assets (in percent)	572.0	455.5	584.1	479.2	462.1	544.0	511.5
Central bank lending rate	10.0	8.5	9.5	11.5	10.0	8.5	...
Private transfers (in percent of GDP)	15.7	18.4	21.0	19.8	20.6	19.8	19.7
Current account, excluding official current transfers (in percent of GDP)	-21.4	-20.6	-15.3	-14.6	-17.6	-14.3	-14.9
Exports of goods and nonfactor services relative to imports of goods and nonfactor services (in percent)	38.6	37.0	44.3	47.0	45.7	50.5	51.2
Tourism receipts and foreign direct investment (in percent of GDP)	5.5	13.5	13.5	10.8	12.4	11.7	12.4
Tourism receipts (annual percentage change)	41.7	46.3	66.2	35.6	14.8	8.6	12.0

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

1/ A minus sign symbolizes a depreciation.

2/ A minus sign symbolizes an appreciation.

Table 7. 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 26, 2003	Observance of the performance criteria for December 31, 2002 and completion of the second review under the arrangement.
SDR 1.23 million	December 19, 2003	Observance of the performance criteria for June 30, 2003 and completion of the third review under the arrangement.
SDR 1.23 million	August 2, 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	March 16, 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.

Table 8. Cape Verde: Millennium Development Goals

	1990	1995	2001	2002	2015 Target
Goal 1. Eradicate extreme poverty and hunger					
Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.					
1. Population below US$ 1 a day (percent)	...	...	...	...	...
2. Poverty gap ratio at US$ 1 a day (percent)	...	...	...	...	...
3. Share of income or consumption held by poorest 20 percent (percent)	...	...	...	...	...
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger					
4. Prevalence of child malnutrition (percent of children under 5)	...	13.5	...	...	6.8
5. Population below minimum level of dietary energy consumption (percent)	...	...	...	...	...
Goal 2. Achieve universal primary education					
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling					
6. Net primary enrollment ratio (percent of relevant age group)	...	...	...	...	...
7. Percentage of cohort reaching grade 5	...	...	...	...	...
8. Youth literacy rate (percent age 15-24)	81.5	85.0	88.6	89.1	...
Goal 3. Promote gender equality and empower women					
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015					
9. Ratio of girls to boys in primary and secondary education (percent)	...	96.1	...	...	100.0
10. Ratio of young literate females to males (percent ages 15-24)	87.5	90.4	93.3	93.8	100.0
11. Share of women employed in the nonagricultural sector (percent)	...	...	...	...	...
12. Proportion of seats held by women in the national parliament (percent)	12.0	11.0	11.0	11.0	...
Goal 4. Reduce child mortality					
Target 5: reduce by two-thirds between 1990 and 2015, the under-five mortality rate					
13. Under-five mortality rate (per 1,000)	60.0	50.0	38.0	36.0	20.0
14. Infant mortality rate (per 1,000 live births)	45.0	37.0	29.0	30.0	...
15. Immunization against measles (percent of children under 12-months)	79.0	66.0	72.0	...	...
Goal 5. Improve maternal health					
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	190.0	...	...	...
17. Proportion of births attended by skilled health personnel	...	54.0	...	...	...
Goal 6. Combat HIV/AIDS, malaria and other diseases					
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS					
18. HIV prevalence among females (percent ages 15-24)	...	...	...	...	...
19. Contraceptive prevalence rate (percent of women ages 15-49)	...	...	...	...	...
20. Number of children orphaned by HIV/AIDS	...	...	...	...	...
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases					
23. Incidence of tuberculosis (per 100,000 people)	...	...	182.0	...	...
24. Tuberculosis cases detected under DOTS (percent)	...	...	...	...	...

Table 8. Cape Verde: Millennium Development Goals (concluded)

	1990	1995	2001	2002	2015 Target
Goal 7. Ensure environmental sustainability					
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources					
25. Forest area (percent of total land area)	8.7	...	21.1	...	...
26. Nationally protected areas (percent of total land area)	...	0.0	0.0	...	
27. GDP per unit of energy use (PPP $ per kg oil equivalent)	...	...	...	...	...
28. CO2 emissions (metric tons per capita)	0.2	0.3	0.3	...	...
Target 10: Halve by 2015 proportion of people without access to safe drinking water					
30. Access to improved water source (percent of population)	...	...	74.0	...	...
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers					
31. Access to improved sanitation (percent of population)	...	...	71.0	...	...
32. Access to secure tenure (percent of population)	...	...	...	...	...
Goal 8. Develop a Global Partnership for Development 1/					
Target 16: Develop and implement strategies for productive work for youth.					
45. Unemployment rate of population ages 15-24 (total)	...	...	...	...	...
Target 18: Make available new technologies, especially information and communications					
47. Fixed line and mobile telephones (per 1,000 people)	...	...	21.5	...	...
48. Personal computers (per 1,000 people)	...	81.7	68.6	...	...

Sources: World Bank; and Fund staff estimates.

1/ Targets 12-15 and indicators 29, 33-44 are excluded because they can not be measured on a country specific basis. These are related to official development assistance, market access, and the HIPC Initiative. Indicators 21 and 22 are not relevant for Cape Verde.

Cape Verde: Relations with the Fund
(As of June 30, 2004)

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	0.05

III. **SDR Department**:	SDR million	%Allocation
Net cumulative allocation	0.62	100.0
Holdings	0.00	0.56

IV. **Outstanding Purchases and Loans**:	SDR million	% Quota
Poverty Reduction and Growth Facility (PRGF) Arrangement	4.92	51.25

V. **Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	4/10/2002	4/09/2005	8.64	4.92
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				
	2004	2005	2006	2007	2008
Principal	0.00	0.00	0.00	0.12	0.49
Charges/interest	0.02	0.04	0.04	0.04	0.03
Total	0.02	0.04	0.04	0.16	0.53

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the Bank of Cape Verde (BCV) is subject to an assessment with respect to the PRGF arrangement approved on April 10, 2002. A safeguards assessment of the BCV was completed on December 9, 2002. The assessment identified certain vulnerabilities in the reporting, internal control, and audit areas, and made appropriate recommendations, as reported in Country report No. 03/152 (06/23/03). The BCV has taken steps to implement many of the recommendations and has requested technical assistance for the rest.

