Cape Verde

2011

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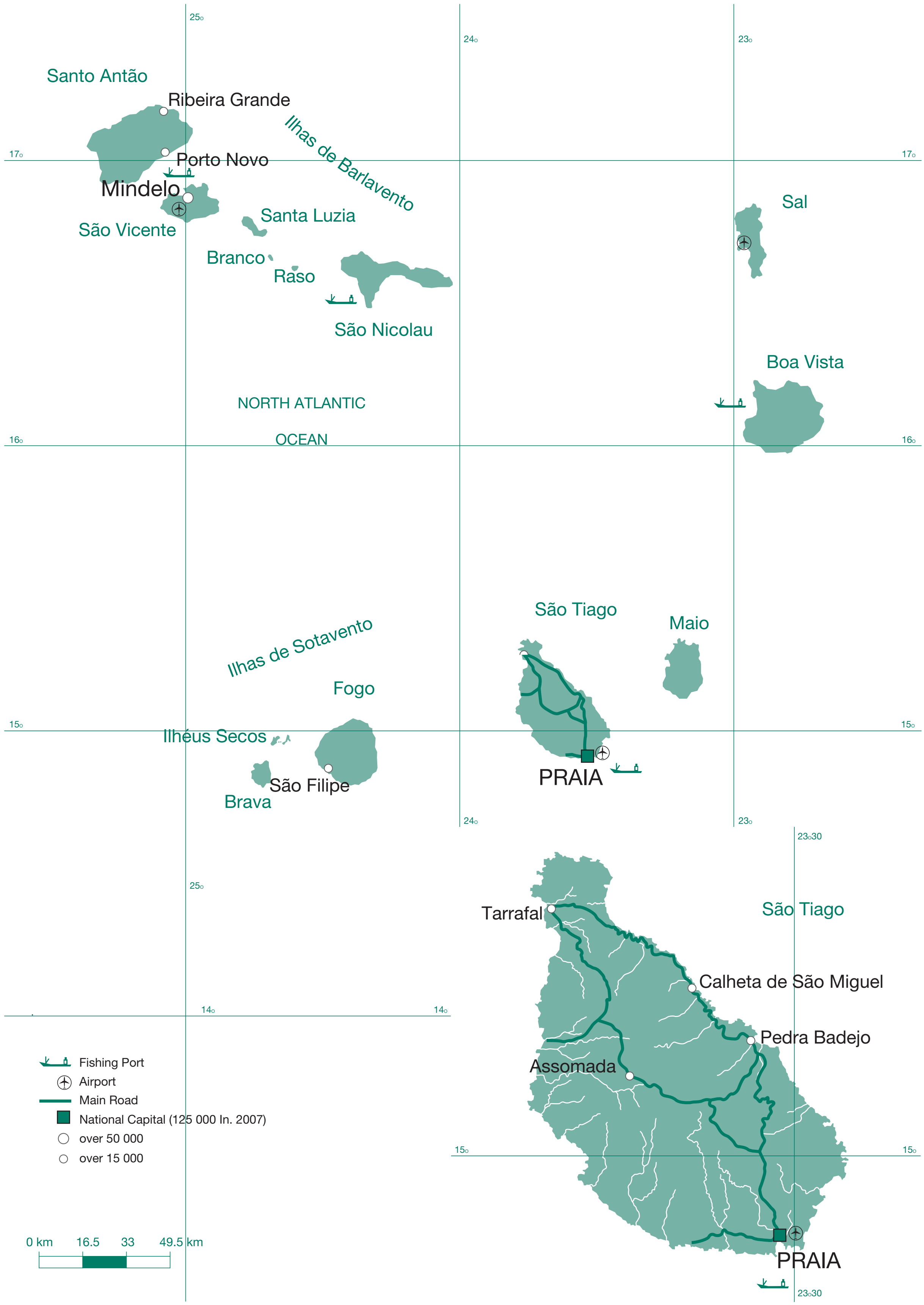

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Cape Verde

Overview

Cape Verde's economy showed signs of recovery from the impact of the global financial crisis with 2010 gross domestic product (GDP) growth estimated to reach 5.3% compared to 3.6% in 2009. In 2010 there were signs of recovery in tourism and air transport and strong support from the Public Investment Programme (PIP). However, in 2010 foreign direct investment (FDI) and associated construction inflows continued to shrink. The outlook remains uncertain for 2011 as investment largely originates from the European Union (EU), which is growing only slowly. Remittances remained fairly constant in 2010 after a slight decrease of 2.2% in 2009.

The inflation rate was 2.1% in 2010, down from 6.7% in 2008, mainly as a result of the euro peg and the large import component of goods and labour of the PIP. Inflation is expected to rise slightly in 2011 because of increases in commodity and fuel prices and the weak resumption in private economic activity.

The government has put in place an ambitious strategy that addresses, on the one hand, the large PIP in infrastructure and, on the other, an improvement of the business environment through the creation of marketing and certification strategies. The extent to which these strategies generate direct benefits for the population and foster high value-added tourism will affect the resilience of the economy in the face of external shocks in the medium term, the trend in poverty rates and ultimately, the success of the government's PIP. In addition, the resumption in FDI flows will be key once the PIP is over as the country depends on external financing for large investment programmes.

To counter the impact of the crisis and to restructure the economy in view of Cape Verde's graduation to Middle Income Country (MIC) status, the government reinforced the 2010-12 PIP to address binding constraints: transport (particularly ports and roads), energy and water. In line with the PIP, the fiscal balance deteriorated considerably from -6.3% in 2009 to -13.7% in 2010 and is expected to remain large in 2011. International reserves are expected to remain at prudential levels in 2010-12, since the deficit is financed by external borrowing. Donor budget support increased considerably in 2010 to counter the crisis.

To reduce its strong dependence on fuel imports, Cape Verde has a 300 million US dollar (USD) plan to cover 25% of its needs with renewable energy by 2011 and 50% by 2020. The country is developing 28 megawatt (MW) onshore wind farms expected to come into operation in June 2011 in Sal, Boavista, São Tiago and São Vicente islands. This is the first large-scale wind project in Africa and the first renewable energy Private Public Parnership (PPP) in sub-Saharan Africa.

