Document of

The World Bank

Report No: PGD356

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR

PROPOSED DEVELOPMENT POLICY CREDITS

IN THE AMOUNTS OF

SDR 17.6 MILLION (US$22.5 MILLION EQUIVALENT,
OF WHICH US$15 MILLION EQUIVALENT FROM THE IDA CRISIS RESPONSE WINDOW)

EUR 20.5 MILLION (US$20 MILLION EQUIVALENT)
FROM IDA SCALE-UP WINDOW ON SHORTER MATURITY LOANS TERMS

AND A

CATASTROPHE-DEFERRED DRAWDOWN OPTION
OF SDR 7.9 MILLION (US$10 MILLION EQUIVALENT)

TO THE
REPUBLIC OF CABO VERDE

FOR THE
SECOND RESILIENT AND EQUITABLE RECOVERY DEVELOPMENT POLICY FINANCING
WITH A CATASTROPHE-DEFERRED DRAWDOWN OPTION

October 21, 2022

Macroeconomics, Trade And Investment Global Practice
Urban, Disaster Risk Management, Resilience and Land Global Practice
Western and Central Africa Region

Republic of Cabo Verde

GOVERNMENT FISCAL YEAR

July, 1 – June, 30

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of September 30, 2022)

Currency Unit: Cabo Verdean Escudo (CVE)

US$1.00 = CVE 110.26

US$1.00 = SDR 0.78132325

US$1.00 = Euro 1.02443272

ABBREVIATIONS AND ACRONYMS

AAL	Annual Average Losses	IDRF	Household Income and Expenditure Survey (*Inquérito às Despesas e Receitas das Famílias*)
AfDB	African Development Bank	IFH	Real Estate and Housing Fund (*Imobiliária Fundiaria e Habitat*)
ASA	Airport Security Administration (*Aeroportos e Segurança Aérea*)	IGF	General Inspectorate of Finance (*Inspeção Geral das Finanças)*
AMI	Advanced Metering Infrastructure	IMF	International Monetary Fund
BCV	Central Bank of Cabo Verde (*Banco de Cabo Verde*)	IPC3+	Integrated Food Security Phase Crisis Classification
BSG	Budget Support Group	IPF	Investment Project Financing
CAD	Current Account Deficit	KPI	Key Performance Indicators
CASUEB	Unified Strategic Framework for the Blue Economy (*Quadro Estratégico Unificado para a Economia Azul*)	LDP	Letter of Development Policy
CaT DDO	Catastrophe-Deferred Drawdown Option	M&E	Monitoring and Evaluation
CEM	Country Economic Memorandum	MFIDS	Ministry of Family and Social Inclusion (*Ministério da Família, Inclusão e Desenvolvimento Social*)
CH	Harmonized Framework (*Cadre Harmonise*)	MoF	Ministry of Finance
CPF	Country Partnership Framework	NDC	Nationally Determined Contribution
CPI	Consumer Price Index	NEWCO	Special Purpose Vehicle Created to Absorb CVA Debt Before Privatization
CSU	Single Social Registry (*Cadastro Social Único*)	NPL	Non-performing Loan
CVA	Cabo Verde Airlines	PCI	Policy Coordination Instrument
CVE	Cabo Verdean Escudos	PDNA	Post-Disaster Needs and Assessment
DeMPA	Debt Management Performance Assessment	PEDS	Strategic Plan for Sustainable Development (*Plano Estratégico de Desenvolvimento Sustentável*)
DNA	National Directorate of Environment (*Direcção Nacional do Ambiente*)	PEFA	Public Expenditure and Financial Accountability
DGPOG	General Directorate of Planning, Budget and	PEMSMAA	Emergency Program for Mitigation of

	Management *(Direcção Geral de Planeamento, Orçamento e Gestão*)		Drought and Bad Agricultural Year
DNP	National Directorate of Planning (*Direção Nacional de Planeamento*)	PFM	Public Financial Management
DPF	Development Policy Financing	PNIEB	National Investment Plan for the Blue Economy
DRAS	Disaster Resilience Analytics and Solutions	POT	Tourism Zoning Plan (*Plano de Ordenamento Turístico*)
DRM	Disaster Risk Management	PPA	Performance and Policy Action
DSA	Debt Sustainability Assessment	PPG	Public and Publicly Guaranteed
DSSI	Debt Service Suspension Initiative	PPP	Public-Private Partnership
ECF	Extended Credit Facility	PRH	Housing Rehabilitation Program (*Programa de Regeneração do Habitat*)
ECOWAS	Economic Community of West African States	PROMEB	Blue Economy Promotion Program (*Programa de Promoção da Economia Azul*)
EIA	Environmental Impact Assessment	PRSC	Poverty Reduction Support Credit
ELECTRA	Public Water and Electricity Company (*Empresa de Electricidade e Água*)	PV	Present Value
EMPROFAC	National Pharmaceutical Products Company (*Empresa Nacional de Produtos Farmacêuticos*)	RPP	Revenue Protection Program
ENAPOR	Cabo Verdean Port Authority (*Empresa Nacional de Administração dos Portos de Cabo Verde*)	RSI	Cash Transfer Program (*Rendimento Social de Inclusão*)
ENRRD	National Disaster Risk Reduction Strategy (E*stratégia Nacional de Redução de Riscos de Desastres*)	RSIE	Emergency Cash Transfer Program (*Rendimento Social de Inclusão Emergencial)*
ESA	External Stability Assessment	RSO	Cash Transfer to Informal Workers (*Rendimento Solidário*)
EU	European Union	SDFP	Sustainable Development Finance Policy
FDI	Foreign Direct Investment	SDG	Sustainable Development Goal
FMIS	Financial Management Information System	SDR	Special Drawing Rights
FNE	National Emergency Fund	SIGOF	Integrated Budget and Financial Management System (*Sistema Integrado de Gestão Orçamental e Financeira*)
FRM	Fiscal Risk Management	SOE	State-Owned Enterprise
FRS	Fiscal Risk Statement	SSA	Sub-Saharan Africa
GDP	Gross Domestic Product	TA	Technical Assistance
FY	Fiscal Year	TSA	Treasury Single Account
GHG	Greenhouse Gas	TSO	Transmission System Operator
GoCV	Government of Cabo Verde	US$	United States Dollar
GRS	Grievance Redress Service	VAT	Value-added Tax
IBRD	International Bank for Reconstruction and Development	WB	World Bank
ICT	Information and Communications Technology	WBG	World Bank Group
IDA	International Development Association	ZDTIs	Integrated Tourism Development Zones *(Zonas de Desenvolvimento Turístico Integrado)*

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REPUBLIC OF CABO VERDE

SECOND RESILIENT AND EQUITABLE RECOVERY DPF WITH A CAT DDO

TABLE OF CONTENTS

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic	If programmatic, position in series
P176148	Yes	2nd in a series of 2

Proposed Development Objective(s)

The program development objective is to support the Government's efforts to strengthen the foundations for a resilient and equitable economic recovery through (i) reducing fiscal risks and improving debt transparency; (ii) strengthening the resilience of poor and vulnerable households to climate shocks; and (iii) enabling a sustainable private sector-led recovery.

