Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 01-Nov-2021 | Report No: PIDA32389

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Cabo Verde	P174754	Cabo Verde: First Sustainable and Equitable Recovery DPF (P174754)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
AFRICA WEST	06-Dec-2021	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Cabo Verde	Ministry of Finances		

Proposed Development Objective(s)

The programmatic DPF series aims at strengthening policies for a sustainable, equitable, and greener economic recovery.

Financing (in US$, Millions)

SUMMARY

Total Financing	30.00

DETAILS

Total World Bank Group Financing	30.00
World Bank Lending	30.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. **The impact and persistency of the pandemic caused the largest economic contraction on record and exposed the vulnerabilities of Cabo Verde's growth model.** Prior to the crisis, Cabo Verde experienced robust economic growth on the back of a thriving tourism sector and strong structural reforms. These included reform to SOEs, fiscal restraint, and debt reduction. The crisis reversed this progress. GDP contracted 14.8 percent in 2020 (15.7 percent per-capita), the second largest reduction in Sub-Saharan Africa. The main transmission channels are through the tourism sector, which represents 25 percent of GDP and drives around 40 percent of overall economic activity, and FDI, a critical source of external finances and key driver of growth. Despite the large threat posed by the crisis and very limited policy buffers, the authorities rapidly implemented in 2020 decisive measures to contain and mitigate the impact of the pandemic.

2. **The COVID-19 crisis reversed the progress in poverty reduction achieved since 2015.** Cabo Verde witnessed significant poverty reduction over the last decade. Using a national poverty line equivalent to US$5.5 in purchasing power parity (PPP) terms per person per day in 2015 prices, the incidence of poverty was projected to fall from 41.3 percent in 2015 to 34 percent in 2020. Extreme poverty, defined as those below the national food poverty line (PPP US$1.9 per person in 2015), was expected to drop from 3.3 percent to 2 percent during the same period. The economic impact of the crisis increased the national (extreme) poverty rate to 42 (3.7) percent in 2020. With the progressive resumption of economic growth, the national (extreme) poverty rate is projected to fall back to 38.9 (3) percent in 2022.

3. **Increased fiscal pressure from the crisis interrupted the gradual decline in public debt from high levels since 2016, raising the urgency to implement measures to reduce fiscal risks and increase debt transparency.** Starting in 2016, a successful fiscal consolidation program put public debt (as a share of GDP) on a declining path. The overall fiscal deficit fell from 7.6 percent of GDP in 2014 to 1.8 percent in 2019. Consequently, the debt-to-GDP ratio declined from 128.4 percent in 2016 to 124.2 percent in 2019 but increased to 155 percent in 2020 due to increased financing needs and the contraction of GDP. Nevertheless, public debt remains sustainable. According to the Debt Sustainability Assessment (DSA) updated by the World Bank for this operation in August 2021, debt service ratios remain below relevant thresholds due to its concessional nature, which is characterized by long maturity profiles and low interest rates even as the overall and external risk of debt distress remains high. Compared to the previous joint World Bank/IMF DSA, conducted in September 2020, the extension of the COVID-19 crisis resulted in higher debt burden indicator paths.

4. **The crisis impacted the financial performance of an already weak SOE sector, which required emergency fiscal support and led to the reversal of the privatization of Cabo Verde Airlines (CVA), further exacerbating already high fiscal risks.** The authorities extended loan guarantees amounting to US$54.1 million in 2020 to support financially distressed SOEs, with CVA accounting for almost half of this amount. Until July 2021, additional loan guarantees were US$34.3 million, driven by CVA (US$20.2 million). Capitalization of SOEs accounted for US$7.8 million in 2020, with NEWCO (the Special Purpose Vehicle created to absorb CVA debt before privatization) being the largest recipient with US$5.6 million. In July 2021, authorities reversed the privatization of CVA on the grounds of fiscal responsibility, following the exceptional high financial uncertainty of the company, which could trigger contingent liabilities totaling $US47 million (2.8 percent of GDP).