VIII. **Exchange Arrangements**:

The currency of Cape Verde, the Cape Verde escudo, it has been pegged to the euro, at a rate of CVEsc 110.3 per EUR 1 since January 4, 1999. Cape Verde avails itself of the transitional arrangements of Article XIV. The staff is not aware of any remaining exchange restrictions on current transactions.

IX. **Article IV Consultation**:

Discussions of the 2002 Article IV consultation and the first review under the 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 (Country report No. 03/152 (06/23/03); and www.imf.org. 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 the Bank of Cape Verde, the Ministry of Finance, and, more recently, the National Institute of Statistics in several areas: (i) The Bank of Cape Verde has received technical from MFD, in organization and methods, management of external debt, monetary and banking statistics, accounting, credit, and foreign exchange operations, management of public debt, and the separation of the functions of the Bank of Cape Verde, as well as on the choice of exchange rate regime. It has also received technical assistance from STA in monetary and balance of payments statistics. (ii) The Ministry of Finance has received technical assistance from FAD, in organization and budgetary procedures, budgeting, tax policy, and tax administration; and (iii) the National Institute of Statistics has received technical assistance in national accounts and is now starting to receive assistance in price statistics. Cape Verde is a participant in STA's GDDS Regional Project for Lusophone Africa, and has recently posted its metadata on the web. It is receiving technical assistance to implement the GDDS plan for improvement in the context of this project.

Most recently, technical assistance has been provided in the following areas:

- An FAD follow-up visit in June 2004 was the most recent mission to help the authorities move to a VAT, including the rationalization of the import tariff and the overhaul of the domestic indirect tax system. Many visits and a two-year resident advisor have gone into this effort.

- STA missions have recently taken place on national accounts (November 2003), balance of payments statistics (February 2004), government finance statistics (March 2004), and price statistics (June 2004).

- In July 2003, an MFD expert visited the Bank of Cape Verde to advise on safeguards issues.

XI. **Resident Representative:** None.

Cape Verde: IMF-World Bank Relations

(Data as at April 30, 2004)

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) (www.imf.org). The I-PRSP focuses on promoting governance, entrepreneurial capacity, competitiveness, and growth; developing human capital through the education and training system; promoting social development, combating poverty, and strengthening cohesion and solidarity; and developing basic and economic infrastructure. The authorities are now preparing their final PRSP (expected by August 2004).

World Bank Group strategy

2. The objective of the World Bank Group's assistance strategy is to help Cape Verde reduce poverty by supporting the Government's I-PRSP and forthcoming PRSP. The Bank has engaged the Government in a dialogue on budget support, on the basis of sector programs presented in the forthcoming PRSP. The Bank's current strategic focus supports efforts in the areas of (i) macroeconomic management and institutional capacity building; (ii) policy reforms in support of private sector development; and (iii) human resource development and poverty reduction. Bank-supported interventions aim at broadening the basis of private sector participation in Cape Verde's economy and enhancing private sector competitiveness. Components of the strategy include the following: improving the investment climate; building institutional capacity; implementing pension reforms; and modernizing and restructuring the financial sector.

World Bank Group activities and assessment of country policies

IDA portfolio

3. The current World Bank portfolio gives a high priority to capacity building in the social, public, and infrastructure sectors, and to the careful introduction of market-based incentives for private sector development. 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.

4. 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. A proposed Road Sector operation is under preparation. 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 lower 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 Growth and Competitiveness Project supports the private sector development strategy.

5. In the social sectors, the Social Sector Development Supplemental Credit supports poverty reduction for the 30 percent of the population living below the poverty line by (i) assisting the government in restructuring 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 (NGOs) in carrying out cost-effective poverty alleviation interventions; 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 commensurate with Cape Verde's social and economic goals. An HIV/AIDS project went into effect in 2002. The credit supports (i) mitigation of the health and socioeconomic 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.

6. The Bank's 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 – currently under preparation), which will 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.

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 policymaking, 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 and a public expenditure review, leading a study of the pension system, participating in a Country Financial Accountability Assessment (along with the Netherlands and the European Union) and an assessment of the procurement mechanisms of the state, and supporting important statistical work (such as a household survey).

9. In addition to advisory services, the Bank has shifted toward providing 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. They both closed in June 2003. The associated credits supported the Government's stabilization program and helped 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.

As of April 30, 2004, IDA had extended 21 credits to Cape Verde, amounting to about US$198 million equivalent, of which about US$162 million equivalent has been disbursed. Twelve credits have closed, and the current portfolio includes nine credits, with associated credit amounts of about US$90 million equivalent and an undisbursed balance of about US$36 million. The involvement of the International Finance Corporation (IFC) in Cape Verde is limited.

World Bank-Fund collaboration in specific areas

10. The Fund and the Bank continue to collaborate in many areas, including fiscal operations and tax reform; public enterprise reform and privatization; utility regulation and private sector development; and the strengthening of 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 reform program with the government of Cape Verde in the context of the PRGF arrangement. The Fund and the Bank have collaborated in the areas of the privatization program, utility regulation, public expenditure management, and civil service and pension system reform.

11. Questions may be referred to Mr. John McIntire (tel.: 1-221-849-5011), Ms. Francoise Perrot (tel: 1-202-473-4465), or Mr. Jean van Houtte (tel.: 1-202-473-0156).

Relations with the World Bank Group

Statement of IDA Operations

(As of April 30, 2004; in millions of U.S. dollars)

Credit No.	Projects	Principal Amount	Disbursed	Undisb-ursed	Approved Date	Closing Date
	12 credits closed	*107.3*	*104.7*	*0.0*		
32241	Social Sector Development Supplem.	4.0	0.0	4.2	16-Dec-03	31-Mar-05
3755	Growth & Competitiveness	11.5	0.9	11.4	13-May-03	28-Feb-08
36290	HIV/AIDS	9.0	3.5	7.0	28-Mar-02	31-Dec-06
24660	Transport Infrastructure	12.5	12.3	0.0	04-Mar-93	30-Jun-04
24661	Transport Infrastructure Suppl.	5.0	2.9	2.7	30-Jan-01	30-Jun-04
32230	Education &Training Consolidation	6.0	5.7	0.3	25-May-99	30-Jun-04
31210	Privatization Technical Assistance	9.0	7.8	1.4	21-Jul-98	31-Dec-04
32050	Energy/Water	17.5	9.0	8.3	11-May-99	30-Jun-04
32240	Social Sector Development	16.1	15.6	0.2	25-May-99	31-Mar-05
	Total active projects	90.6	57.7	35.5		
	Active and closed projects	197.9	162.4	35.5		

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	Partic.
1992	Growela 1/	Shoe manu-facturing	0.15	0.00	0.00	0.00	0.15	0.00	0.00	0.00
2001	Moura 2/	Transport	0.63	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Total portfolio		0.78	0.00	0.00	0.00	0.15	0.00	0.00	0.00

1/ Growela = shoe manufacturing.
2/ Moura = public transportation.