Organizations

Borrower:	CABO VERDE
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**52.50**

DETAILS

International Development Association (IDA)	52.50
IDA Credit	52.50

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Substantial

Results

Indicator Name	Baseline (2020)	Progress (2021)	Target (year)
Result Indicator 1: Sectoral coverage score in the World Bank debt reporting heat map (text).	Partial	Partial	Full (2023)
Result Indicator 2: Support to SOEs (capitalization, guarantees, on-lending) above what is established in the annual budget (percentage).	30	30	10 (2023)
Result Indicator 3: Share of annual average loss from disaster and climate-related risks covered under the existing risk financing instruments (percentage).	14	12	>50 (2025)
Result Indicator 4: Female-headed households benefitting from temporary income support in response to shocks, including climate-related, through emergency cash transfer programs (cumulative number).	4,578	17,872	20,800 (2023)
Result Indicator 5: FNE audit report produced and published by the Court of Account including evaluation of drought response expenditures (yes/no).	N/A	N/A	yes (2025)
Result Indicator 6: Additional households identified using the social registry that are from the two poorest quintiles (percentage).	0	55	50 (2023)
Result Indicator 7: Improved ELECTRA's commercial operational performance: Overall system losses (percentage).	26.1	25.5	21 (2025)
Result Indicator 8: New tourism investment projects approved in ZDTIs, in compliance with the corresponding POTs and with approved environmental impact assessments (percentage of total number of new investments in ZDTIs).	N/A	0	100 (2023)
Result Indicator 9: Total investments generated in aquaculture – cumulative (US$ million).	6	8	9 (2023)

IDA PROGRAM DOCUMENT FOR A PROPOSED DEVELOPMENT POLICY *CREDIT* TO THE *REPUBLIC OF CABO VERDE*

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Second Resilient and Equitable Recovery Development Policy Financing (DPF) with Catastrophe-Deferred Drawdown Option (Cat DDO) supports Cabo Verde's efforts to strengthen the foundations for a climate resilient and equitable private sector-led recovery.** The program development objective is to support the Government's efforts to strengthen the foundations for a resilient and equitable economic recovery through (i) reducing fiscal risks and improving debt transparency; (ii) strengthening the resilience of poor and vulnerable households to climate-related shocks; and (iii) enabling a climate resilient and sustainable private sector-led recovery. The proposed development policy financing comprises of (i) an IDA credit in the amount of SDR 17.6 million (US$22.5 million equivalent, of which US$15 million equivalent is from the Crisis Response Window); (ii) a credit on Scale-up Window Shorter Maturity Loans (SUW-SML) terms[1] in the amount of EUR 20.5 million (US$20 million equivalent); and (iii) a Cat DDO in the amount of SDR 7.9 million (US$10 million equivalent). The proposed operation is the second in a programmatic series of two operations, with the first DPF (P174754) in the amount of US$30 million approved by the Board on December 6, 2021. The previous Cabo Verde Disaster Risk Management (DRM) DPF with Cat DDO (P160628) in the amount of US$10 million was approved on June 2019 and fully disbursed to support Government's COVID-19 response in May 2020.

2. **The shock resulting from COVID-19 produced the largest economic contraction on record and exposed the country's economic vulnerabilities.** Prior to the crisis, Cabo Verde experienced robust and accelerating economic growth driven by a thriving tourism sector and benefiting from deep structural reforms, including reforms in the State-Owned Enterprise (SOE) sector, fiscal restraint, and debt reduction. The crisis reversed this progress, with GDP contracting by 14.8 percent in 2020 (15.7 percent in per-capita terms), the second largest reduction in Sub-Saharan Africa (SSA). Recognizing the economic threat posed by the crisis, and despite limited policy buffers, the authorities rapidly implemented measures to contain and mitigate the impact of the pandemic, including a comprehensive vaccination campaign. As of July 2022, 85 percent of the eligible adult population had received two doses; about 87 percent of eligible teenagers had received at least one dose; and boosters had been applied to 30 percent of eligible adults. Cabo Verde's number of administered vaccine doses was much higher than SSA averages, ranking 4th in SSA with 137.7 doses per 100 people.

3. **The Ukraine war exacerbated inflationary pressures and reduced growth prospects in 2022, with a severe and disproportionate impact on the poorest through increasing food insecurity and malnutrition.** The main direct transmission channels are higher international oil and food prices. Because the country imports 80 percent of food, there is a high transmission of international prices to domestic prices, affecting the poor disproportionally. The headline inflation rate in June 2022 stood at 8.2 percent (y/y). The annual inflation for food & beverage and energy was 16.2 and 31.8 percent, respectively. Around 20.4 percent of the population is predicted to have insufficient food consumption in 2022, according to the UN World Food

[1] In accordance with current Republic of Cabo Verde per capita income and IDA20 lending criteria, the SUW-SML credit will be financed under the single currency IDA SML credit terms, i.e. 12 years' amortization with a grace period of 6 years. As a Small-State Blend country at moderate risk of debt distress, Cabo Verde is eligible to receive SUW-SML financing.

Program. Malnutrition levels are believed to start deteriorating given the overreliance on food imports, the reduction of local agricultural production given the drought, and the erosion of purchasing power. Cabo Verde was added to the list of hotspot countries in the June 2022 edition of the Hunger Hotspots Warning on Acute Food Insecurity report published by the World Food Program and the Food and Agriculture Organization of the United Nation.

4. **Authorities reacted swiftly in April 2022 with a policy package targeted to protect the most vulnerable from the impact of the Ukraine war.** The Government implemented measures aimed at stabilizing the prices of fuel, wheat, corn, beans, rice, cooking oil, and powdered milk. Authorities also strengthened the bulk stocking capacity of cereals, increased the period for offering meals in schools, escalated subsidies in livestock feed; provided credit lines for agriculture and semi-industrial fishing, and incentivized importers for grouped purchases. The number of beneficiaries of the cash transfer program was also increased to cover households with food insecurity. Finally, the measures included the reduction of value-added tax (VAT) on electricity from 15 to 8 percent; an increase in the social energy tariff subsidy for water and electricity from 30 to 50 percent; and a temporary suspension of the automatic indexation mechanism for fuel prices. In June, the authorities renewed the measures until December 2022. The estimated fiscal cost of the policy response package is US$84.9 million (4.2 percent of GDP) in 2022.

5. **Disasters and climate-related shocks pose a major challenge for the sustainability of Cabo Verde's growth model, as reflected by the impact of the five-year long drought.** Over the last decade, economic losses from disaster and climate-related shocks have been on an upward trend, revealing the increasing exposure and vulnerability of the archipelago. Annual average losses (AAL) from disaster and climate-related shocks are estimated at 1 percent of Gross Domestic Product (GDP), mainly driven by climate-related events. Climate change is expected to further exacerbate existing hydrometeorological hazards and could increase losses associated with climate-related shocks. Climate projections indicate that temperature in Cabo Verde could gradually increase by 1.2°C to 3.7°C by the end of the century, while the hydrological cycle will intensify, resulting in more intense rainfall and flooding, as well as more intense droughts. With a third of the population engaged in activities potentially affected by climate change, increased weather variability entails a major threat to the sustainability of poverty reduction efforts. Successive rainfall deficits of 49 percent in 2019 and 34 percent in 2021 have caused significant decreases in agricultural production. In 2021, 93 percent of cereal and 34.5 percent of tuber production were lost, the largest shares recorded in the Economic Community of West African States (ECOWAS) region.

6. **In alignment with the Government's strategic Plan for Sustainable Development (***Plano Estratégico de Desenvolvimento Sustentável)* **2022-2026, this operation supports reforms to strengthen the foundation for a resilient and sustainable private sector-led recovery.** The operation is structured around three mutually reinforcing pillars:

a. **Pillar A improves debt transparency and reduces fiscal risks from SOEs and climate shocks:** The reform program includes measures to (i) strengthen SOE risk management, including quarterly fiscal risk assessment and the enhancement of the guarantees' legal framework; (ii) increase the frequency and quality of debt reporting, including publishing debt for the non-financial public sector; and (iii) strengthening the management of fiscal risks associated to disasters and climate-related risks.

b. **Pillar B strengthens the resilience of poor and vulnerable households to shocks, particularly droughts.**

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 to climate-related shocks of the safety net system in the medium-term; (ii) strengthening the usability of the social registry; and (iii) expanding the eligibility criteria of the National Emergency Fund (*Fundo Nacional de Emergência,* FNE) to respond to droughts. The reform to institutionalize a shock responsive safety net will be crucial for the authorities to respond to increasing food insecurity caused by the impact of the Ukraine war.

c. **Pillar C supports a climate resilient and sustainable private sector-led recovery:** The reform program promotes socially and environmentally responsible investment by (i) supporting reforms in the electricity sector to attract private investment; (ii) promoting harmonized, streamlined, and more predictable regulations for a climate resilient tourism sector; and (iii) developing the regulatory framework of aquaculture.