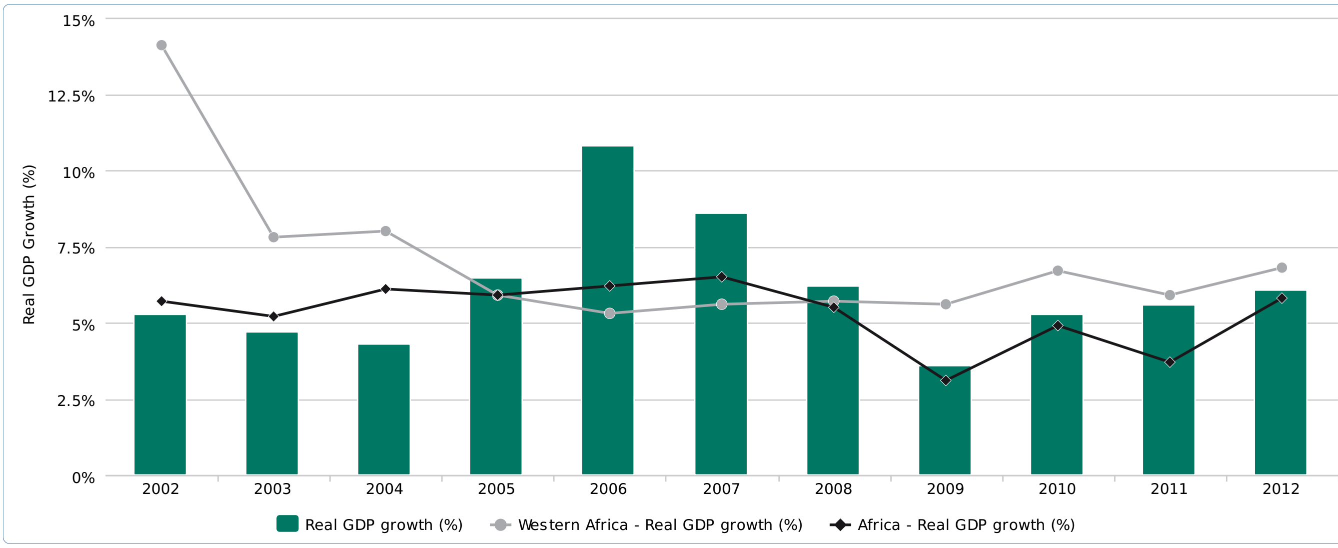
Cape Verde is one of the few African countries that may meet the Millennium Development Goals (MDGs) by 2015. Four of the eight goals - achieving universal primary education, promoting gender equality, reducing child mortality and improving maternal health - were attained by the end of 2010. The sustainability of these outcomes largely depends on donor support. Some donors, however, phased out aid in 2010 from certain social sectors. With its graduation to the MIC category, Cape Verde faces reduced access to concessional loans and has requested an extension from 2012 to 2015 in order to access the Low Income Country (LIC) instruments under the assumption that this will prove sufficient to address key structural bottlenecks.

The PIP aims at crowding in private investment in 2011-12 by fostering growth clusters in line with the 2003 Economic Transformation Strategy (ETS): tourism, fisheries (export and processing), creating a transport hub, financial services and information technology. In spite of attempts to use its geopolitical situation and economic stability to find new partners, the country's trade and investment partners remain largely European. Diversification has been slower than expected under government plans.

Cape Verde has asked the EU to extend its LIC status until 2011 while negotiating new commercial agreements including services, favourable rules of origin and quotas for fish exports. Co-operation with Brazil is primarily in the fields of education and capacity building. Exchanges with China are linked to the construction of infrastructure. Cape Verde is reinforcing its relationship with the Economic Community of West African States (ECOWAS). Since 2010 it has been hosting the West African Institute (WEA) and the ECOWAS Centre for Renewable Energy and Energy Efficiency (ECREEE).

On the political front, 2011 is the year of the fourth democratic legislative and presidential elections in Cape Verde. Parliamentary elections took place on 6 February. After a tight race, the ruling African Party for the Independence of Cape Verde (PAICV) won 37 out of 72 parliamentary seats. The main opposition party Movement for Democracy (MPD) picked up 33 seats. Presidential elections will take place six months later.

Figure 1: Real GDP growth (W)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Table 1: Macroeconomic indicators

	2009	2010	2011	2012
Real GDP growth	3.6	5.3	5.6	6.1
CPI inflation	1.2	2.1	3	2.1
Budget balance % GDP	-6.3	-13.7	-11.3	-8.9
Current account % GDP	-9.9	-18.4	-15.5	-13.2

Source: National authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Table 2: GDP by sector (in percentage)

	2005	2009
Agriculture, forestry, fishing & hunting	17.6	17.1
Agriculture, livestock, fishery, forestry and logging	-	-
of which agriculture	-	-
of which food crops	-	-
Mining and quarrying	0.4	0.6
Mining, manufacturing and utilities	-	-
of which oil	-	-
Manufacturing	6.7	6.7
of which hydrocarbon	-	-
Electricity, gas and water	2.2	2.2
Electricity, water and sewerage	-	-
Construction	6.5	8.3
Wholesale and retail trade, hotels and restaurants	24.4	26.5
of which hotels and restaurants	1.3	1.5
Transport, storage and communication	14.2	14.1
Transport and storage, information and communication	-	-
Finance, real estate and business services	6.7	12.3
Financial intermediation, real estate services, business and other service activities	-	-
General government services	13.4	8.3
Public administration & defence; social security, education, health & social work	-	-
Public administration, education, health	-	-
Public administration, education, health & other social & personal services	-	-
Public administration, education, health & social work, community, social & personal services	-	-
Public administration, education, health & social work, community, social services	-	-
Other community, social & personal service activities	-	-
Other services	7.8	4
Gross domestic product at basic prices / factor cost	100	100

Source: AfDB Statistics Department, National Institute of Statistics data.

Figures for 2010 are estimates; for 2011 and later are projections.