July 23, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Rato:

On April 10, 2002, the Executive Board of the IMF approved a three-year arrangement for Cape Verde under the Poverty Reduction and Growth Facility (PRGF) in the amount of SDR 8.64 million (90 percent of quota). The purpose of this letter is to inform you of the progress in implementing the second-year economic program, and to request the fifth loan disbursement upon completion of the fourth review under the arrangement.

The attached memorandum of economic and financial policies (MEFP) supplements the MEFPs of March 11, 2002; December 6, 2002; June 9, 2003; and December 2, 2003. It sets out the objectives and policies the government of Cape Verde will pursue during the remainder of 2004.

Cape Verde's economic performance in 2003 was generally better than envisaged under the program. As discussed more fully in the MEFP, however, transitional issues delayed the effectiveness of October's tightening of monetary policy, and the performance criteria for end-December 2003 on net domestic assets of the central bank and on net international reserves were not observed. In addition, the performance criterion on the contracting of nonconcessional debt was not observed by a small margin as a result of a loan that we were not aware had only a 34 percent grant element.

While we have continued to observe the structural performance criteria, our structural reform agenda suffered some delays during October-March. However, as noted in the attached MEFP, we are regaining this momentum and will accelerate the structural reform agenda during the remainder of 2004.

The government believes that the measures it has taken, and the policies it intends to pursue in the remainder of 2004 (as described in the attached MEFP), will help to establish the conditions for achieving a high level of sustainable economic growth and a reduction in poverty. On this basis, the government of Cape Verde requests the completion of the fourth review under the arrangement. In that connection, the government is requesting waivers for the non-observance of the end-December 2003 performance criteria pertaining to net domestic assets of the central bank and to net international reserves, as well as for the continuous performance criterion pertaining to nonconcessional external debt. We believe our policies are consistent with the other end-June 2004 quantitative performance criteria and benchmarks.

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

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

Sincerely yours,

/s/

João Pinto Serra

Minister of Finance and Planning

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

CAPE VERDE

SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR JULY-DECEMBER 2004

I. INTRODUCTION

1. Cape Verde's ongoing program of economic stabilization and reform is being supported by an arrangement under the Poverty Reduction and Growth Facility (PRGF) covering the period 2002-04. Consistent with the goals set out in our memorandum of economic and financial policies dated March 11, 2002, and updated most recently on December 2, 2003, this supplementary memorandum reviews the implementation of the program in 2003 and early 2004, and sets forth the government's policies through December 2004.

II. ECONOMIC AND POLICY DEVELOPMENTS THROUGH MARCH 2004

2. Economic performance in 2003 was broadly in line with the program. Preliminary data suggest that real GDP grew by 5.3 percent, led by strong rebounds in agriculture and tourism. With the resulting decline in food prices, the consumer price index rose by only 1.2 percent on average during the year.

3. Fiscal policy was implemented broadly as programmed. The fiscal deficit (including grants) was 3.3 percent of GDP, notably lower than targeted, and the primary recurrent surplus was 4.0 percent of GDP, also better than envisaged. With revenues developing in line with expectations, the better overall fiscal performance reflected lower recurrent and capital outlays. The value-added tax (VAT) was introduced in January 2004, with a single rate of 15 percent. At the same time, the new import tariff structure came into effect, reducing the number of tariff bands to seven and eliminating the customs fee. The reduction in corporate income tax rate from 35 to 30 percent also became effective January 1, 2004. In executing the public investment program, the government contracted a loan to construct a health facility that it believed, on the basis of commercial interest reference rates (CIRRs) prevailing during loan negotiations, to be concessional. By the time of signing in March 2004, declining CIRRs had reduced the grant element to 34 percent, leading to the nonobservance of the limit on the contracting of nonconcessional external debt.

4. The results of the end-October tightening of monetary policy can be clearly seen in slower credit growth and stronger international reserve accumulation thus far in 2004. However, transitional factors, notably lending commitments by banks already made at the time the reserve requirement was raised—postponed the effectiveness of the tightening and resulted in the non-observance of the quantitative performance criteria on net domestic assets (NDA) of the central bank and on net international reserves for December 2003 (Table 1).

5. The government's structural reform agenda has been subject to some delays, but we have recently taken actions to accelerate its implementation in the areas of economic regulation and privatization.

- The Board of the Economic Regulatory Agency (ARE) was sworn during February 2004. When it becomes fully functional, the ARE will be responsible for economic regulation in energy, water, telecommunications, and urban and maritime transportation. The government has recently approved the 2004 budget for the ARE, as well as the salaries of the ARE Board, and the privatization coordination unit has signed a memorandum of understanding with ARE on project financing. This will allow the staff salary structure to be determined and core staff to be hired.

- The government is preparing an automatic tariff adjustment mechanism for electricity and water with technical and financial support from the World Bank.

- Reforms of the TACV (the national airline) have resulted in sharply lower losses for 2003. The government recently approved the terms of reference for placing the company under private management to restructure it and prepare it for privatization.

- Interbase (the government-owned fish freezing enterprise) was offered for sale in December 2003. Technical and financial bids from qualified bidders were received in May, and the government expects to finalize the contract negotiations by August.

- The government has published the invitation for bids for the purchase or lease of the ships owned by Arca Verde.

- The government has recently approved a Policy Statement for ARFA, the new food and drug regulator, and has nominated an installation committee to set up the agency, which is expected to begin operations by November 2004. This will open the way for the privatization of drug maker and distributor EMPROFAC.