7. **The proposed DPF is aligned with the priorities identified for World Bank Group (WBG) support in Cabo Verde and with the World Bank's approach to respond to the COVID-19 crisis.** The operation selectively addresses binding constraints to economic growth identified in the 2018 Systematic Country Diagnostic (SCD, Report No. 130289), namely risks to macroeconomic and fiscal sustainability, weak public sector performance, and lack of resilience. The development objective falls within the third and fourth strategic objectives of the fiscal year (FY)20-FY25 World Bank Country Partnership Framework (CPF, Report No. 127164). The DPF is also aligned with Pillars 2 and 4 of the WBG COVID-19 response, which seek to protect the poor and vulnerable people as well as strengthening policies, institutions, and investments for rebuilding better. Additionally, the DPF implement Pillars 1 and 3 of the WBG crises framework that support the policy response to food insecurity and strengthening resilience. The authorities have continued to strengthen debt management and transparency through the proposed Performance and Policy Actions (PPAs) under the Sustainable Development Finance Policy (SDFP). The focus of FY23 PPAs includes (i) the continuation of the zero Non-Concessional Borrowing ceiling on external debt and (ii) the broadening in the coverage of public debt in the debt bulletin to include the nonfinancial public sector.

8. **The macroeconomic policy framework is deemed adequate for the proposed operation.** While the economy remains vulnerable in face of uncertainty surrounding the COVID-19 pandemic and the impact of the war in Ukraine on global food and fuel prices, the macroeconomic and structural policies the authorities are pursuing should support growth to gradually recover over the medium term. A return to a sustainable fiscal path and key structural reforms, particularly in the SOE sector, will support growth. This operation, through the first pillar, promotes fiscal consolidation by enhancing the management of fiscal risks and, through the third pillar, support the reform of the electricity utility company. Further, monetary policy is expected to continue to be effective at supporting price stability and the exchange rate peg. The Government has a good track record in and is committed to fiscal consolidation to return to fiscal sustainability. Although the risk of overall debt distress is high, public debt remains sustainable. The risk of external debt distress is moderate. International reserves are expected to remain at a comfortable level (5.5 months of prospective imports) over the medium term. The macroeconomic framework is anchored in the International Monetary Fund (IMF) three-year Extended Credit Facility (ECF) program, approved in June 2022.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

9. **The COVID-19 crisis caused an economic contraction of 14.8 percent in 2020, despite the quick reaction of authorities to mitigate its economic and health impacts.** Prior to the crisis, Cabo Verde experienced robust economic growth driven by a thriving tourism sector and strong structural reforms, mainly around the SOE sector. Between 2016 and 2019, growth averaged 4.7 percent (3.2 percent in per capita terms). The COVID-19 shock negatively impacted the country through the tourism sector, which represents 25 percent of GDP and drives around 40 percent of overall economic activity, and through the reduction of Foreign Direct Investment (FDI), a critical source of external finances and a key driver of growth. The crisis was driven by the nine-month shutdown of the tourism sector and their associated negative spillovers in upstream sectors. Net exports were a drag on growth, with a reduction of exports of goods and services of 58.4 percent. Reversing the progress made since 2015, the national poverty rate (based on the lower-middle income poverty line of US$3.2 a day, 2011 Purchasing Power Parity) increased from 10.2 percent in 2019 to 14.7 percent in 2020.

10. **A comprehensive vaccination campaign in 2021 was fundamental for the recovery of the economy, despite several waves of the COVID-19 pandemic.** Notwithstanding early containment measures, COVID-19 cases spiked the second half of 2020, reaching 1,973 cases per 100,000 inhabitants by the end of the year (the highest in the African Union). In 2021 Cabo Verde administrated approximately 700,000 vaccine doses obtained through the COVAX mechanism and donations from partner countries – a substantially higher number relative to world standards. By mid-July 2022, 85.4 percent of the eligible adult population had received two doses, about 86.7 percent of eligible teenagers received at least one dose, and boosters were applied to 30 percent of eligible adults. Cabo Verde's number of administered vaccine doses was much higher than SSA averages, ranking 4th in SSA with 137.7 doses per 100 people.

11. **Economic activity expanded by 7 percent in 2021, magnified by base effects.** Supported by the gradual restarting of tourism from the second quarter, the services sector contributed 4.3 percentage points (p.p) to GDP growth (Table 1). Manufacturing, driven by fish processing industries, contributed 2.3 p.p to growth. The agriculture and fishing sector contributed to 0.3 p.p. to growth, reflecting a gradual return on external demand for fish. Agricultural production remains suppressed as the 5-year long drought continues battering the country. On the demand side, private consumption, led by the recovery of tourism, contributed 6.3 p.p. to GDP growth. Likewise, public consumption contributed 6.2 p.p., due to the continuation of exceptional expenditures measures to respond to the pandemic. The contribution of total investment to growth was negative, driven by a reduction in public investment. Exports recovered during the second half of the year with the gradual recovery of tourism, but at the same time goods and services imports increased substantially making the contribution of net exports to growth for the year slightly negative.

12. **Inflationary pressures emerged in 2021, fueled by high international oil prices and global supply chain disruptions.** Cabo Verde's monetary policy is fully aligned with the European Central Bank as the Escudo is pegged to the Euro, with the Portuguese Treasury providing access to a short-term credit facility to support foreign exchange reserves. The hard peg provides a credible nominal anchor to the economy. The objective of monetary policy is to ensure price stability while supporting the peg. Inflationary pressures emerged in 2021 reflecting the increase in international oil prices and global supply disruptions. Prices increased by 1.9 percent y/y, on average, in 2021, compared to 0.6 percent in 2020. This rise in prices was

primarily driven by an 8 percent increase in alcoholic beverages and tobacco, 6.2 percent increase in transport, and a 4.8 percent increase in accessories, household equipment and home maintenance prices.

Table 1: Contribution to GDP Growth (Percentage Points)

	2018	2019	2020	2021	2022p	2023p	2024p	2025p
GDP Growth	**4.5**	**5.7**	**-14.8**	**7.0**	**4.0**	**4.8**	**5.7**	**5.5**
				Demand Side				
Consumption								
Public	0.4	0.8	0.1	6.2	1.4	0.3	0.5	0.9
Private	1.0	3.8	-7.3	6.3	2.1	3.1	3.4	3.3
Investment								
Public	-0.6	0.2	-0.8	-2.4	1.6	-0.4	0.3	0.6
Private	2.2	-2.7	7.5	-1.9	3.9	3.5	2.5	1.5
Exports	5.2	4.2	-28.6	1.4	1.5	3.1	2.7	2.6
Imports	3.9	0.5	-14.7	2.6	6.5	4.7	3.8	3.4
				Supply Side				
Agriculture	-1.6	-0.5	-0.4	0.3	0.1	0.1	0.2	0.2
Industry	1.6	1.6	-0.4	2.3	0.6	1.1	1.6	1.7
Services	4.5	4.6	-14.0	4.3	3.4	3.5	3.9	3.5

Source: Cabo Verdean authorities, IMF, and World Bank estimates and projections (September 2022).

13. **The impact of the Ukraine war exacerbated inflation in the first quarter of 2022,** affecting **disproportionally the poorest and most vulnerable households, increasing food insecurity, and aggravating inequality.** The main direct transmission channels of the war are higher international oil and food prices. Because the country imports about 80 percent of consumption products, there is a high transmission of international prices to domestic prices, affecting the poor disproportionally. Households in the bottom decile of the income distribution spend, on average, 25 percent of their disposable income on food and beverages.[2] The headline inflation rate in June 2022 stood at 8.2 percent (y/y). The annual inflation for food & beverage and energy was 16.2 and 31.8 percent, respectively. Around 20.4 percent of the population is predicted to have insufficient food consumption by end 2022, according to the UN World Food Program. The Harmonized Framework (*Cadre Harmonisé*, CH) for Food Security and Nutrition of March 2022 indicates that 9 percent of the population are in crisis, emergency, or famine situations (stages 3-5 in the CH). This percentage was 2 percent in 2020 and is estimated to reach 11 percent in August 2022. Should this trend continue, the population under food crisis may approach 20 percent towards the end of the year.

14. **Authorities reacted swiftly in April 2022 with a policy package to protect the most vulnerable through measures to prevent food insecurity and control electricity and fuel prices.** Measures to protect the most vulnerable households from rising food insecurity include (i) public work programs for 95 percent of the population in crisis stage or worse (CH3 and above); (ii) price controls for corn, wheat, and cooking oil; (iii) extension of coverage of the social pension; (iv) extension of school meals throughout the summer; (v) cash transfers; and (vi) food assistance to the 5 percent of the population in crisis stage or worse (CH3 and above). Measures to support food production include (i) animal feed subsidies and (ii) an increase in the

[2] Household in the top decile of the income distribution spend, on average, 18 percent of their disposable income in food and beverages.

storage capacity for grains. The cost of these measures is US$34 million or 1.6 percent of GDP (Table 2). Measures to control the rising prices of electricity and fuel, include (i) the reduction of VAT on electricity from 15 to 8 percent; (ii) an increase in the social energy tariff subsidy for water and electricity from 30 to 50 percent; (iii) and a temporary suspension of the automatic indexation mechanism for fuel prices. While these measures are important to support livelihoods of rural farmers and fisherman, the targeting is broader than those measures directly tackling food insecurity, rising concerns on their efficacy and regressive nature of some interventions.[3] The Government response package will be in implementation until December 2022, with an estimated fiscal cost of US$84.7 million (4.2 percent of GDP).