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In 2010, real GDP grew by 5.3%, compared to 3.6% in 2009, after a 10.8% peak in 2006. Growth in 2010 continued to be adversely affected by the global financial crisis through depressed FDI inflows and reduced construction for tourism. As in 2009, the decline was limited by the large expansion of the PIP. Because of its economic links with the EU, Portugal and Spain in particular, FDI and related construction projects are not expected to improve substantially in 2011 as a consequence of the slow recovery in most OECD countries. By contrast, tourism flows and air transport services rebounded in 2010, stimulated by lower tariffs.

Services accounted for 80.6% of GDP in 2009 with tourism as the leading sector. According to the tourism survey, *Movimentação de Hóspedes*, the number of tourists increased by 17.5% in the third quarter of 2010 compared with the same quarter in 2009. The sector's potential has yet to be fully exploited with an average hotel occupancy rate of 64%.

Tourists in 2010 came primarily from the UK (20.6% of entries), followed by Portugal (19%), Italy (15%), Germany (10%) and France (8%). In terms of the numbers of tourists, the island of Boavista accounted for 38.6% of entries in the *arquipiélago*, enjoying a 90% occupancy rate, followed by Sal island (36.6% of entries) and São Tiago island (13.2%).

Growth in the number of tourists slowed from 11.5% in 2007 to 1% in 2009 but the sector is expected to recover to 10% annually over 2010-13, from 363 351 in 2010 to 483 620 tourists in 2013. Supply is also being upgraded accordingly, with a 10% annual increase in establishments from 198 in 2010 to 263 in 2013 and in staff from 4 501 in 2010 to 5 991 in 2013.

The first high-speed ferry from Cabo Verde, *Kriola*, began operations in November 2010, after four years of negotiations, to foster the development of tourism as well as socio-economic integration between the nine populated islands. The 45-metre ferry can carry 50 tonnes of cargo and 158 passengers. A second vessel, *Liberdadi*, is expected to be operational in early 2011. Cabo Verde Fast Ferry is a EUR 25 million PPP, with the municipalities of Brava and Fogo contributing EUR 1 million to secure connections between Fogo, Brava and São Tiago islands.

By 2012, the EUR 300 million port sector investment plan will be completed, in line with government objectives to make the country a logistic hub in the mid-Atlantic. The projection is to grow from 150/200 to 400/500 ships and to increase the number of re-exported containers from 2 000 to 4 000/5 000, serving as a platform for ocean-going oil tankers. The plan includes expanding and modernising the ports of Porto Novo (São Antão), Praia (São Tiago), Vale dos Cavaleiros (Fogo), Boavista (Boavista) and Palmeiras (Sal). The government plans to create an economic hub at the port of São Vicente with a duty-free zone.

To cope with the 12% increase in energy demand, particularly in Sal, Boavista and São Tiago islands, and to reduce the high dependence on fuel imports, Cape Verde has implemented an ambitious USD 300 million investment plan to cover 25% of its needs with renewable energies by 2011, up from 2.3% currently. Two USD 27 million solar power plants funded by Portugal were inaugurated in 2010 in Sal and São Tiago islands, with a capacity of 2.5 and 5 MW respectively.

In 2010 the European Investment Bank and the African Development Bank (AfDB) agreed to provide EUR 45 million in financing to design, build and operate 28 MW onshore wind farms costing EUR 65 million. These farms will be functional by June 2011 in Sal (8 MW), Boavista (4 MW), São Tiago (10 MW) and São Vicente (6 MW) islands. This is the first large-scale wind project in Africa and first renewal energy PPP in sub-Saharan Africa. In addition, there is an ongoing project on São Tiago island to reinforce the distribution network and to centralise production.

In 2010, the Portuguese builder MonteAdriano started construction of three dams in Salineiro, Saquinho and Faveta in São Tiago Island worth EUR 14 million through a Portuguese credit line. These dams are expected to prevent the loss of 2 million cubic metres of water during the rainy season from July to November. This aims at increasing the area of irrigated land in the country. The government plans to build 17 more dams by 2013 to mobilise 75 million cubic metres of water by 2015. The government projects a gross annual production of CVE 564 million (Cape Verde escudos), employing 2 000 workers directly and more than 2 000 indirectly.

Construction projects remained stalled with few exceptions because of the drop in FDI flows. Real estate companies such as Tecnicil issued bonds for EUR 10 million in February 2010 for the Vila Verde EUR 190 million tourist complex in Sal Island. The International Finance Corporation (IFC) also issued bonds for EUR 2.9 million in September 2010 for 2 873 residential houses and 550 commercial locations in Palmarejo Grande, due for completion in July 2011.

The government seeks to raise the contribution to GDP of fishing, agriculture and manufacturing. Statistically, the current contribution of fishing and agriculture is underestimated since only artisanal fishing and traditional crops are captured in statistics, leaving out industrial fishing, the impact of the PIP on dams, and microcredits for irrigation to raise agricultural productivity. Transport investment will enable food produced on Brava and Fogo islands to be sent to Sal and Boavista tourism resorts.

Public investment will be the main component driving the economic growth in 2010 and 2011. But private investment (residential and business) did not pick up in 2010 and is expected to recover slowly in 2011, according to projects subject to approval from Cabo Verde Investimentos and in line with the economic uncertainty in EU markets. Indeed, there is uncertainty in FDI flows from Europe.

Public consumption is expected to accelerate in 2011 partly because of the elections, with transfers to political parties, expenditures on goods and services, and hiring of staff. Private consumption has been on an upward trend since 2010 thanks to the impact of public investment and consumption on employment.

In 2010, there was an 8.6% increase in imports, supported by the PIP. Exports also increased moderately in 2010 by 2.6% through the rise in tourism exports (3%), air transport (5%) and goods (18%), in line with a slight recovery of economic activity in the country. In 2011, exports are expected to accelerate thanks to fisheries and agriculture while imports are expected to decrease with the slowing down of investment in the PIP.