5. **The crisis also significantly impacted the private sector, threatening the survival of otherwise viable firms.** Domestic and multinational companies were severely affected, particularly in the tourism sector. Cabo Verde's economic activity is characterized by large presence of micro, small and medium-size companies (MSMEs). There is a strong concentration of companies in commerce (44.6 percent) and hospitality (16.2 percent)– sectors that are vulnerable. According to the National Statistics Institute, about 20 percent of domestic companies suspended activities following the declaration of a state of emergency in March 2020. About 83 percent of firms suffered a reduction in business turnover during the second quarter of 2020, whereas 43 percent reduced the effective workforce. In the tourism sector, 77 percent of firms reported being temporarily closed during the same period.

6. **The macroeconomic policy framework is deemed adequate for the proposed operation.** The government acted swiftly to mitigate the health and economic impacts of the COVID-19 crisis. The IMF, the World Bank, and other development partners provided support to bridge the resulting financing gap in 2020. Participation in the Debt Service Suspension Initiative (DSSI) supported the fiscal response to the crisis. Real GDP growth is projected to recover gradually in 2021 and average 5.1 percent between 2021 and 2023 driven by a progressive resumption of tourism and capital flows, and the resumption of structural reforms. Key structural reforms that were in progress before the crisis are expected to resume, which would improve growth-supporting service delivery. The Government is committed to the implementation of fiscal consolidation, including resuming SOE reforms, in the aftermath of the pandemic. International reserves are expected to remain at a comfortable level over the medium term. Public debt is expected to return to its declining path and remain sustainable, although the risk of debt distress will remain high. The macroeconomic framework with be anchored in an IMF program, expected to be in place in the first quarter of 2022. A zero ceiling on non-concessional debt and improving the monitoring of fiscal risks from SOEs form the basis for the FY22 Performance Policy Actions (PPAs) under the Sustainable Development Finance Policy (SDFP).

Relationship to CPF

6. **The reform program supported by the DPF is consistent with the objectives of the Cabo Verde 2020 -2025 CPF.** The WBG CPF (report number 127164-CV), approved by the board in November 2019, builds on the findings of the Systemic Country Diagnostic produced in 2018. Pillar A supports the CPF's third objective supporting increased fiscal and macroeconomic resilience and manage the economic impact of climate shocks. Pillar B supports the CPF's second objective to overhaul of social assistance, with a focus on productive inclusion. Finally, Pillar C also supports the CPF's third objective of improving the foundations for private sector growth. The proposed operation will advance reforms that meet the goals of the CPF, reinforcing the country's fiscal position as it seeks to return to a sustainable growth path and adjust its development model towards greater private sector participation.

C. Proposed Development Objective(s)

7. This programmatic Development Policy Financing series aims to support Cabo Verde's efforts to: i) Improve debt transparency and reduce fiscal risks from SOEs; ii) Strengthen the resilience of poor and vulnerable households to shocks, particularly women and including climate-related shocks; and ii) Support a sustainable and private sector-led recovery of economy.

Key Results

8. **This DPF supports reforms to strengthen the foundation for an equitable and sustainable private sector-led recovery and a return to fiscal sustainability.** Tackling fiscal vulnerabilities arising from loss-making SOEs and improving debt transparency are paramount to support fiscal and debt sustainability, and the recovery of the economy. In addition, the rapid social protection response to the crisis is an opportunity to cement reforms aimed at increasing the resilience of social safety nets, including to climate-related shocks. Finally, supporting reforms to increase private investment that mitigates the impact of climate change while supporting economic diversification is also important to increase the resilience of the economy to external shocks. The reform program also supports a responsible debt and fiscal management stance that would allow Cabo Verde to return to inclusive economic growth and debt sustainability in the aftermath of the pandemic.

D. Project Description

9. **The operation is structured around three mutually reinforcing pillars:**

- **Pillar A on improving debt transparency and reducing fiscal risks from SOEs:** With reform program measures to (i) strengthen fiscal risk management, including the adoption of a framework to issue state guarantees; and (ii) reduce fiscal risks by improving the quality, frequency, and coverage of both public and SOEs debt reporting.