- CABNAVE shipyard and port operator ENAPOR are being prepared for privatization in 2005, by which time the ARE will be ready to assume its regulatory functions in the maritime transportation sector.

6. The government is making substantial progress in identifying and repaying old domestic arrears and previously disputed claims. A special commission has been established to determine the government's liabilities to Electra (the electricity and water utility), including obligations arising from the non-adjustment of electricity tariffs during 2000-2002, when world oil prices increased significantly. The World Bank is providing technical assistance for this project. Once the findings of the commission have been finalized, the government will agree with Electra on a schedule of repayment. In the meantime, the government made a good-faith payment of CVEsc 260 million to Electra in the second quarter of 2004. In addition, the government has reached an agreement with Cape Verde Telecom to swap CVEsc 240 million in payments arrears to be offset by an equivalent amount of non-tax arrears. We have identified CVEsc 287 million in payment arrears to construction companies which we propose to partially offset with an

estimated CVEsc 174 million in tax arrears owed to government, with the balance to be paid in cash. The government is currently negotiating with the suppliers to confirm these claims. We have also proposed to offset payments arrears to Shell Oil of CVEsc 277 million against CVEsc 389 in overdue tax payments, resulting in a net payment to government. We have verified obligations of CVEsc 739 million to a commercial bank for unpaid interest subsidies and other fees. Finally, the government owes substantial amounts to the private pension fund (INPS), which will be regularized in the context of the growth and competitiveness project, supported by the World Bank.

III. The Program for July-December 2004

7. Our fiscal and monetary policies for 2004 are based on a projected real GDP growth rate of 5.5 percent and an average inflation rate of 1 percent. The external current account (excluding official grants) is projected to expand somewhat to about 15 percent of GDP, based on relatively strong import growth and a cautious outlook for private transfers. Monetary policy will be directed toward achieving an increase in gross international reserves from 1.8 to 2.0 months of imports.

A. Fiscal Policy

8. The fiscal program for 2004 reaffirms the government's commitment to expand education, health, and security services, while providing the necessary support to monetary policy. Revenue is projected to rise by 12 percent to CVEsc 19.6 billion (22.5 percent of GDP), reflecting the collection of the tax and non-tax arrears, strong growth in import-based taxes (including the VAT), the elimination of exemptions to the previous consumption tax, and the incorporation of the budgets of autonomous agencies into the national budget. Total expenditure will be as laid out in our previous memorandum and confirmed in the 2004 budget approved by the National Assembly, rising to CVEsc 28.2 billion (32.2 percent of GDP), with much of the increase in current spending allocated to hiring new teachers, doctors, and security personnel, and raising their pay scale. Capital spending, particularly for donor-funded projects, is also expected to rise. Thus, the fiscal deficit (excluding grants) will rise relative to 2003, but it will be lower than indicated in our previous memorandum. The primary recurrent surplus is programmed to remain broadly constant in nominal terms. Net official financing (including grants) already committed and a modest amount of domestic bank financing will enable the government to reduce domestic arrears by about 1.2 percent of GDP. The program is fully financed. If the government succeeds in securing more than the CVEsc 2.5 billion (€ 23 million) in budget support already committed, it will use the first CVEsc 0.2 billion to pay down additional domestic arrears and use any remaining balance to reduce domestic bank financing and increase international reserves.

9. Given the introduction of the VAT and the new import tariff structure, the government does not intend to introduce any new taxes this year. We will focus our efforts on ensuring that the VAT department has sufficient resources to enforce VAT compliance, provide the necessary information and customer relations services, and provide VAT refunds on a timely basis. As a program benchmark, a VAT Service and Information Unit will be fully functional by

September 2004 to assist taxpayers to comply with the law. In addition, VAT processing offices in charge of registering taxpayers, receiving tax forms, and compiling data will be fully functional in the four main districts, and at least 10,000 taxpayers will be registered by that time. This will be a benchmark for end-December.

10. We have had some difficulties finding a consultant to undertake a comprehensive assessment of the cost of all tax exemptions and fiscal incentives, despite donor funding. However, we will endeavor to complete the assessment by end-June 2004 in time to inform the National Assembly debate on tax policies for 2005. The government is on track to begin submitting quarterly reports of fiscal operations to the National Assembly by end-June. Furthermore, submission of the report of fiscal operations for the first half of 2004 to the National Assembly by end-September 2004 will be a benchmark under the program.

B. Monetary and Financial Sector Policies

11. Given the importance of international reserve coverage to investor confidence and the sustainability of the exchange rate peg, the Bank of Cape Verde (BCV) will not ease monetary policy until a clear upward trend in reserves has been established. Broad money growth is to remain near 8 percent through 2004, in line with nominal GDP. Growth in credit to the economy is projected to expand on the order of 10 percent for the year, resulting in an average growth of 12.5 percent during 2002-04.

12. The BCV began auctioning its own bills in 2003 to manage bank liquidity. However, the lack of competition in the banking system inhibits the effectiveness of indirect monetary instruments. The BCV has already begun to analyze the possibilities of reducing the unremunerated reserve requirement, currently 19 percent, without affecting bank liquidity and has requested technical assistance from the IMF in this endeavor. The BCV will continue to monitor financial institutions through its monthly off-site reporting system. Work is also underway on a new regulation to limit the open foreign exchange positions of commercial banks and steps are being taken to complete compliance with the Fund's safeguards assessment report.

13. The BCV and the government are working to create the conditions for a reduction of interest rates on domestic bank credit without endangering the balance of payments. Fundamental to this objective is continued fiscal prudence to minimize government recourse to domestic bank credit. The BCV's efforts to reduce the level of unremunerated reserves, together with donor-supported programs to improve commercial banks' ability to assess project risks, will help reduce the costs of financial intermediation. The regional chambers of commerce, with donor assistance, are helping their members strengthen financial transparency, which will improve their prospects for gaining access to commercial bank credit. Finally, the government and the BCV will continue to promote financial sector competition by licensing qualified banks and other financial institutions.