Table 3: Demand composition

	Percentage of GDP (current price)		Percentage changes, volume			Contribution to real GDP growth		
	2002	**2009**	**2010**	**2011**	**2012**	**2010**	**2011**	**2012**
Gross capital formation	35.8	44.7	15.2	-2.4	0.3	7.4	-1.3	0.1
Public	12.7	14.3	61	-14	-7	9.5	-3.3	-1.4
Private	23.1	30.5	-6.3	7	5	-2.1	2.1	1.5
Consumption	100.2	83.8	4.1	7	5.6	3.6	6.1	4.9
Public	10.6	13.8	3.2	6.4	2.7	0.4	0.7	0.3
Private	89.6	70.1	4.2	7.1	6	3.2	5.4	4.6
External sector	-36	-28.6	-	-	-	-5.7	0.7	1
Exports	32.5	37.2	2.6	9.6	8.6	1.1	4	3.7
Imports	-68.5	-65.7	8.6	4	3.3	-6.8	-3.3	-2.7
Real GDP growth rate	-	-	-	-	-	5.3	5.6	6.1

Source: Data based on estimations using National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Fiscal Policy

The Medium Term Expenditure Framework (MTEF) for 2010-12 is set in accordance with the 2008-11 Growth and Poverty Reduction Strategic Paper (GPRSP) II priorities and supported by the IMF's 2006-09 Policy Support Instrument (PSI) that was extended to 2010. In 2010, the government negotiated a new PSI for 2011-13 for future engagement with the International Monetary Fund (IMF) after the 2011 elections which, together with the budget support group input, contributed to the 2011-12 MTEF.

The Ministry of Finance adopted an operational procedure and organised training workshops to ensure that five sector ministries prepare their budgets under the 2010-12 MTEF: environment, agriculture and fisheries; education and human resource development; health; labour, vocational training and social solidarity; and transport and infrastructure. However, there are inconsistencies between the GPRSP-II and the sectoral MTEFs because documents are not appropriately integrated. The appropriation of the MTEFs by sector ministries is expected to improve in a second phase.

The fiscal deficit is accelerating because of a large increase in capital expenditure in 2010-12. This investment rise is linked to the construction of ports, and to a lesser extent roads, energy, agriculture and social housing. In 2010, decreasing equipment orders led to a downward revision in current expenditures. Social security payments to non-contributing individuals were nevertheless increased to CVE 5 000 in 2010 from 3 500 in 2009. A monthly committee monitors revenue collection and budgetary execution to assure tight fiscal control. Current expenditure is expected to increase in 2011 owing to the financing of the elections.

Following the 2001-08 Public Financial Management (PFM) reform, which led to improvements in expenditure management, the 2009-12 PFM Action Plan seeks to increase transparency in revenues by strengthening taxation, customs and budget procedures and by reinforcing the national planning system. There was a 4% revenue increase in 2010 thanks to an increase in efficiency with cross-checking and auditing procedures targeted at medium and large-size companies, despite the 5% decrease in corporate income tax in 2009 and the substantial requests for tax waivers and moratoriums in 2010. Tax revenues aim to reach 28% of GDP in 2017, up from 20.8% in 2010, through gains in efficiency and private sector development.

The PFM plan also aims to improve the budget cycle by reducing the lag between the submission of state accounts to Parliament and the approval of the next budget. It seeks to improve the quality of expenditures by having an integrated functioning of central and local administration: Integrated System of Budget and Financial Management (SIGOF) and Integrated System of Municipal Information SIM (Pilar C). This will improve tracking of domestic operations and raise transfers to municipalities from 10% to 17%.

The joint 2006 budget support Memorandum of Understanding (MOU) will be revised in 2011. The new MOU in line with the GPRSP-III seeks to increase harmonisation in procedures for disbursement, attain mutual government-donor accountability and have a more qualitative review framework. Members include Spain, the Netherlands, the AfDB, the World Bank, the EU, Portugal (since 2008) and Austria (left in 2010), with the possible arrival of Luxembourg as a new member.

There was a record disbursement in 2010 to counter the crisis with an EU grant and AfDB and World Bank concessional loans. Budget support accounted for 11% of the total 2010 budget and increased by 55% from 2009. Nevertheless, because of the improvements in social indicators, some countries such as Austria, Switzerland, Germany, Sweden and the Netherlands have not renewed their support to the *arquipiélago*.

Since Cape Verde graduated as a MIC in 2008, it is increasing the volume of long-term concessional loans, which accounted for over 90% of its 2010 public external debt portfolio, most notably 79% from multilateral agencies and 13% from Portugal. All public debt ratios are expected to remain well below their thresholds up until 2030 with the exception of the debt-to-GDP ratio that will nearly reach the debt burden threshold (50%) in 2012. The rate of external borrowing will decrease significantly from 2012 onwards.

The government has used external debt to finance the fiscal deficit more than domestic debt. The government seeks to avoid putting pressure on reserves and the balance of payments in a country heavily dependent on imports, to avoid a crowding-out effect on the private sector. Domestic debt accounts for one-third of the stock of public debt and is projected to stay below 20% of GDP. Cape Verde's graduation from LIC to MIC will reduce its access in the medium term to concessional loans and grants, China and Middle East donors are expected to become more important.

Table 4: Public finances (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Total revenue and grants	31.3	32.3	33.8	29.3	30.5	28.8	27.9
Tax revenue	20.2	24.4	25.6	20.6	20.8	20.5	20.2
Oil revenue	-	-	-	-	-	-	-
Grants	8.7	5.2	5.6	5.5	6.4	5	4.6
Other revenues	-	-	-	-	-	-	-
Total expenditure and net lending (a)	34.5	33.5	35.2	35.7	44.2	40	36.9
Current expenditure	21.3	21.9	21.1	21.4	21.8	21.8	21
Excluding interest	18.6	20.1	19.5	19.9	19.9	20.1	19.4
Wages and salaries	9.7	11.6	11.7	11.9	11.5	10.9	10.6
Goods and services	0.8	1.7	1.8	1.9	2	2.2	2.1
Interest	2.7	1.8	1.6	1.5	1.9	1.7	1.6
Capital expenditure	12.9	11.4	14.1	14.3	22.4	18.2	15.9
Primary balance	-0.5	0.5	0.3	-4.8	-11.8	-9.5	-7.4
Overall balance	-3.2	-1.3	-1.4	-6.3	-13.7	-11.3	-8.9

a. Only major items are reported.