- **Pillar B on strengthening the resilience of poor and vulnerable households to shocks, particularly women and including climate-related shocks:** This pillar builds on the COVID-19 response program and continues to strengthen the social protection system by (i) supporting the continued use of safety nets to respond to COVID-19 in the short-term and further strengthening the shock-responsiveness of the safety net system in the medium-term; and (ii) strengthening the usability of the social registry and enabling broader usage for targeted service delivery.

- **Pillar C on supporting a green, sustainable, and private sector-led recovery:** This pillar promotes social and environmental sustainable private investment for a better recovery and resilience by (i) supporting reforms of the electricity sector to attract private investment necessary to lower the cost of electricity services, strengthen energy independence, and reduce greenhouse gas emissions; (ii) promoting a harmonized, streamlined and more predictable regulation for sustainable private sector investment in the tourism sector; and (iii) supporting the sustainable development of aquaculture, as a core climate adaptation measure for the fishery sector.

10. **The operation is closely aligned with the government priorities established in the PEDS and Cabo Verde Ambition 2030 to recreate the conditions for a sustainable, equitable, green, and private sector led recovery while ensuring the return to fiscal sustainability over the medium term.** The series complements other activities to address fiscal risks, debt transparency –notably through the Performance and Policy Action (PPA) under the Sustainable Development Finance Policy (SDFP), social protection, and technical assistance to the tourism sector. Specifically, the series supports the authorities in their efforts to recover after the COVID-19 crisis and to reposition the role of the state in the economy, by promoting private sector recovery and growth and supporting the transition towards a low-carbon economy. In parallel, the DPF series supports measures to increase debt transparency and reduce fiscal risks while strengthening the resilience of the most vulnerable to shocks.

E. Implementation

Institutional and Implementation Arrangements

11. **The National Directorate of Planning (Direção Nacional de Planeamento, DNP) at the Ministry of Finance will be responsible for the overall implementation of the proposed operation and for reporting on its progress.** the World Bank team has worked in close collaboration with the government and its budget support partners to ensure adequate monitoring and evaluation of development interventions. The government has invested substantially in developing an electronic platform for monitoring results of government spending. However, the system is currently only partially operational. A key weakness is inadequate data systems that should generate and update results information. The new national strategy for the development of statistics and the revised law on statistics are designed to address key weaknesses and provide a strong foundation for improvement and sharing of survey and administrative data. The National Institute of Statistics will play a central role in coordinating the statistical system and ensure quality and independence of data systems and sharing these with users to respond to key monitoring and policy analysis demand. The team's assessment is that the country's M&E system is sufficiently robust for the purpose of this operation.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

12. **The prior actions supported by this operation are expected to significantly contribute to avoiding surges in chronic poverty in the short term, protect mostly women-led households, and foster poverty reduction over medium term.** The DPF focus on reducing fiscal risk and increasing debt transparency contributes to establishing an enabling environment for prudent fiscal management and sustained economic growth. Strengthening the resilience of the poor to economic shocks will contribute to prevent vulnerable households, particularly women-led, from falling into poverty as a result of the shock in the short term and contribute to a more efficient and responsive social protection system to protect them over the medium term. Enabling a private sector led and sustainable recovery is also expected to support sustainable growth and job creation, which will be beneficial for the poor over the medium-term.

13. **Pillar B would contribute to poverty reduction, particularly amongst women, in the short and medium term including as a response to shocks.** The reform program is expected to not only ensure that the purchasing power of targeted poor households is maintained but also to contribute towards protecting the livelihoods and strengthening the resilience of poor and vulnerable households, particularly women. These reform areas would prevent households from resorting to negative coping mechanisms and, therefore, avoiding worsening human capital development. The extension and expansion of the emergency cash transfers would have a short-term positive impact on poverty. The expansion of the social registry would increase the efficiency of targeting of social programs with a direct positive impact on poverty and make the social register more suitable to be used for future rapid expansion of the safety net as a response to shocks. Shock-responsive safety nets providing temporary income support, enables households to protect and insure against risks, while reducing the cost of coping ex-post. The reforms would particularly benefit women, since 74 percent of households in the social registry are female-headed households and around 67 percent of the RSO beneficiaries (who will be included in the social registry) are women. In addition, women constitute a large portion of the extreme poor of which 43 percent are households where a single mother is the only breadwinner.