C. Enterprise Reform

14. Private-sector-led economic growth is a crucial component of Cape Verde's poverty reduction strategy and external viability. Critical to this element of the strategy is the reform of large enterprises providing public services that are either owned or regulated by the state. These enterprises have imposed unnecessary costs both on the budget and on the private sector. While substantial progress in reforming these companies has been made already, additional steps will be taken during 2004 that will serve as benchmarks and performance criteria (where indicated) for the PRGF-supported program:

- By end-December 2004, the Board of the ARE will approve an automatic and transparent mechanism for adjusting electricity and water tariffs on the basis of costs, which will be published in the official gazette (performance criterion).

- The government will not pay any subsidy to either Electra or TACV in 2004 (continuous performance criterion). This would replace the performance criterion pertaining to the memorandum of understanding with Electra.

- The Commission for Negotiation will conclude its report on the government's financial liabilities to Electra by end-September (benchmark). The government intends to begin negotiating with Electra by end-2004 on a strategy for settling the government's accumulated liabilities.

- The government intends to appoint a specialized international management team for TACV by end-September, with assistance from the World Bank, to complete the operational and financial restructuring of the company, develop a recovery and privatization strategy for the airline, identify international partners and networks, and initiate integration and privatization negotiations.

- The new international airport in Praia constitutes an integral part of the government's growth and development strategy, notably through promotion of the tourism sector, and this project will also support the financial performance of TACV. In this regard, the government has negotiated a loan with ECOWAS for around US$7 million to help fund the completion of airport facilities. The grant element of this loan is estimated at 31 percent, marginally below the concessionality threshold of 35 percent. In view of the importance of the airport development, its strong commercial viability, and the continuing improvement in Cape Verde's external debt position, the government proposes that the ceiling on nonconcessional debt be raised to US$20 million to accommodate this loan.

IV. The PRSP and Medium-Term Macroeconomic Objectives and Strategy

15. A draft PRSP was completed in mid-April 2004. A process of national consultation on the draft is now underway, and the government intends to produce a final (PRSP) by the third quarter of 2004. The foundations of the government's strategy remain:

- maintaining price stability by sustaining the exchange rate peg through a monetary policy aimed at reserve accumulation;

- maintaining fiscal discipline in order to free resources for the private sector, reduce pressure on the external current account, and support a reduction in interest rates;

- implementing reforms to enhance private sector competitiveness and promote economic growth; and

- accelerating public investment in health, education, and infrastructure to reduce poverty, particularly once the PRSP is finalized.

16. In support of the PRSP, the government has begun to develop a medium-term expenditure framework for 2005-07 with assistance from our development partners. The key macroeconomic assumptions underpinning this framework are broadly consistent with those of the PRGF arrangement set forth in our previous memorandum: (i) real GDP growth on the order of 5-7 percent; (ii) inflation between 2 percent and 3 percent; and (iii) a gradual increase in gross international reserves to the equivalent of 2½–3 months of imports of goods and services. Broad money is projected to grow broadly in line with nominal GDP, and credit to the economy would need to grow somewhat more rapidly to provide the necessary support to the private sector. The government anticipates the need for additional budget support during this period and will convene a donor conference in the second half of 2004 to seek the support of our development partners.

V. PROGRAM MONITORING

17. Program implementation through the end of December 2004 will be monitored according to the performance criteria and benchmarks presented in Tables 3 and 4. The definition of the variables monitored as quantitative performance criteria and benchmarks and reporting requirements are set out in the attached technical memorandum of understanding (TMU). The TMU is substantially unchanged from the TMU for the third review of the PRGF, but incorporates revised projections for the flows on which the program adjusters will be based. The fifth review will be conducted by December 15, 2004 and the sixth review, for the last disbursement, will be conducted by March 16, 2005.

Table 1. Cape Verde: Quantitative Performance Criteria and Benchmarks for December 2002-June 2004 Under the PRGF Arrangement 1/ 2/

	Cumulative flows from End-December 2002											
	2002	2003							2004			
	Dec.	Mar	Jun.			Dec.			March			June
	Level	Actual	Performance criteria	Performance criteria (adjusted)	Actual	Performance criteria (unadjusted)	Performance criteria (adjusted)	Actual	Indicative target (unadjusted)	Indicative target (adjusted)	Prel.	Performance 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	0.0	0.3	1.3	0.9	0.5	2.0	1.7	0.5	1.7
Ceiling on net domestic assets of the central bank 3/	7.6	0.6	0.4	0.4	1.0	0.2	0.6	1.6	0.6	0.6	1.2	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	0.0	...	0.0	0.0	...	0.0	0.0
						(In millions of euros)						
Ceiling on the accumulation of new external debt arrears by the central government 5/	...	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/ 6/	...	0.0	0.0	0.0	0.0	10.0	...	0.0	10.0	...	5.0	10.0
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one one year by the central government 5/ 7/	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) 8/	72.4	1.0	0.4	0.3	-1.3	2.9	-0.6	-4.1	4.9	-0.4	-1.4	7.9
Memorandum item:												
						(In billions of Cape Verde escudos)						
Floor on the primary current fiscal balance (indicative target)	...	...	2.2	2.2	0.9	3.2	...	3.2	3.1	...	...	3.4
Program assumptions												
Nonproject external financial assistance, including credit line (program assumption)	...	0.9	1.4	...	1.2	1.9	...	1.5	2.5	...	2.0	3.5
External debt service 9/	...	0.4	1.2	...	1.0	2.7	...	2.2	3.3	...	2.4	4.1
Cash payments of domestic arrears	...		0.0	...	0.0	0.4	...	0.1	0.0	...	0.1	0.0

1/ Quantitative performance criteria and benchmarks are described in the technical memorandum of understanding (EBS/03/162, Appendix IV).
2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program 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 paymentsof 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 . 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.
9/ Beginning end-December 2003, external debt service projections have been corrected downward by CV Esc 550 million to eliminate the double counting of projected repayments of the Portuguese credit line, which are already captured in projected nonproject external financial assistance.