Source: Data based on estimations using National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Monetary Policy

Cape Verde's monetary policy is procyclical and geared towards maintaining the peg with the euro. The slowdown in the main trade partners in Europe prompted a tighter monetary stance to offset the impact of declining export growth on the balance of payments and reserves. The Banco de Cabo Verde (BCV) raised its policy rate well above the Euribor and set a high minimum reserve requirement in late 2008 to encourage inflows of migrant deposits and to restrain private sector credit that would encourage imports. Even though reserves fell only marginally, the BCV reduced its policy rate in January 2010 by 1 percentage point to 4.25%. The BCV intends to keep interest rates and reserve requirements high in 2011 and 2012 until the global environment recovers.

The inflation rate was 2.1% for 2010, down from 6.7% in 2008 because of the euro peg and the large import component of goods and labour of the PIP. This evolution is also due to the decrease in food and fuel prices, substantial increase in irrigated areas and the good performance of agriculture in 2009 and 2010. It is expected that inflation will rise slightly in 2011 as a result of the increase in commodity and fuel prices and a weak resumption in private economic activity. The nominal effective exchange rate depreciated slightly in 2010 because of the peg to the euro.

Given the reduced availability of external and domestic credit during the global crisis, the Borsa do Cabo Verde has become the most important channel for financing projects. Municipal bonds were issued for the first time in Sal for EUR 1.8 million in July 2010, for infrastructure in Santa María and Espargos and in Praia for EUR 4 million in August 2010 for a new market. The Banco Africano de Investimentos (BAI), Banco Comercial do Atlântico (BCA) and Banco Interatlântico also issued bonds in late 2010 and early 2011. The second phase of the Initial Public Offering (IPO) of the Fast Ferry Cabo Verde is expected in early 2011. Large infrastructure and tourism projects are, however, strongly dependent on external financing, which is not recovering in 2010 and is not expected to improve in 2011 either.

Novo Bank was established in 2010 with an initial capital of CVE 300 million associating Banco Português de Gestão (with a 10% share) in a partnership with local public authorities. The aim is to channel lower-income segments of the population into the formal economy along with micro and small companies not associated with the banking system, thus combating financial exclusion in Cape Verde. Espiritu Santo opened its first branch in January 2010 on Sal Island. Ecobank also opened a branch in 2010.

External Position

The current account balance of Cape Verde, structurally negative because of the heavy reliance on imports of manufactures and food, is deteriorating further in the period 2010-12 as a result of the rise in food imports and decreasing exports of services. Exports of goods remained stable in 2010 in contrast to the 17.3% contraction in 2009. They were supported by the 39.9% increase in fish exports by October 2010, 86.6% of which were sent to the Spanish market. Exports of goods make, nevertheless, a marginal contribution to the current account. Exports of services slightly improved by October 2010 with a 7.2% and 4.5% rise in air transport and in tourism respectively. This contrasts with the 16.7% and 18.2% shrinkages in 2009.

As of October 2010, FDI remained 8.1% and 46.6% lower than in the equivalent periods in 2009 and 2008 respectively. This was due to the contraction in construction projects related to tourism. Remittances stabilised by October 2010 as compared with October 2009. The 9% increase in remittances from the United States more than counterbalanced the 1.7% drop from the EU zone. Only remittances from Portugal and France followed a positive trend, with 4.5% and 1.5% increases, respectively.

Current transfers benefited in 2010 from budget support from Spain, Portugal, Austria, the Netherlands, as well as with the Millennium Challenge Account funds. Capital transfers also rose from CVE 592.7 million to CVE 1.1225 billion as of October 2010, mostly linked to construction and equipment goods. External debt disbursements in favour of central government rose by 49% by October 2010, compared with 2009, by commercial creditors in energy renewal, social housing and infrastructure projects.

After decreasing since 2003, external debt rose by 0.5% in 2009, followed by 10.6% in 2010 and 5.3% in 2011 and is expected to stabilise in 2012 at a rate of 0.6% and decrease thereafter. Cape Verde's external debt maturities are typically longer than ten years and interest rates remain low so debt service ratios remain very modest, minimising liquidity and solvency risks.

Spain has become the most important partner in the export of goods, mainly fish and clothes, progressing from 37.1% of exports in 2008, to 61.7% in 2009 and 69.5% as of October 2010. Exports to Portugal fell from 40.6% in 2008 to 25.2% by October 2010. In terms of imports of goods, as of October 2010, Portugal led the way with 51.6% of imports, followed by the Netherlands with 18.3% and Spain with 8.8%. Trade in goods with African countries is largely absent.

Negotiations are still underway on the regional Economic Partnership Agreement (EPA) between the EU and ECOWAS. Côte d'Ivoire signed a bilateral EPA in 2008. Ghana's interim EPA is still pending signature. Without a regional agreement, ECOWAS runs the risk of seeing Côte d'Ivoire and Ghana implementing their EPAs. This would be problematic for the ECOWAS Common External Tariff (CET). ECOWAS is reviewing the CET increase from the 2006 four bands to a fifth band for certain categories of goods traded in the region. The new regime is part of efforts to harmonise the CET structure in the zone in the build-up to the creation of a common market.

Cape Verde is strengthening its role in ECOWAS. Since 2010, it has hosted the West African Institute (WAI), founded with ECOWAS, the West African Economic and Monetary Union (UEMOA), UNESCO and Ecobank. Its assignments are: academic analysis of the processes and institutions of regional integration in West Africa, policy consulting and the dissemination of knowledge about regional integration in West Africa. In addition, since 2010, Cape Verde has been hosting the ECOWAS Centre for Renewable Energy and Energy Efficiency (ECREEE), supported by the United Nation's Industrial Development Organisation (UNIDO) and the governments of Cape Verde, Austria and Spain. ECREEE is set to become the main implementing agency of the USD 150 million programme focusing on the energy access agenda and energy efficiency.

Cape Verde has a working group on immigration between the *arquipiélago* and West Africa. Immigrants, about 15 000 in 2010, are mostly from Côte d'Ivoire, Guinea Bissau and Senegal.