Table 2: Response Plan to the Impact of the Ukraine War (US$ million)

Food security	**34.0**
Support Vulnerable households	**32.5**
Public Work Program "Cash for Work" for 95% in food crisis (Phase 3 QH)	17.6
Price control compensations	5.9
Social pension: Extension of coverage to 3,000 more beneficiaries	3.3
School food	3.2
Cash transfers (currently 5,000 beneficiaries)	1.6
Food Assistance to 5% of the Population in Food Crisis (Phase 3+ QH)	0.9
Support production and producers	**1.5**
Animal feed subsidy	1.1
Increase in storage capacity	0.4
Electricity	**44.0**
Electricity (Deficit until June 2022)	20.1
Electricity (Deficit from July to December 2022)	12.4
Acceleration of energy transition	11.5
Fuel	**6.7**
General fuel in case of increase of more than 5%	5.8
Butane Gas (ensure price increase is zero compared to January 2022)	0.9
Total	**84.7**

Source: Cabo Verdean authorities (September 2022).

15. **The gradual recovery in net service exports helped narrow the Current Account Deficit (CAD) slightly from 15 percent of GDP in 2020 to 11.3 percent in 2021.** At the end of 2020, international reserves stood at 7.9 months of imports of goods and services, well above the level of 3.6 months recommended by the IMF 2019 External Stability Assessment (ESA). As such, reserves permitted the accommodative monetary policy response to the COVID-19 shock. The decline in the CAD in 2021 reflects a higher surplus in net service exports due to the gradual recovery in tourism and, to a lesser extent, a smaller deficit in net goods exports, reflecting the upturn in external demand for fish. Additionally, with the economic rebound in advanced economies, remittances increased by 6 percent in nominal terms and remained an important source of foreign currency. International reserves in 2021 are estimated to account for 7.2 months of imports.

16. **Fiscal revenues decreased from 24.7 percent of GDP in 2020 to 22.6 percent in 2021, driven by the extension of tax deferral payments on consumption and corporate incomes.** All sources of taxes decreased except those levied on international trade, which increased by 20 percent due to the gradual recovery on

[3] Irrigation reliant agriculture and livestock is heavily impacted by cost of energy and fuel needed for desalinization and pumping of underground water. Fishermen have been severely impacted by 37 percent increase in diesel for fishing fleets demanding response from the Government to help subsidize the increase to allow for continued artisanal fishing and food supply.

trade activity. Grants declined by 32 percent indicating the fact that partners frontloaded support in 2020 due to the crisis. As a share of GDP, grants went from 3.2 percent in 2020 to 2 percent in 2021. Non-tax revenue increased by 19 percent in 2021 (3.6 percent of GDP), reflecting an increase in the collection of various fees (registry, notary, and hospital services), and remunerations in the provision of services and property income, namely dividends and other concessions.

Table 3: Key Macroeconomic and Financial Indicators

	2018	2019	2020	2021	2022p	2023p	2024p	2025p
Real economy and prices								
GDP (nominal - CVE billion)	201.2	213.9	180.7	196.8	213.8	229.8	247.7	266.6
GDP growth (%)	4.5	5.7	-14.8	7	4	4.8	5.7	5.5
Inflation (deflator, %)	1.5	0.6	-0.9	1.8	4.5	2.6	2	2
Inflation (CPI average, %)	1.3	1.1	0.6	1.9	7.5	3.5	2	2
Government financial operations (percent of GDP, unless stated otherwise)								
Revenue	25.8	26.8	24.7	22.6	24.9	24.3	24.9	25.3
Expenditures	28.2	28.5	33.8	29.9	33.1	31.4	30.7	29.3
Primary balance	-0.1	0.6	-6.5	-5.1	-5.5	-4.2	-3	-2
Overall balance	-2.4	-1.7	-9.1	-7.3	-8.2	-7.2	-5.8	-4
Total public debt	114.6	114	142.6	143	147.7	141.6	134.4	125.8
Domestic public debt	30.3	31.4	39.5	41.5	42.3	42.1	39.4	35.5
External public debt	84.2	82.6	103.1	101.5	105.4	99.5	94.9	90.3
External sector (percent of GDP, unless stated otherwise)								
Current Account Balance	-4.9	0.2	-15	-11.3	-14.1	-6.1	-5.9	-4.7
Imports, Goods and Services (annual percentage change)	11.4	-2.7	-19.3	5.3	11.2	7.6	5.9	8.8
Exports, Goods and Services (annual percentage change)	18.2	7.2	-43.7	23.3	7.6	13.7	10.4	13.2
Net FDI	4.3	4.3	3.3	3.5	3.8	5.3	4.0	4.4
Gross Reserves (months of imports)	5.6	6.9	7.9	7.2	5.2	5.5	5.4	5.5
Selected Monetary Accounts								
Credit to economy (annual % change)	3.1	3.7	4.8	2.9	8.2	2	4.3	3.4
Broad Money (annual % change)	1.4	8.4	3.8	2.0	1.6	7.7	6.8	6.7
Emigrant deposits/total deposits (%)	36.7	34.6	34	53.9	58.2	58.2	58.2	58.2
Memorandum items								
GDP (nominal – MM. of Euro)	1,826	1,940	1,639	1,785	1,939	2,084	2,246	2,418
GDP per capita (nominal – MM. of Euros)	3,358	3,528	2,948	3,176	3,414	3,637	3,879	4,016

Source: Cabo Verdean authorities, IMF, and World Bank estimates and projections (September 2022).

17. **Total expenditures decreased from 33.8 percent in 2020 to 30 percent in 2021, due to restraint in public investment.** Current expenditures decreased by 1 percent, due to a reduction of current transfers of 15 percent driven by the gradual unwinding of the COVID-19 response. Capital expenditure decreased by 27 percent due to the delay of several public investment projects, mainly investments to improve housing conditions, strengthen infrastructure in education, health, and roads. As a share of GDP, capital expenditure went from 3.3 percent in 2020 to 2.2 percent in 2021. Social expenditure decreased from 11.1 percent of GDP in 2020 to 9.3 percent in 2021, driven by the reduction in health expenditures.

18. **The COVID-19 crisis continued to undermine the financial viability of the SOE sector in 2021, demanding additional fiscal support, exacerbating fiscal risks.** The authorities had extended loan guarantees of US$52.4 million in 2020 to support financially distressed SOEs, with Cabo Verde Airlines (CVA) accounting for almost half of the amount of loan guarantees (US$25 million). In 2021, additional loan guarantees accounted for US$43.6 million, driven again by CVA (US$20.1 million). Capitalization of SOEs accounted for US$8 million in 2021 (US$7.9 million in 2020), with NEWCO (the Special Purpose Vehicle created to absorb CVA debt before privatization) being the largest recipient with US$6.8 million. The stock of total guaranteed debt accounted to US$225 million in 2021. In February 2022 the State extended another guarantee to CVA for US$1.6 million to support the restart of commercial operations. In May 2022 the authorities announced the concession of the airport management company (*Aeroportos e Segurança Aérea,* ASA) for 40 years.