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

Measures	Test Dates	Status or Amended Test Dates
Structural performance criteria		
Refrain from providing budgetary subsidy to Electra until MOU on monitoring is signed	Continuous	Observed
Refrain from providing budgetary subsidy to TACV	Continuous	Observed
Structural performance benchmarks		
Complete comprehensive assessment of the cost of all tax exemptions and incentives	June 2004	Pending
Adopt regulations establishing the methodology for determining electricity and water tariffs at the Economic Regulatory Agency	June 2004	Still in preparation. Implementation delayed to end-December
Submit report of fiscal operations for first quarter of 2004 to the National Assembly	June 2004	Underway

Table 3. Cape Verde: Quantitative Performance Criteria and Benchmarks for 2004 Under the PRGF Arrangement 1/ 2/

	2003 Dec. Level Actual	Cumulative flows from End-December 2003, 2004: March Indicative target (unadjusted)	March Indicative target (adjusted)	March Prel.	June Performance crieria	Sep. Indicative target	Dec. Performance criteria
Quantitative targets				(In billions of Cape Verde escudos)			
Ceiling on net domestic credit to the central government from the banking system 3/ 4/	14.9	1.1	0.9	0.0	0.8	0.7	0.3
Ceiling on net domestic assets of the central bank 3/	9.2	-0.6	-0.8	-0.4	0.0	-0.1	-0.1
Ceiling on the accumulation of new domestic payment arrears by the central government	...	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 5/	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/ 6/	...	10.0	...	5.0	10.0	...	20.0 5/
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one one year 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/	68.2	5.5	4.3	2.8	8.5	7.0	11.0
Memorandum item:							
				(In billions of Cape Verde escudos)			
Floor on the primary current fiscal balance (indicative target)	...	0.0	...	...	0.3	-0.9	3.2
Program assumptions							
Nonproject external financial assistance, including credit line (program assumption)	...	0.4	...	0.4	0.8	1.0	2.5
External debt service	...	0.6	...	0.4	1.4	1.7	2.6
Cash payments of domestic arrears	...	0.0	...	0.0	0.0	0.4	0.4

1/ Quantitative performance criteria and benchmarks are described in the technical memorandum of understanding.
2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program 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. The $20 million ceiling on nonconcessional external debt with original maturity of more than one year takes effect as of completion of the Fourth review.
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 . 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 exchange valuation gains (losses), 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 4. Cape Verde: Supplementary Structural Performance Criteria and Benchmarks Under the Third Annual Program Supported by the PRGF Arrangement

Measures	Test Date
Structural performance criteria	
Refrain from providing budgetary subsidy to Electra for current operating expenses. (Paragraph 14)	Continuous
Refrain from providing budgetary subsidy to TACV for current operating expenses. (Paragraph 14)	Continuous
Approval by the Board of the ARE of an automatic and transparent mechanism for adjusting electricity and water tariffs on the basis of costs, and publication of such mechanism in the official gazette. (Paragraph 14)	End-December 2004
Structural benchmarks	
Establish VAT Service and Information Unit. (Paragraph 9)	End-September 2004
Conclude report on government's financial liabilities to Electra. (Paragraph 14)	End-September 2004
Present report on fiscal operations in the first half of 2004 to the National Assembly. (Paragraph 10)	End-September 2004
Establish VAT processing offices in four main districts. (Paragraph 9)	End-December 2004
Present budget incorporating reduction of tax exemptions to the National Assembly. (Paragraph 10)	End-December 2004

Cape Verde: Technical Memorandum of Understanding for the Fourth Review 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[7] [8]

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 2004 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 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.

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,

---

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

[8] 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.

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 2004, 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 2004, 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. The limits on new nonconcessional external debt contracted or guaranteed by the central government (excluding borrowing from the Fund) are specified in Tables 1 and 3 of the memorandum of economic and financial policies. 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 Payments 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.

20. **Reporting requirements.** The Ministry of Finance and Economic Planning, through the D.G.T., 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 Payments 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.

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. Foreign currency amounts will be evaluated at the following program exchange rates:

CVEsc 110.3 = €1; CVEsc 87.3 = USD 1.00; and CVEsc 129.7 = SDR 1.

25. The 2004 program assumes the following nonproject budget support during 2004:
(i) €2.5 million from the European Union in the third quarter of 2004 and €3 million in the fourth quarter of 2004; (ii) US$15 million from the World Bank in the fourth quarter of 2004;
(iii) US$3.0 million from the African Development Bank, in the fourth quarter of 2004;
(iv) €3 million from the Netherlands in the second quarter of 2004, as stipulated in the TMU for the Third Review; and (v) the repayment during the first quarter of 2004 of the outstanding €1 million from the Portuguese credit facility drawn in 2003 and the drawing of €5 million from the Portuguese credit facility in the first quarter of 2004, as stipulated in the TMU for the Third Review; €4 million of the Portuguese credit line drawings will be repaid in the fourth quarter of 2004.

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.

Statement by the IMF Staff Representative
August 27, 2004

This statement provides information that has become available since the staff report was issued. The appraisal of the staff remains unchanged.

1. **Preliminary data on the monetary sector through July 2004 are in line with Cape Verde's PRGF program.** The end-June quantitative performance benchmarks on net domestic credit to the central government and net domestic assets of the central bank were met. At end-July, broad money growth was 8.0 percent on an annual basis, in line with nominal GDP growth and slightly lower than the increase recorded in June. Growth of credit to the economy continued to slow—reaching just over 12 percent at end-July, consistent with the projected 10 percent increase for the end of 2004. Growth of net credit to the government, which has been slowing for the last 12 months, declined to 14.8 percent in July on an annual basis.

2. **The reserve position of the Bank of Cape Verde (BCV) strengthened significantly in the second quarter of 2004.** The cumulative flow of the BCV's net international reserves increased from €2.6 million in March 2004 to €10.3 million in June, comfortably above the program floor of €8.5 million. The stock of reserves at end-July stood at €82 million (1.9 months of imports of goods and services).

3. **No price pressures are apparent**. Annual inflation was negative in July for the tenth consecutive month, reflecting an excellent harvest and the currency's peg with the euro.

4. **The government has not yet completed the assessment of the cost of tax exemptions and fiscal incentives**, **a structural performance benchmark for end-June**. To help with this assessment, a technical assistance mission from the Fiscal Affairs Department will go to Cape Verde in October 2004.

5. Former Finance Minister Carlos Burgo has been named Governor of the BCV, effective August 2.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No.04/181
FOR IMMEDIATE RELEASE
August 30, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fourth Review Under Cape Verde's PRGF Arrangement and ApprovesUS$2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed its fourth review of Cape Verde's economic performance under an SDR 8.64 million (about US$13 million) Poverty Reduction and Growth Facility (PRGF) arrangement (see Press Release No. 02/18). The completion of this review enables the release of a further SDR 1.23 million (about US$2 million), which would bring the total amount drawn under the arrangement to SDR 6.15 million (about US$9 million). Cape Verde's three-year PRGF arrangement was approved on April 10, 2002.