Table 5: Current account (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Trade balance	-38.1	-49.6	-46.5	-40	-43.8	-43.2	-42.1
Exports of goods (f.o.b.)	6.7	6.1	7.5	5.7	5.5	5.2	5
Imports of goods (f.o.b.)	44.8	55.7	53.9	45.8	49.3	48.5	47.1
Services	2.1	14.7	16	11.5	7.5	9.5	12.2
Factor income	-2.3	-2.4	-3.2	-3.4	-3.3	-3.2	-3.1
Current transfers	27.2	22.6	20.8	22	21.2	21.4	19.8
Current account balance	-11.1	-14.7	-12.9	-9.9	-18.4	-15.5	-13.2

Source: Data based on estimations using National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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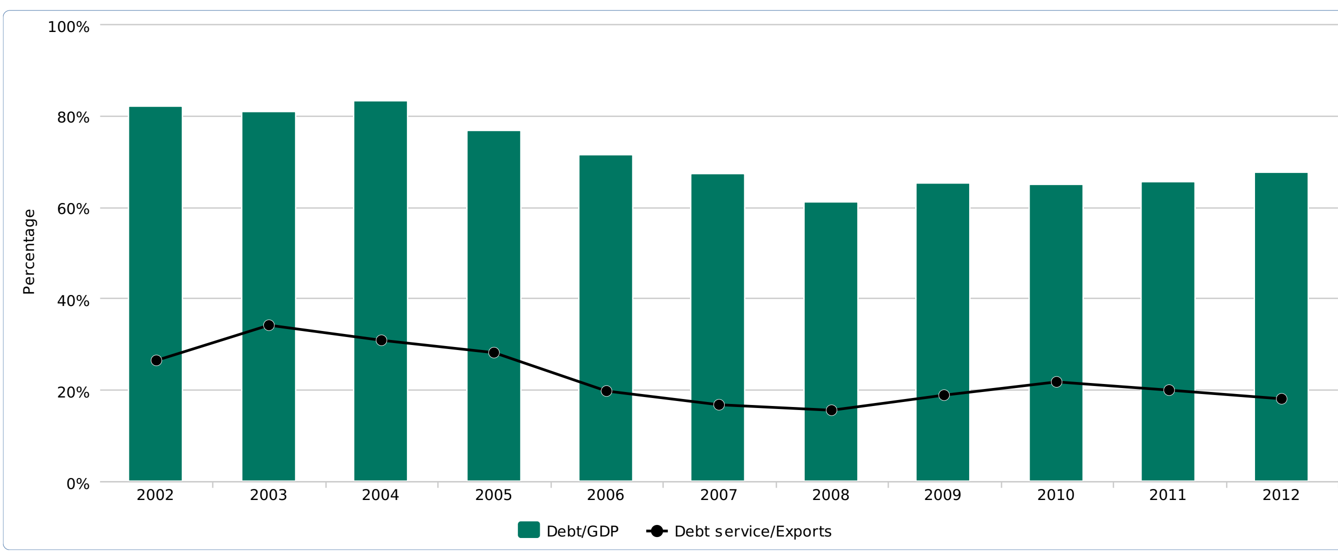
Figure 2: Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Structural Issues

Private Sector Development

The business environment continues to improve and Cape Verde moved up 10 places in 2010 in the World Bank's *Doing Business* report, to 132nd place out of 183 countries, and was one of the ten that most improved their ranking. Major reforms included abolishing mandatory municipal inspections before starting a business, computerising municipal permits, reducing the cost of registering property and the abolition of stamp duty on sales and cheques. The time needed to set up a business fell to 11 days (from 52 in 2007). An agency for company development and innovation (*Agência para o Desenvolvimento Empresarial e Inovação* - ADEI*)* was created in May 2009 to help small business-people plan their operations and get better access to credit. The country has also complied with international accountancy standards since January 2009.

Starting a business and paying taxes have become faster and easier but other things are still a problem, such as differences in interpreting the application of tax laws. Courts take a long time to settle cases and effective laws and data on bankruptcies are lacking.

The financial system has prudential rules and still few links to foreign markets so it weathered the international crisis quite well, though bank liquidity deteriorated in 2009. The local stock exchange, set up at the end of 2005, plays an important role for companies, banks and town governments and supplied 94% of all credits to the economy by the financial system in 2009. A central bank proposal in 2009 to step up supervision of offshore banking operations was approved by the government in 2010.

The financial system's capacity is small, despite the growing role of the stock exchange, the opening of three new banks in 2010 and the increased capitalisation of two others. The main sectors of the economy need major investment, but bank loans are limited to EUR 9 million while, for example, EUR 25 million is needed for two fast ferries and EUR 780 million to build tourist accommodation. The private sector is still penalised in the short term by a lack of funding and competition from foreign companies with better access to loans and subsidies.

Cape Verdeans abroad actively participate in the economy, especially through private investment, thanks to a range of incentives introduced at the end of the 1990s. They get tax breaks (for five years and then a further ten taxed at half the rate) and their bank accounts earn more interest than those of residents.

Other Recent Developments

The government's reform plan involves integrated and innovative management of state business and decentralising public services with the help of the computerisation group NOSI (*Núcleo Operacional de la Sociedad de la Información*i). Two data centralisation computer programmes are already in use, one by town governments and the other by central government services. They will shortly be linked together. About 350 state bodies are covered and this should rise to 800 in July 2011 (95% of the total).

The new system centralises all bureaucratic formalities through a one-stop shop, at the Citizens' Office (*Casa do Citadão*), with facilities also accessible online or by mobile phone. About 25 000 accounts have so far been set up. Firms and households can use them to deal with registrations, certificates, taxes and other charges, licences, elections, healthcare and social security. This streamlining should also encourage parts of the informal sector to officialise their activities and thus bring in more taxes. The programme was allocated 8.6% of the national budget in 2009, with support from several aid donors.

The government has also begun a huge multi-sector expansion of the country's infrastructure to diversify the economy. Large chunks of the budget (47% in 2009 and 50% in 2010) have been earmarked for this, including modernisation of ports and sea transport, upgrading roads, building agricultural dams and expanding energy production capacity.

Infrastructure is poor, and transporting goods between one island and another is 1.8 times dearer than between Lisbon and Cape Verde. It costs an average EUR 2 577 to send 20 containers inter-island. Roads are few (only 36 km of roads for every 100 sq km) and not very good, despite the building of 256.7 km between 2001 and 2009. Only about 318 km (20% of the total) are considered good quality.