15. **Pillar C is expected to have positive poverty impacts through the reforms in Energy and Tourism.** On Energy, the privatization of the utility company will improve the financial situation of the company by reducing large commercial losses. As tariffs are cost reflective, it is expected that the reduction in losses is passed through tariffs over the medium, which would reduce the cost of electricity, particularly for poor households. On tourism, by attracting new private investment in the tourism sector in islands outside Sal and Boa Vista, the reform is expected to lead to significant positive effects through the creation of new jobs.

Environmental, Forests, and Other Natural Resource Aspects

16. **The strengthening of the capabilities of the social protection system to respond to crises, the reform in the energy sector, the enhancement of the planning and regulation for sustainable tourism, and the regulatory framework governing aquaculture are expected to have a significant positive environmental impact on climate adaptation and mitigation and support Cabo Verde in implementing its NDC.** The investment in the social registry would raise the climate adaptation potential of the social safety nets since it underpins the ability of programs to expand coverage of households in response to climate-related shocks. The power sector reform plan will tackle commercial losses in electricity generation and also rationalize electricity demand and reduce greenhouse gas emissions. Support to the effective implementation of the planning and regulation for sustainable tourism will promote environment protection and climate adaptation, by requiring among others the use of disaster and climate-related risk information for territorial planning. Finally, the regulatory framework for Aquaculture will support climate adaptation, as recognized in the country’s NDC, noting that aquaculture will provide a buffer to mitigate the volatility that climate change could impose on marine fisheries.

17. **The Government’s capacity for environmental management is adequate and will play a key role in maximizing the sustainability of the DFP reform program.** The tourism investments supported by the operation might impact water demand (and availability), energy demand (and sourcing), and waste generation, among others. The by-laws under consideration regulate the process flow and deadlines for project approval, including the National Directorate of Environment. The overall guidance on environmental safeguards is included (i) in the ZDTI framework law and (ii) the overall environmental impact assessment law updated in March 2020. Finally, environmental risks from aquaculture investment are primarily linked to water pollution and species contamination. The proposed law considers environmental issues and refers to the overall impact assessment regulations (see next paragraph). In addition, specific technical assistance will be provided on the preparation and review of environmental assessment instruments.

G. Risks and Mitigation

18. **The overall risk rating for the DPF series is substantial.** Macroeconomic risks are high and depend primarily on the duration of the crisis and the speed of recovery of the tourism sector. The risks are compounded by the delay in fiscal consolidation and SOE reforms due to the crisis, including the reversal of the privatization of CVA. While the long-term future of CVA is uncertain, the re-nationalization of the company is grounded in valid fiscal considerations due to the poor performance of the Airline after privatization, which were compounded by the pandemic. A lower economic growth in 2021 could cause further reversals of the gains in fiscal and debt sustainability achieved in recent years. Financial support to the SOE sector could also increase significantly, leading to a further deterioration in the fiscal deficit and delaying the projected decline in public debt. External and natural shocks remain an important source of risks, which could increase fiscal pressures and result in fiscal slippages in 2021. The impact of such scenario would be compounded as fiscal buffers to respond to the crisis have been exhausted, including with the disbursement of the CAT DDO DPF (P160628) in 2020. However, the Government has shown a strong commitment to achieving fiscal consolidation targets and is making a considerable effort to strengthen its oversight of SOEs. These efforts are supported by World Bank SOEs Related Fiscal Risk Management Project (P160796). These actions are to be complemented by the implementation of a comprehensive strategy for managing fiscal risks and for improved debt transparency, with the support of the World Bank and the IMF.

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APPROVAL

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