After the Executive Board's discussion on Cape Verde, on August 27, 2004, Agustín Carstens, Deputy Managing Director and Acting Chair, said:

"The Cape Verdean authorities have succeeded in putting macroeconomic policy back on track following some slippage in 2003. Economic outturns in 2003 were generally better than expected, with higher growth, lower inflation, and improved external balances. Going forward, continued commitment to sound macroeconomic policies and structural reforms directed at enhancing competitiveness will be essential for sustaining high growth and reducing poverty.
"The authorities' proposed macroeconomic policy mix for 2004 strikes an appropriate balance between the desired increase in priority spending and the need to support growth in international reserves and credit to the private sector. Looking ahead, the authorities will need to ensure that the pace of implementing their poverty reduction strategy remains fully consistent with continued macroeconomic stability, especially in view of the rapid growth of recurrent expenditures over recent years and spending pressures that may arise in the run-up to the 2006 parliamentary elections. At the same time, every effort needs to be taken to limit nonconcessional borrowing so as to avoid jeopardizing medium-term debt sustainability.

"The authorities are determined to regain momentum in key areas of structural reform. In addition to ongoing reforms in the transport and utility sectors, it is important that an automatic and transparent mechanism be adopted for the adjustment of electricity and water tariffs in response to changes in costs. Moreover, to improve the environment for private sector development, the authorities should implement the privatization program with vigor and press ahead with regulatory reform.

"The authorities should finalize the PRSP as soon as possible while ensuring its high quality. The PRSP will provide a useful framework for setting clear and attainable social objectives, and for prioritizing and costing development programs that will contribute to stronger growth and poverty reduction," Mr. Carstens said.

The PRGF is the IMF's concessional facility for low income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

Statement by Damian Ondo Mañe, Executive Director for Cape Verde
August 27, 2004

On behalf of my Cape Verdean authorities, I would like to express my appreciation to Management and staff for the ongoing support to the country's growth and development efforts. In particular, they appreciate the constant and helpful advice provided by staff all along the current PRGF-supported program. Cape Verde has established a broadly good track record of policy implementation, and the authorities remain fully committed to the achievement of the objectives of the medium-term program

Since the last review under the ongoing PRGF arrangement, growth has remained strong, above the 5 percent mark on an annual basis; inflation has been contained, owing to the credible exchange peg regime and to the monetary policy tightening which has started to bear fruits, including the rebuilding of international reserves; and fiscal and external current account deficits remain consistent with the sustainable debt profile. Fiscal policy has been on track. Indeed, while total expenditure was lower than programmed primarily reflecting a more modest implementation rate for the investment program, total revenue has remained in line with the program with lower tax revenue largely offset by higher non-tax revenues due to better financial outturns in publicly-owned enterprises. The latter development owes to the authorities' efforts to reduce losses of these entities. Monetary conditions in 2003 were less tight than programmed, due to limited banking competition and the lack of adequate instruments, as the central bank of Cape Verde has relied solely on reserve requirements to mop up liquidity. Consequently, bank credit has increased more than programmed, leading to the nonobservance of performance criteria on net domestic assets and net international reserves at end-December 2003. My authorities are requesting waivers for these two missed criteria on the basis that transitional factors are vanishing, credit growth is now slowing and international reserves are increasing anew in 2004.

Progress is being achieved on structural reforms, although there have been some delays, due, among others, to difficulties in obtaining the necessary technical assistance as in the case of the review of tax exemptions. Achievements include the reform of the previously loss-generating public utility Electra and state-owned airline TACV. The government has recently taken steps to accelerate the regulatory reform and resume the privatization agenda, with six enterprises envisaged to be transferred to the private sector, including the maritime transport company Arca Verde, the fish freezing and storage facility Interbase, the port-operating enterprise ENAPOR, the dockyard CABNAVE, the pharmaceutical maker and distributor EMPROFAC, and TACV.

While the Growth and Competitiveness Project, which is being supported by the World Bank, will help to alleviate impediments to sustainable growth, the economy of Cape Verde remains vulnerable to unfavorable exogenous shocks and faces low absorptive capacity, which calls for the building of infrastructure through the enhancement of public investment. My authorities understand these challenges and will make their utmost efforts to meet them. In this vein, they request the adjustment of quantitative performance targets on nonconcessional borrowing to take account of the highly needed increase in public investment, and on the ground that external public debt will remain sustainable.

Performance Under the Current PRGF Arrangement

The economic performance of Cape Verde has been broadly positive and better than programmed. Indeed, the overall performance in 2003 was better than expected, and preliminary data for the first months of 2004 point to continuous improvement, owing to the rapid growth in tourism activities and steady recovery in agriculture. This has prompted an upward revision of the programmed growth rate to 5.5 percent and a downward revision of the expected inflation rate to 1.1 percent for 2004. The latter also owes to the authorities' successful exchange peg regime, confidence in which has helped prevent the use of restrictive capital account measures.

The implementation of the value-added tax (VAT) and the tariff reform since January 2004, as scheduled is part of the efforts to strengthen the structure of revenues. The overall budget deficits in 2003 and 2004 will be smaller than programmed on account of larger non-tax receipts and lower increase in outlays, although the latter comprises increased spending in the education and health sectors as well as in public investment to enhance the country's physical capacity.

As regards monetary policy, the October 2003 tightening, has now started to yield positive results; credit growth is slowing and international reserves have started to increase anew in 2004, with the support of strengthened fiscal policy and a credible exchange peg.

On the structural front, my authorities have pursued the reforms envisaged under the program, notably as regards the regulatory framework, establishing the methodology for determining electricity and water tariffs at the new Economic Regulatory Agency, and preparing the report on fiscal operations to the National Assembly. As highlighted above, progress is also being made in the loss-reducing reforms of the public utility company Electra and the state-owned airline enterprise TACV. The two structural performance criteria pertaining to these entities have been observed, while actions to meet the three structural benchmarks through June 2004 have been engaged.