Table 4: Key Fiscal Indicators (% of GDP)

	2018	2019	2020	2021	2022p	2023p	2024p	2025p
Total Revenues	25.8	26.8	24.7	22.6	24.9	24.3	24.9	25.3
Tax revenues	20.2	19.6	18.2	16.9	17.2	18.3	19.1	19.7
Tax on income and profit	6.1	5.9	5.5	4.6	4.5	4.9	4.8	5.1
Tax on Goods and Services	9.9	9.7	8.6	8.0	8.2	8.7	9.3	9.4
Tax on trade	3.8	3.7	3.6	4.0	4.2	4.3	4.6	4.7
Other tax	0.4	0.3	0.5	0.3	0.3	0.4	0.4	0.4
Non-Tax revenues	4.3	4.3	3.2	3.6	5.6	4.7	4.7	4.7
Grants	1.3	2.9	3.2	2.0	1.9	1.2	1.1	1.0
Total Expenditure	28.2	28.5	33.8	29.9	33.9	31.4	30.7	29.3
Current expenditure	24.1	24.8	30.4	27.8	30.5	28.3	27.6	26.3
Compensation to employees	9.6	9.6	12.1	11.3	10.8	10.2	10.0	9.6
Goods and services	3.6	3.7	6.1	5.1	5.9	5.4	5.3	5.1
Interest payments	2.3	2.3	2.6	2.2	2.7	3.0	2.8	2.1
Subsidies	0.1	0.1	0.1	0.1	0.3	0.3	0.1	0.1
Current transfers	8.6	9.2	9.6	9.2	11.1	9.7	9.5	9.4
Social benefits	3.1	3.7	5.0	4.7	5.0	4.8	4.8	4.7
Other expenses	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Net acquisition of nonfinancial assets	4.0	3.6	3.3	2.2	3.4	3.1	3.1	3.0
Primary fiscal balance	-0.1	0.6	-6.5	-5.1	-6.3	-4.2	-3.0	-2.0
Overall fiscal balance	-2.4	-1.7	-9.1	-7.3	-9.0	-7.2	-5.8	-4.0
Net other liabilities	-1.0	-3.0	-1.1	0.9	-2.2	-0.5	-0.1	-0.2
On-lending	1	-1	-0.7	0.6	-1.3	-0.7	-0.1	-0.2
Capitalization	-2	-2	-0.4	0.3	-0.9	0.2	0	0
Financing Needs	-3.4	-4.7	-10.2	-6.4	-11.2	-7.7	-5.9	-4.2
Total financing[1]	2.7	4.6	14.0	6.4	11.2	7.7	5.9	4.2
Net domestic financing	1.3	1.3	2.8	1.6	5.3	3	1.5	1
Net external financing	1.4	3.3	11.2	4.8	5.9	4.7	4.4	3.2
Net errors and omissions	-0.8	0	3.7	0	0	0	0	0
Public Debt	114.6	114.0	142.6	143.0	147.7	141.6	134.4	125.8
External debt	84.2	82.6	103.1	101.5	105.4	99.6	94.9	90.3
Domestic debt	30.3	31.4	39.5	41.5	42.3	42.1	39.4	35.5

Source: Cabo Verdean authorities, IMF, and World Bank estimates and projections (September 2022).

19. **The fiscal deficit and financing needs remained high in 2021 because of sustained high current expenditure.** The overall deficit (including grants) stood at 7.3 percent of GDP in 2021 (compared to 9.1 percent in 2020). Consequently, fiscal financing needs for 2021 remained high at US$139.8 million and were covered by concessional credits for budget support of US$58.1 million provided by the World Bank and the African Development Bank (AfDB). Grants amounting to US$14 million were provided by the European Union (EU), Luxemburg, and Portugal. The remaining financing gap was covered by Government securities market (US$38.7 million), project disbursements (US$19.8 million), and resources freed up by the Debt Service Suspension Initiative (DSSI) (US$23.2 million).

Table 5: Fiscal Financing Needs and Sources

	2021		2022[p]	
	US$ millions	Percent of GDP	US$ millions	Percent of GDP
Total Revenue & Grants	475.9	22.6	526.9	24.9
Tax Revenue	358.0	17.0	364.0	17.2
Nontax revenue	75.8	3.6	118.5	5.6
Grants	42.1	2.0	40.2	1.9
Total Expenditure	629.6	29.9	717.4	33.9
Overall balance (incl. grants)	-153.7	-7.3	-190.5	-9.0
Net other Liabilities	19.0	0.9	-46.6	-2.2
onlending to SOEs for investment purposes and other (net)	-12.6	-0.6	-27.5	-1.3
Financing needs	**134.8**	**6.4**	**237.0**	**11.2**
Financing sources	**139.8**	**6.4**	**237.0**	**11.2**
Domestic Financing (net)	38.7	1.6	118.0	5.6
External Concessional Financing (net)	101.1	4.8	119.0	5.6
Budget support	58.1	2.8	106.0	5.0
IMF			29.6	1.4
WB	25.0	1.2	42.5	2.0
African Development Bank	33.1	1.6	33.9	1.6
Project and Program loans	19.8	0.9	11.0	0.5
DSSI	23.2	1.1	2.1	0.1

Source: Cabo Verdean authorities, IMF, and World Bank estimates and projections (September 2022).

20. **Public debt as a share of GDP remained relatively stable at 143 percent in 2021.** Public debt (as a share of GDP) had been on a declining path before the COVID-19 crisis, falling from 128.4 percent of the GDP in 2016 to 114 percent in 2019. The increase in concessional external borrowing and domestic lending to cover fiscal financial needs (and the contraction of GDP) increased public debt to 142.6 percent of GDP in 2020. Public debt increased in 2021 by about 7.3 percent in nominal terms, which was offset by the expansion of the GDP. External debt accounted for 101.5 percent of GDP, whereas domestic debt represented 41.5 percent of GDP. Debt service increased 26.1 percent in 2021, due to the increase in domestic debt service, at 8.6 percent of GDP. Approximately 95 percent of central Government external debt is on concessional terms, characterized by low interest rates and long maturity profiles.

21. **The financial sector continues to display structural weaknesses and risk aversion due to high levels of non-performing loans (NPLs).** High liquidity levels reflect risk aversion in an environment of persistently high NPLs (a ratio of 9.5 percent at end-December 2021), as well as limited investment opportunities meeting acceptable credit standards. The sector is struggling with low asset quality, and despite a relatively strong

capital adequacy ratio, banks in Cabo Verde are potentially vulnerable to high NPL ratios. High debt levels of public enterprises, non-financial corporations, and households compound the problem. The sector remains highly concentrated with two (of the seven active) commercial banks holding 64 percent and 68 percent of credit and deposit market shares. Given the associated risks in the financial sector, authorities have been implementing prudential measures, particularly to strengthen the adequacy of capital and liquidity ratios.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

22. **The strong post-COVID-19 economy recovery was set to continue in 2022 underpinned by the reactivation of the tourism sector, but the impact of the Ukraine war reduced growth perspectives.** Real GDP growth was set to remain high, while public debt as a share of GDP was set to start decreasing driven by fiscal consolidation and economic growth. However, the war in Ukraine substantially impacted the short-term outlook due to significant higher oil and food prices. The fiscal measures taken by the Government to alleviate the impact of inflation on the poor will increase fiscal financing needs in 2022, thereby increasing public debt. Tourism flows can also be impacted as economic conditions in Europe tighten and air transportation costs increase.

23. **Real GDP growth is projected to reach 4 percent in 2022 (5.5 percent before the Ukraine war) due to inflationary headwinds from the Ukraine war but is expected to gradually increase thereafter.** Growth will be supported by the continued gradual recovery of the tourism sector as the impact of the pandemic fades and vaccination coverage increases. In the baseline, tourism flows are expected to reach the 2019 level by 2023. Growth is expected to average 5.3 percent between 2023 and 2025, led by the recovery of tourism and investments in the Information and Communications Technology (ICT), energy, and fishery sectors. Newly opened hotels have increased capacity and will support a sustained increase in tourist arrivals. As the Government restructures the operation of several important SOEs through public-private partnerships (PPPs), direct sale, and concession arrangements, and implements structural reforms under the Strategic Plan for Sustainable Development (*Plano Estratégico de Desenvolvimento Sustentável,* PEDS 2022-2026, further private investment will be mobilized.

24. **Inflation is expected to peak in 2022, reaching 7.5 percent.** High international oil prices will drive increases in the domestic price of fuels and grains, with a negative impact on various sectors of economic activity. Inflationary pressures in energy, coupled with rising food import prices, will continue increasing food insecurity. Inflation is projected to start stabilizing in 2023 as the shock from the war in Ukraine is fully absorbed, supply disruptions abate, and energy prices stabilize.[4] Over the medium term, the strong nominal anchor provided by the peg with the Euro and the return to fiscal consolidation (mostly revenue driven) will keep inflation contained, converging to 2 percent by 2025.