The country was 95% supplied with electricity in 2010, but demand keeps rising and the government will have to meet it while reducing its dependence on oil. Plans are under way to build a thermal electricity plant on each island.

Scale economies can therefore be made, reducing the 26% of electricity output currently lost. Renewable sources are expected to supply a quarter of all energy production by the end of 2011 and half by 2020, requiring EUR 300 million of extra funding. Total public investment in energy between 2001 and 2009 was

EUR 45 million, including 9.7 million in 2009 (5.96% of all public investment that year). This shows the strong need for external funding until 2014.

Another challenge is the cost of energy to consumers. Oil prices have steadied since August 2009, but the narrow control of the market has facilitated monopoly and pump prices have not fallen. Electricity rates are set according to the cost of producing it, so unsubsidised efforts to boost energy output will see the extra cost again added to the already high price of CVE 26.4 (EUR 0.24) per kWh in 2009, leaving the danger of social unrest. Rates went up much faster than inflation between 2001 and 2009 (an average 7.4% a year, compared with annual inflation of 2.4%).

The telecommunications sector continues to expand rapidly. The country was linked up to the international network by two cables -- Atlantis 2 and the West Africa Cable System (WACS). A Chinese operator is also planning to increase connection speeds from 150 Mb to 20 Gb by July 2011. Fixed-line phone penetration was 15% in 2009 and mobile phones 65%.

Water supply, always a problem, should improve, especially in the capital (on São Tiago island), after the installation in 2010 of a third desalination plant adding 5 000 cubic metres of daily output capacity to the total 7 400 cubic metres provided by two existing plants. Water supply should reach a daily 80 litres per person, above the World Health Organisation’s target of 50 litres. Underground water will now only be used for irrigation.

Agriculture employs 15% of the working population and 6.61% of the 2009 budget went to modernisation programmes to boost quantity and quality of production. Clear progress has been made with the building of dams and investment loans for drip irrigation systems. But farming still has to adapt to demand and master the value-chain. Processing and product certification is undeveloped but a start has been made through the Millennium Challenge Account (MCA). Fisheries remains a subsistence activity and got only 0.90% of the 2009 budget.

Tourism accounts for about 4% of the workforce. The government launched a strategic sector plan in December 2009 to integrate tourism more into the economy by focusing on higher-grade tourism, with each of the 10 islands getting a share of the cake under a new slogan of “One Country, 10 Destinations.” A national tourism logo has been chosen and a new tourist trades school will open in 2011. Several legal reforms and amendments to laws are being made and three of them (concerning supply of services) were completed in 2010. The urbanisation law was due to be amended in 2011 and new regulations will affect classification of hotels and eco-tourism.

Emerging Economic Partnerships

Aid and economic ties are still dominated by the EU but the government also wants to link up with emerging-partner countries to boost its long-term comparative advantages.

The opening-up of the country to foreign trade is very important. Imports and exports averaged 55.3% of GDP between 2005 and 2008 and nearly 50% in 2009, despite the world economic crisis, owing to structural dependence on imports for two-thirds of the country's food needs. Exports are much less important and focused on a few products, with four accounting for 90% of the total. Apart from raw materials, clothing is exported to Europe.

Brazil (4.5% of imports in 2009), Thailand (1.5%) and China (1.1%) are starting to emerge as partners. Oil re-exports (7% of GDP) and oil imports from Angola, also a Portuguese-speaking country, make it Cape Verde's main economic partner in Africa.

Brazilian investors seem little interested so far, but Chinese firms are moving into the flourishing construction sector, notably in the sub-contracting of government procurement contracts negotiated by the Chinese government.

Traditional partners focus on governance and institutional support, while emerging partners concentrate on training people, providing university scholarships and offering to build administrative and public infrastructure.

Brazil, another Portuguese-speaking country, is by far the biggest emerging partner and provides education and vocational training, with places for students at Brazil's best universities, along with postgraduate scholarships, one to two-month introductory scientific courses and, since 2008 especially, teacher training, which has produced 120 maths teachers and 80 teachers of Portuguese. Brazil also gives specific forms of aid to other sectors of the economy.

China offers loans for economic infrastructure and grants for administrative infrastructure. Work is often contracted out to Chinese firms most of which have solid experience and a good reputation. China has built the government headquarters, the parliament building and a national library.

The government's national strategy is to make the country in the medium term a key centre of transatlantic trade and international financial services as well as a sustainable tourist destination with substantial local input. This requires major infrastructure work in the short term. The involvement of multiple parties that complement each other is seen as an effective way of achieving this modernisation, but funding needs are still considerable.

This complementarity is already evident in the project to expand the Nosi technology centre, involving both emerging and traditional partners.

The AfDB has funded the feasibility study for the second phase of the Nosi extension project and a loan of USD 35 million is being negotiated. China has already provided USD 17 million for work by the Chinese telecommunications firm Huawei and USD 13 million has been earmarked for the second phase, with the prospect of further funding from India. Complementarity can also be seen in the setting up of a 20 GB broadband network, designed by Brazil, with equipment from China and software and training provided by India.

A public/private partnership has seen the government negotiate with the banks and Microsoft a 30-40% discount on computer equipment for the *Mundo Novo* programme, with the aim of supplying students and teachers with computers costing only USD 25.

Apart from the standard items recorded in international data – commerce, FDI and remittances – China has for the past decade supplied a lot of staple goods, notably clothing and restaurants, which have increased and diversified in the past five years. China's activity ranges from building discothèques to selling vehicles, and a large number of Chinese businesses seem to have substantial turnover, but they have not been tallied yet because of the lack of government manpower and equipment. Customs has 250 officials and other tax bodies 241.

Political Context

The African Party for the Independence of Cape Verde (PAICV), which has been in power for 10 years, lost four seats in parliamentary elections on 6 February 2011 but retained an absolute majority, with 37 out of 72 seats. Presidential elections are due in August.