Substantial progress has also been achieved in identifying and clearing arrears with public service enterprises, including Electra and Cape Verde Telecom, as well as private entities among which a commercial bank, an oil company and a pension fund company. The repayments of old arrears and previously disputed claims will be made through agreed-upon scheduled payment plans, offsetting arrangements for tax arrears owed to the government, or through the World Bank-supported Growth and Competitiveness Project. The pursuit of the reforms of public service enterprises, including the envisaged privatization of six major enterprises by the end of 2005, as committed by my authorities, is a core component of this development strategy. The preparation of action plans for this wave of privatization is advancing well.

Modification of Program Criterion on Borrowing

While remaining current on its external debt service obligations, the central government of Cape Verde has not accumulated new external arrears since the clearance of all arrears to multilateral creditors in 2003 and the rescheduling of arrears with most of bilateral partners. The results of these remarkable efforts have made the debt burden more sustainable. However, as was pointed out in my statement, during the last review under the PRGF arrangement in December 2003, and again above, there are tremendous infrastructure and social needs in Cape Verde that require external borrowing. My authorities have made clear again in their supplementary MEFP that capacity building is an integral part of their growth and development strategy. In particular, the importance of the new international airport in the capital city, Praia, has prompted the government to negotiate a loan with the regional Economic Community of West African States (ECOWAS), which has a grant element of 31 percent compared to the concessional threshold of 35 percent. Consequently, my authorities are requesting a modification of the related performance criterion, in view of the importance of the airport development in their strategy, its strong commercial viability, and its relatively marginal impact on the country's debt sustainability.

A Sound and Comprehensive Program through End-2004

My authorities remain committed to the implementation of the ongoing program of economic stabilization and reforms, as confirmed and enhanced in their supplementary MEFP. They view the implementation of the program as helping to build the strong foundation needed to face the numerous challenges facing the economy.
My authorities remain committed to private sector-led growth as the crucial basis for their poverty reduction strategy and a critical component of external viability. In this vein, they will continue to implement policies that will strengthen the development of the private sector. Under the program, emphasis is also placed on reforming public service enterprises, reducing their financial burden on the government budget and on the private sector, and strengthening the central government's financial profile.

Fiscal Policy

The 2004 Budget is consistent with the objectives of the program. The increase in the fiscal deficit is due mainly to the additional spending resulting from the commitment of the authorities to expand education, health, and security services. Capital outlays, especially for donor-funded projects will also increase. Total expenditures for 2004 will be as laid out in the previous MEFP and confirmed in the budget.

On the revenue side, my authorities are focusing their efforts on ensuring compliance with the two revenue-enhancing reforms introduced last January (VAT and new tariff structure), without recourse to new taxes in 2004. They have obtained commitments for the full financing of the 2004 program and are hopeful that these commitments from bilateral and multilateral partners, notably the European Union, Netherlands, African Development Bank, and World Bank, will all materialize, in which case they intend to pay down additional domestic arrears, reduce domestic bank financing, and increase international reserves.
The authorities will continue their efforts to improve government accountability and transparency, in particular by informing the public of the economic policy and measures, and in reporting the fiscal operations in the first half of 2004 to the National Assembly by September 2004.

Monetary and Financial Sector Policies

The central bank of Cape Verde, BCV, is committed to not easing monetary policy until a clear upward trend in reserves has been established, which should help to strengthen the credibility and viability of the exchange peg. However, the limited effectiveness of the monetary tool (reserve requirements), in face of the currently low competition in the banking sector, calls for the development of more robust instruments of monetary policy and the definition of a strategy for transition to lower reserve requirements that will ensure reduced loan-deposit spreads rather than higher bank profits. BCV has requested technical assistance from the Fund for this purpose.
The BCV will also pursue its reforms to improve the effectiveness of its operations and supervision tasks. With the help of the government, BCV will continue to promote financial sector competition by licensing qualified banks and other financial institutions, and improve financial intermediation, including access by economic entities to commercial credit.

Structural Reforms

My authorities are pursuing their strategy of promoting the private sector and improving the economy's competitiveness, as embodied in their Growth and Competitiveness Project. The pursuit of the reforms of public service enterprises already engaged, including the avoidance of subsidies and a negotiation with Electra by end-2004 on a strategy for settling the government's accumulated liabilities, remains a core component of this approach. The newly established Economic Regulatory Agency (ARE), once fully operational, will be in charge of adjusting electricity and water tariffs on the basis of production costs through an automatic and transparent adjustment mechanism. The government is committed to the approval of such mechanism by the Board of the ARE by end-December 2004.
My authorities also intend to ensure the completion of airline TACV's operational and financial restructuring, prepare a recovery and privatization strategy for the airline company, and initiate integration and privatization negotiations. To this end, they will appoint a specialized international management team for TACV by end-September.

Banking supervision continues to be strengthened, in particular through onsite inspections and the monitoring of developments on foreign exchange open positions of commercial banks, while awaiting the finalization of regulation setting prudential standards.

The Medium-term Framework and the PRSP Process

My authorities intend to finalize the PRSP during the third quarter of 2004 following the national consultation process on the draft PRSP. The authorities' strategy in this regard is clearly outlined in the supplementary MEFP, and it includes: (i) price stability through sustained exchange peg with reserve accumulation; (ii) maintaining fiscal discipline; (iii) reforms to enhance private sector competitiveness and promote growth; and (iv) expanding public investment in health, education and infrastructure.

A medium-term economic framework (MTEF) for 2005-07 is being developed by the authorities to support the PRSP, with the assistance of the country's development partners. However, my authorities strongly hope that the needed additional budget support during this period will be met. The Donor's Conference they envisage, in the second half of 2004, is intended for this purpose.

Conclusion

Cape Verde continues to achieve important progress in the implementation of its reform agenda, despite temporary delays due to transitional factors and relatively weak capacity. The various components of the program remain on, or return to, track, owing to my authorities' steadfast pursuit of their agenda, including through the prompt consideration of corrective measures when needed. In this context, and given the strong track record of policy implementation already built, and the improved medium-term prospects, my authorities are hopeful that the international community will continue to support strongly their action. In this vein, my authorities will appreciate the Board's approval of their request for waivers and for the modification of performance criteria and benchmarks, as well as the completion of this fourth review under the PRGF-supported program.