25. **Considering the uncertainties of the economic recovery process, the Central Bank plans to keep an accommodative stance over the short term.** In the absence of domestic pressures that could endanger the objectives of price stability and the credibility of the exchange rate regime, since the stock of net international reserves continues to be adequate (covering at least 5 months of prospective imports), authorities do not envision an increase in interest rates. The latest monetary policy report, published in April 2022, maintained the current long-term financing program.

[4] Sanctions on Russia may have a lasting impact on international oil and gas prices.

26. **While export of services will continue rebounding in 2022, the CAD is projected to increase to 14.1 percent of GDP due to the recovery in consumption and the increase in import prices.** The CAD is expected to decline to 6.1 percent of GDP in 2023 supported by the increase in tourism receipts and the reduction of consumption import prices and will remain around that level in 2024 supported by ongoing investments in the tourism sector. The stable growth in remittances, reflecting the gradual improved conditions in the European labor market, will also support the decline in the CAD over the medium term. Higher public debt amortization outflows are expected to increase external financing needs, which are projected to be met primarily by official borrowing and FDI, which will be also supported by the investment inflows from emigrants. Despite the COVID-19 crisis, the Government has signed several investment establishment agreements for projects in the tourism sector, amounting to US$1,876 million, which will contribute to finance the CAD over the medium term. Robust export growth and rising remittances, coupled with higher FDI inflows, are expected to keep international reserves at around 5.5 months of prospective imports over the medium term.

27. **The impact of the Ukraine war will delay the fiscal adjustment envisioned to start in 2022, but authorities are committed to returning to fiscal consolidation over the medium term and to placing the debt-to-GDP ratio decisively on a downward trend.** Given the structural rigidity of the budget, fiscal consolidation will be mainly revenue-driven, supported by the (i) steady recovery of the economy; (ii) improvement in tax systems efficiency; (iii) streamlining of tax incentives; (iv) increase in environmental and health taxation; (v) and broadening of the tax base to cover e-commerce. Authorities aim to invoice electronically at least 50 percent of taxpayers for VAT in 2022. These policies are supported by the IMF program, which also includes a tax revenue floor. Non-tax revenues in 2022 are expected to increase significantly mainly driven by the concession of the airport management company (ASA) and to a lesser extent sale of goods and services. On the expenditure side, the Government is reprogramming external disbursements under the Multi-annual Public Investment Plan and containing non-priority expenditure.[5] The primary deficit should improve from 5.1 percent of GDP in 2021 to 3 percent in 2024, reflecting increased domestic revenue mobilization and expenditure restraint. The overall fiscal deficit is projected to increase from 7.3 percent of GDP in 2021 to 9 percent in 2022, and gradually decline to 5.8 percent by 2024. Consequently, the stock of public debt is projected to increase from 143 percent of GDP in 2021 to 147.7 percent in 2022 and decline to 134.4 percent by 2024.

28. **The Government aims at maintaining the strong level of total revenue over the medium term, with a progressive increase in tax revenue in lieu of grants.** Fiscal revenue is expected to increase driven by higher tax collection and administration, including strengthening the tax and customs units to improve tax collection efficiency and fight tax evasion. This includes developing a data-matching platform to detect tax fraud, reinforcing tax arrears recovery, and strengthening technical skills and capacity of the units. The adoption of the ECOWAS Common External Tariff, which was postponed to 2023 due to the lingering impact of COVID-19 crisis, is also projected to increase trade tax revenue over the medium term. These measures will lead to an increase in tax revenue from 16.9 percent of GDP in 2021 to 17.2 percent in 2022, and to 19.1 percent by 2024. In parallel, grants should decline from 2 percent of GDP in 2021 to 1.1 percent in 2024.

[5] Expenditure is projected to return gradually to its level before the pandemic (29 percent of GDP by 2025) driven by the progressively unwinding of emergency support to response to the COVID-19 pandemic and the Ukraine war.

Table 6: Balance of Payments Financing Requirements and Sources

	2018	2019	2020	2021	2022p	2023p	2024p	2025p
Financing Requirements	4.9	-1.6	14.7	11.3	14.1	6.1	5.9	4.7
Current Account Deficit	4.9	-0.2	15	11.3	14.1	6.1	5.9	4.7
Errors and omissions	0.0	-1.4	-0.3	0.0	0.0	0.0	0.0	0.0
Financing Sources	4.9	-1.6	14.7	11.3	14.1	6.1	5.9	4.7
Capital Account Balance	0.8	0.6	1.3	1.5	2.0	1.4	1.7	1.6
FDI inflows (net)	4.3	4.3	3.3	3.5	3.8	5.3	4.0	4.4
Portfolio inflows (net)	-2.4	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net other investment	2.7	3.2	6.1	5.3	3.1	2.0	1.8	0.6
Net All Other Flows	0.1	-2.8	-0.6	0.0	0.0	-0.1	-0.1	0.0
Change in reserves (- means accumulation)	-0.5	-6.8	4.6	1.0	5.2	-2.5	-1.5	-1.9

Source: Bank of Cabo Verde, IMF and World Bank estimates and projections (September 2022).

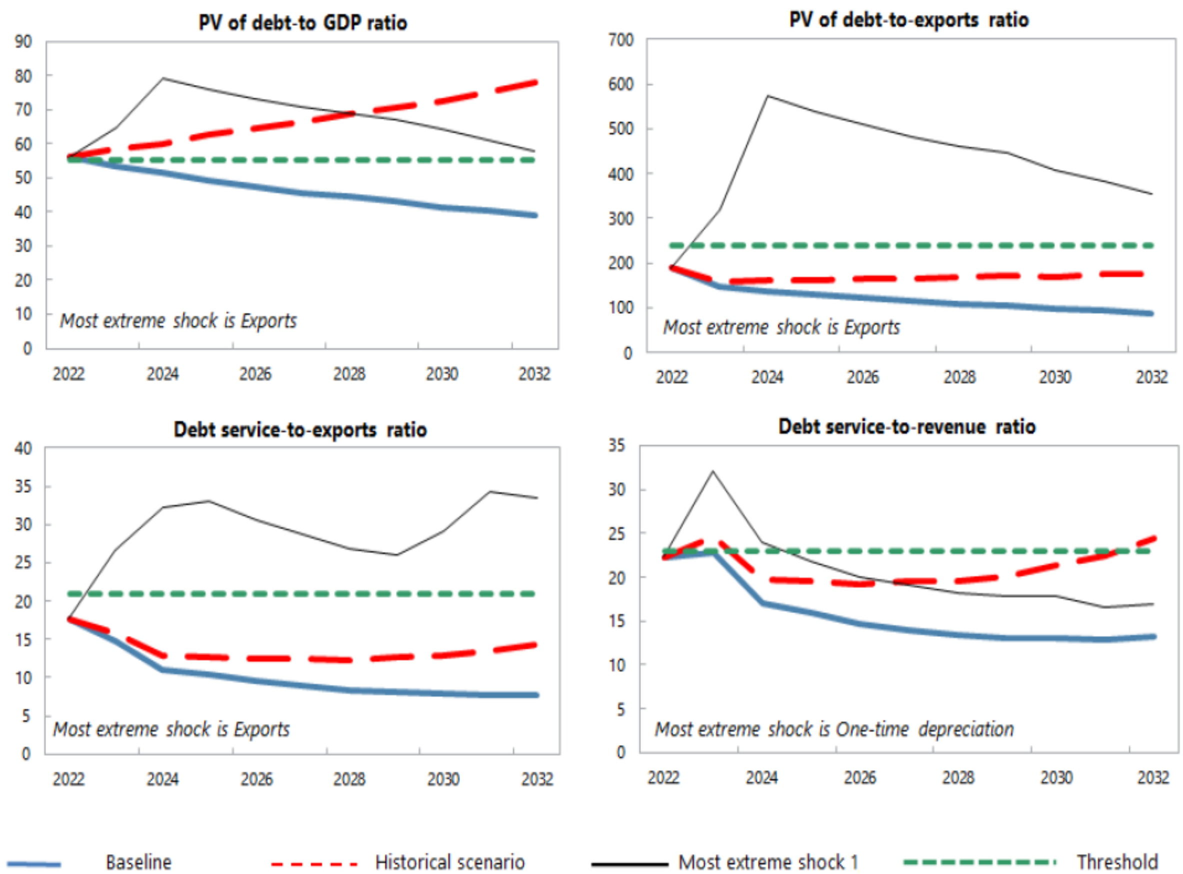
29. **Total expenditure will remain high in 2022, at 33.9 percent of GDP, and gradually decline with the phase out of the exceptional measures to contain the impact of the Ukraine war and improved expenditure efficiency.** Current expenditure is expected to increase from 27.8 percent of GDP in 2021 to 30.5 percent in 2022, driven by the measures adopted by the Government to alleviate the impact of the Ukrainian war, which will be in effect until December 2022. Over the medium term, lower spending on goods and services and the reduction on the wage bill will gradually reduce current expenditures, which are expected to reach 27.6 percent of GDP by 2024. Capital expenditure is projected at 3.4 percent of GDP in 2022 and to approach 3 percent by 2024. Total expenditures will account for approximately 29.3 percent of GDP in 2024. Fiscal financing needs are projected to reach 11.2 percent of GDP and will be covered by domestic financing (5.6 percent of GDP), external concessional financing from the IMF, World Bank, and the AfDB (5.1 percent of GDP), and resources from the DSSI (Table 5). [6]