The PAICV got about 51% of the vote against its main liberal rival, Movement for Democracy (MPD), led by Carlos Veiga, which ruled between 1991 and 2001. The PAICV won an absolute parliamentary majority at the 2006 elections, with 52.2% of the votes and 41 MPs, against the MPD’s 44% of votes and 29 MPs. The PAICV, which will continue to govern for the next five years, won in 10 of the 13 constituencies (three of which are for the Cape Verdeans abroad). The country’s diaspora actively participates in political life and elects six of Parliament’s 72 MPs.

The political and social scene was quiet in 2010 and the country is very often cited as a model of democracy. Only two small strikes, for more pay, occurred in the private sector and negotiations for a minimum wage are fairly easy. The two main parties, the PAICV and the MPD, together approved constitutional amendments on 5 February 2010 extending the interval between parliamentary and presidential elections to six months, as well as reforming the operations of, and access to, the high court and the high judicial council (making it totally independent). They also voted to create an appeals court.

Social Context and Human Resource Development

Cape Verde is one of the few African countries likely to achieve the MDGs. Four of the eight goals were met by September 2010. The country has also moved up on the United Nations Development Programme Human Development Index, from 0.5 in 2000 to 0.534 in 2010, to give it 118th place out of 169 countries. Future progress will depend on help from aid donors.

The MDG target of halving the number of poor people between 1990 and 2015 is on the way to being achieved, with poverty at 26.6% in 2007, down from 49% in 1990. Despite economic problems, social efforts have been maintained and strengthened, with anti-poverty spending at 3.84% of the 2009 budget. Automatic (non-contributing) social security coverage, concerning 23 000 low-income people (36% of the population), has been expanded to include domestic workers and the informal sector. Furthermore, payments have been increased. A low-cost housing programme called "A House for All," is under way. The government wants to reduce the housing shortage (about 80 400 units in 2008) by 20% by the end of 2011. The introduction of a national minimum wage, under negotiation, will provide extra security. In the medium term, the jobs situation should benefit from the extension of tourism to the interior of the islands, the development of craft industries and the promotion of local farm products.

The MDG target of providing jobs is far from being met. Unemployment was 17.8% in 2008, according to the national statistics institute (INE), more (22.7%) in towns than in the countryside (13.1%), more women affected (22%) than men (13.8%). The rate among 15-24 year-olds is particularly high (31%). Male unemployment rose between 2000 and 2008 (from 11.1% to 13.8%) while for women it fell (from 23.8% to 22%). Young secondary school graduates are hardest hit (53% of males, 45% of females), which is largely due to the education system.

The challenge concerns the quality of vocational and university education. Dropout and repeat rates were 8% and 25% in secondary schools and 2% and 10% at primary level. There are serious gaps between what is taught and what the labour market requires, which puts young graduates at a disadvantage. Universities have some 8 000 students, including 3 000 at the state university, while 6 000 more are studying abroad because some subjects, such as medicine, are not taught in Cape Verde. Lack of room for students is the main problem in higher education. In pre-school education, only 20% of teachers are properly trained and in primary schools 13% are not trained at all.

The government has launched an ambitious programme to eradicate these quality shortfalls. All primary and secondary schools have been obliged to teach English and French since September 2009 and curriculum changes have been made to improve learning in some secondary schools. The *Mundo Novo* programme aims to connect all levels of the education system to the Internet, focusing on content, and provide all senior secondary and university students with cheap laptops. The government spent more on hiring teachers in 2009.

Can Cape Verde get the funding it needs? A sizeable part of the budget went to education in 2009 (5.87%), supplemented by funding from the Netherlands and Luxembourg for vocational training and jobs (4.24% of the budget).

The indicators under the second and third MDGs (universal primary education and gender equality) have nearly all been achieved. Average net primary enrolment is 88% for boys and 89% for girls in towns (90% and 87% in the countryside). Enrolment is fairly high in pre-school education (60%) and secondary education (82% for boys and 89% for girls in towns, and 77% and 81% in rural areas). Literacy was 79.6% in 2007 and highest (96%) among 15-24 year-olds, with little difference between genders and places.

Cape Verde has met most of the quantitative MDG indicators for reducing infant mortality and improving maternal health but again, future long-term results depend on support from donors, whose strategies overlap and whose planning, above all, lacks a focus on quality. Three major partners have withdrawn from the country, after making progress, leaving the government with a very costly system to fund.

Health care is free, except for part of it that is means-tested, with charges ranging from CVE 50 to 1 000. Health was 4.31% of the budget in 2009 and efforts are focused on primary care training and infrastructure (including vaccination, prevention and rehabilitation). About 60% of the population is under 25 but rising life expectancy (about 72.7 in 2009) has brought more age-related illness and the country has a shortage of specialist doctors for this.

Mortality of children aged under 5 years fell from 63 per thousand in 1990 to 29 in 2008 and 73.2% of children under 11 months were vaccinated in 2007. Access to perinatal care is almost universal (97.5% of pregnant women) but the maternal mortality ratio (94 per 100 000 en 2008) is currently higher than the MDG target of 17.3 per thousand by 2015. Incidence of HIV/AIDS is 0.8% and testing rose significantly from 3 069 people in 2003 to 8 159 in 2005. Cases of infection were 2 329 in 2007 (including 319 new cases) but this was thought to be only half the actual number. Malaria is insignificant (3.7 cases per thousand in 2007) and 294 new cases of TB were recorded in 2007, to make a rate of 51.9 cases per thousand.

Epidemics of measles and dengue fever – for the first time – in 2009 showed the need for continued vigilance.

The MDG target of halving the number of those without access to safe water and basic sanitation by 2015 has been partly met. The percentage of the population with access to safe water was 89.5% in 2007 (up from 42% in 1990). But geographical disparity persists, with 98.6% having access in towns and only 75.8% in the countryside. Only 40.8% of households (57.4% urban and 15.9% rural) had access to septic tanks and a sewerage system in 2007 and 53.3% of rural homes and 22.7% of urban ones had no toilets or latrines. Some 63% of households had access to some kind of solid waste disposal, with a large geographical disparity (88.5% in towns and 24.3% in the countryside). Sanitation got 3.93% of the budget in 2009 and water 3.38%. A detailed national plan is needed for basic sanitation.

Results of the latest national census, in July 2010, will show how all the social indicators are doing and the Cape Verde INE can then make an in-depth analysis with the aim of improving quality.