30. **The latest joint World Bank/IMF Debt Sustainability Assessment (DSA), published in June 2022, concluded that public debt is sustainable, but the risk of external debt distress is moderated while the risk of overall debt distress is high.** The debt coverage of the DSA comprises the central Government, extra budgetary funds, the central bank, and guarantees, in line with fiscal accounts. Compared to the previous joint World Bank/IMF DSA, published in October 2020, the risk of external debt distress was upgraded from high to moderate. The main driver of this upgrade is the rebasing of the GDP, which mechanically improved debt indicators.[7] The present value (PV) of public and publicly guaranteed (PPG) external debt-to-GDP ratio breaches its threshold only in 2022 under the baseline, and protractedly under stress test scenarios. The breach under the baseline is of shorter duration compared to the last DSA due to the GDP rebasing. The PV of total public debt-to-GDP ratio is projected to breach the threshold during 2022–2028 under the baseline scenario and stress test; at the same time, liquidity indicators (debt service to revenue and to export ratios)

[6] The fiscal rule limiting net domestic financing to 3 percent of GDP has been suspended by Parliament for 2022.
[7] The National Institute of Statistics (INE) rebased the national accounts taking the year 2015 as base. The main changes included the revised nomenclature of activities, improved data coverage, and new data sources. The exercise led to a GDP revaluation of 173,911 million CVE in 2015, representing an upward revision of 9.6 percent in comparison to the 2007 base year. The revision has a direct effect in the public debt ratio, which was revised from 126 percent (GDP base 2007) to 115 percent (GDP base 2015).

remain firmly below their respective thresholds, reflecting the high concessional nature of external debt. The external and overall debt outlook is assessed to be sustainable and is supported by continued recovery of economic activity over the medium term and a return to the pre-pandemic fiscal consolidation path. The US$20 million SML made available for this operation is not expected to lead to changes in the external risk of debt distress classification. Solvency and liquidity indicators are expected to increase slightly with respect to the baseline, but the breach of relevant thresholds remains unchanged.

Figure 1: PPG Debt and Public Debt Indicators (2020-2030)



Source: Post-mission joint World Bank/IMF DSA (September 2022).
1/ Most extreme shocks are those stress tests that yield the highest ratio before 2031.

31. **The outlook is subject to downside risks stemming from new COVID-19 variants, the Ukraine war, and climatic shocks.** While the COVID-19 vaccination rollout is among the highest in Africa, the country remains vulnerable to new variants. An increase in the size or duration of the terms of trade shock emanating from the Ukraine war could lead to higher inflationary pressures and the continuation of policy support to ameliorate its impact on food insecurity, which in turn could deteriorate fiscal and debt sustainability. Social tensions and poverty could increase after allowing for the passthrough of higher energy prices on electricity bills. Political pressures against continued fiscal consolidation in the aftermath of the crisis could also derail or delay SOE reform efforts. However, the authorities remain committed to continuing to improve fiscal and debt management, with a view to lowering the debt burden and enhancing the provision of public services

over the medium term. In addition, the country remains significantly exposed to natural disasters, including those related to climate change.

32. **The macroeconomic policy framework is adequate for the proposed operation.** As a small open economy, the country remains vulnerable in the face of global uncertainty, particularly the COVID-19 crisis and the impact of the Ukraine war. However, the macroeconomic and structural policies being pursued by the authorities should support growth to gradually recover over the medium term. With the gradual resumption of tourism, capital flows, and economic activity, the economy is projected to grow 4 percent in 2022 and to be above potential in 2023-2024. Over the medium term, the return to fiscal consolidation and key structural reforms, particularly in the SOE sector, will support growth. Further, monetary policy is expected to continue to be effective at supporting price stability and the exchange rate peg. The Government has a good track record and is committed to fiscal consolidation to return to fiscal sustainability. Although the risk of debt distress is high, public debt remains sustainable. International reserves are expected to remain at a comfortable level over the medium term.

2.3. IMF RELATIONS

33. **A three-year ECF arrangement for US$63.4 million was approved by the IMF Board on June 15, 2022.** The program will help shore up international reserves, preserve debt sustainability, increase resilience to shocks, including from climate change, and support more inclusive growth. Key policy actions under the ECF include measures to boost revenue and improve the efficiency of spending, strengthen SOEs to mitigate fiscal risks, as well as measures to continue modernizing the monetary policy framework and safeguarding financial stability. The program would be used as budget support as the fiscal and payment of shocks are of a similar magnitude. The ECF follows IMF emergency support in April 2020 under the Rapid Credit Facility (100 percent of quota, equivalent to US$32.3 million) and an 18-month Policy Coordination Instrument (PCI), successfully completed in March 2021. The World Bank has been working closely with the IMF and the authorities to respond to the current terms or trade shock in the short term and to strengthen the legislative framework for debt and budget management over the long term. Additionally, the IMF and the World Bank teams are coordinating in key areas such as debt management, the DSSI, SOE sector reforms, and overall macroeconomic stability.

3. GOVERNMENT PROGRAM

34. **The Cabo Verde PEDS II 2022-2026 aims to operationalize the Government's commitments to recover from the COVID-19 pandemic and accelerate the path towards a sustainable and climate resilient development.** The key objectives include: (1) ensure economic recovery, fiscal consolidation and sustainable growth, promote diversification and transform Cabo Verde into a circular economy located in the Middle Atlantic; (2) promote decentralization, regional development and convergence with territorial cohesion, urban quality and sustainability, environmental sustainability, climate action and resilience, and enhance biodiversity and geodiversity; (3) promote social development through human capital, inclusion, reduction of inequalities, eradication of extreme poverty, and gender equality; and (4) consolidate national sovereignty, deepen the appreciation of democracy, promote regional integration, and the dynamic insertion of the country in the world economic system. The Strategy highlights the need for a major shift in the country’s development model, addressing macroeconomic stability, fiscal risks from the SOEs sector and natural disasters, and broadening Cabo Verde’s economic base.

35. **In response to COVID-19 pandemic, the Government launched a recovery plan –Cabo Verde Ambition 2030– in October 2020 with the main goals of achieving sustainable development and increasing resilience to shocks.** Building on the PEDS, Cabo Verde Ambition 2030 delineates strategic guidelines, programs, and partnerships to reestablish health safety confidence, recover and build back better the tourism sector and businesses, and operationalize the concept of a 'Hub in the mid-Atlantic'. To ensure continued progress towards sustainable development, the plan's main goals are energy transition to renewables; economic diversification; developing sustainable tourism; investing in the blue economy, the digital economy, and innovation; and improving the health system. It also highlights the need to further expand emergency cash transfers, to further strengthen the shock-responsiveness of the safety net and expand the coverage of the social registry.

36. **The Government is committed to strengthening the country's resilience to disaster and climate-related shocks by mainstreaming DRM and climate change adaptation across development planning and fiscal risk management (FRM)**. Over the last decade, economic losses from disaster and climate-related shocks have been on an upward trend, averaging 0.25 percent of GDP over the period 2010-2020 and highlighting the increasing exposure and vulnerability of the archipelago to climate change. The National Action Plan for Climate Change Adaptation (2008-2012)[8], the National Disaster Risk Reduction Strategy 2018-2030 (*Estratégia Nacional de Redução de Riscos de Desastres*, ENRRD) supported under the first Cat DDO, and the 2021 updated Nationally Determined Contribution (NDC) lay out the Government's strategic vision to build resilience to disaster and climate-related impacts. Building upon these strategic documents and the set of "first-generation" DRM reforms supported under the DRM DPF with Cat DDO (P160628), the Government has progressively moved from a DRM system originally focused on emergency preparedness and response activities for adverse natural events towards a more comprehensive approach to disaster and climate-related risk management. These reforms have enhanced the institutional capacity to develop a risk-informed territorial and sectorial planning system with the ultimate objective of reducing existing risks and avoiding the creation of new ones. Likewise, the Ministry of Finance (MoF) has taken a leading role to proactively increase its financial capacity to respond to disaster and climate-related shocks through the establishment of the FNE and strengthen its capacity to manage fiscal risks associated with disaster and climate-related shocks under its broader FRM framework.

37. **Looking forward, the Government seeks to ensure the sustainability of development through further efforts aimed at reducing vulnerability to disaster and climate-related shocks in key economic sectors and adapting to the long-term impacts of climate change**. Through its updated NDC, the Government has identified the key climate challenges, which include the intensification of hydrometeorological hazards such as excess and lack of rainfall producing flash floods and droughts, but also unprecedent threats associated to sea-level rise, and ocean warming. These threats could undermine the archipelago's natural capital upon which the tourism and blue economy sectors rely and further hamper agricultural productivity. To address these potential impacts, the Government has therefore included a priority measure of its updated NDC the need to improve "food and water security" as well as to "defend marine resources and coastal zones" to safeguard the potential of growth-enhancing sectors. These potentially increasing impacts will also translate into more acute fiscal pressures and worsened contingent liabilities associated with disaster and climate-related shocks. In response, the Government has started to incorporate fiscal risks from disaster and climate-related shocks in its FRM Strategy and is seeking to rebuild

[8] The country remains committed to further enhance its climate adaptation policy framework and has committed to elaborate a new National Adaptation Plan for submission to the United Nations Framework Convention on Climate Change by 2023.

fiscal buffers against these exogenous shocks to ensure fiscal sustainability. This operation is supportive of and in-line with these main priorities.

38. **Additionally, to increase the readiness to respond effectively to future food insecurity episodes, the Government will develop a Food Security Crisis Preparedness Plan (FSCPP).** The plan will specify the institutional and operational arrangements for responding early to prevent and mitigate future food crises brought upon by external shocks. It will not only increase the effectiveness of Government response but also soften the direct impact of external shocks on the most vulnerable. Authorities plan to complete the FSCPP within the next 12-months after effectiveness of this operation.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

39. **The proposed hybrid operation is the second in a programmatic series of two single-tranche DPFs designed to support Cabo Verde to achieve faster, equitable, and resilient growth.** The DPF series is closely aligned with the Government's priorities established in the PEDS II, the Cabo Verde Ambition 2030, the ENRRD, and the 2020 NDC. The series complements other activities to address fiscal risks, including those associated with disaster and climate-related shocks, and debt transparency – notably through the PPA under the SDFP and the previous Cat DDO (P160628) and associated technical assistance (TA) program closed in June 2022.[9] Acknowledging the need to increase resilience to climate shocks to ensure the sustainability of the Cabo Verdean growth model, this operation includes a Cat DDO with an associated DRM Program to support the authorities' efforts to strengthen the management of disaster and climate-related risks, reduce vulnerabilities to these risks in key economic sectors, and provide contingent financing to help in safeguarding fiscal consolidation efforts. The Cat DDO included in this operation ensures the continuity of the reform areas supported by the previous Cat DDO.

40. The series is structured around three mutually reinforcing policy areas:

- **Pillar A aims to improve debt transparency and reduce fiscal risks steaming from SOEs and climate-related shocks.** The COVID-19 crisis derailed fiscal consolidation efforts, halted SOE reforms, and significantly increased public debt. Fiscal buffers to respond to exogenous crisis were exhausted, including with the disbursement of the first Cat DDO operation (P160628) that was fully disbursed on April 30, 2020 (IBRD portion) and May 5, 2020 (IDA portion). Current Government efforts are focused on increasing debt management and transparency as well as enhancing the institutional and technical capabilities required to ensure the full integration of contingent liabilities into the fiscal policy framework, including those associated with disaster and climate-related shocks. The reforms supported by this pillar include (i) strengthening the framework regulating the issuances of state guarantees; (ii) increasing the coverage of public debt reporting; and (iii) strengthening of FRM through the incorporation of fiscal risks associated to disasters and climate-related shocks.

[9] Given the surge in public debt and the exacerbation of fiscal risks after the COVID-19 pandemic, FY22 PPAs focused on (i) a zero non-concessional borrowing (NCB) ceiling on PPG external debt and (ii) on improving SOE oversight, including an assessment of fiscal risks. The focus of FY23 PPAs remain unchanged, with (i) the continuation of the zero NCB ceiling on PPG external debt and (ii) the broadening in the coverage of public debt in the debt bulletin to include the nonfinancial public sector.

- **Pillar B seeks to strengthen the resilience of the poor and vulnerable to shocks, particularly droughts.** The COVID-19 crisis and the Ukraine war disproportionally impacted the poorest and most vulnerable households, particularly female headed. In response to these shocks, the Government scaled up the existing safety net, using the social protection delivery systems already in place and provided/extended emergency cash transfers. This pillar seeks to build on this progress and continue to strengthen the social protection system by (i) strengthening the safety net to respond to external shocks, in particular droughts and the impact of the Ukraine war; and (ii) expanding the scope of response and recovery expenditures funded through the FNE to complement shock-responsive cash transfers with targeted activities aimed at enhancing resilience and reducing the impact of droughts; and (iii) strengthening the management and use of the social registry, including ensuring feedback of data into the social registry related to support for targeted households to enable better coordination and ensure that there is no overlap in support to households.

- **Pillar C supports a climate resilient and sustainable private sector-led recovery.** The COVID-19 pandemic caused an unprecedented shock to the country's growth engines, notably the tourism sector, and created an opportunity to pursue needed structural reforms to build forward better. This pillar builds on private sector-led reform progress in the blue economy –a sector with high growth potential and promising prospects to adapt to climate change– as well as in the tourism sector to attract new and resilient private sector investment. It includes reforms aiming at (i) increasing the operational performance of the electricity utility company and bringing private investment; (ii) enhancing the licensing of tourism accommodations in line with the ENRRD; and (iii) promoting the development of aquaculture with the updating of the institutional and licensing framework.

41. **The Cat DDO provides rapid access to financing in the event of a natural catastrophe, including public health-related events, primary to support the immediate response and recovery phase.** This line of contingent financing acts as an intermediate layer of financial protection that will increase the availability of immediate liquidity to the Government, as demonstrated by the triggering of the previous Cat DDO in response to COVID-19 crisis. The Cat DDO may be drawn upon the Government's declaration of a "*State of Calamity"*.[10] The declaration should be issued through a Resolution of the Council of Ministers to respond to an imminent or occurring natural catastrophe, under article 20 of Law no. 12/VIII/2012 of March 7th, 2012, and under no. 2 of article 265 of the Constitution, last revised in 2010. Law no. 12/VIII/2012 establishes the general basis for civil protection and clarifies the definition and scope of a "Sate of Calamity", which can result from both natural disasters and public health-related emergencies. The State of Calamity is to be declared according to the magnitude of the event and its spatial extent (municipal, supra-municipal or national level, no. 3 of article 9) and duration are to be detailed in the resolution. Historically, only four records of events leading to the declaration of State of Calamity based on Law no. 12/VIII/2012 could be found in Cabo Verde: in 2015 after the Fogo Volcanic eruption, in 2016 after Santo Antão floods, in 2020 after the COVID-19 outbreak and in 2022 after the poor rainy seasons of 2021-2022. The Government has chosen to fund the US$10 million IDA Cat DDO using the Concessional Core option. Under this option, 25 percent (US$2.5 million) of the IDA Cat DDO amount would come from the country's Concessional Core IDA envelope.

[10] *Situação de Calamidade*, as chosen for the previous Cat DDO. *Situação de Calamidade* differs from the *Estado de sitio* and *Estado de emergência* (articles no. 270 and no. 271 of the Constitution), which are more likely to be used to respond to man-made events or other emergencies.

Terms and conditions of the Cat DDO are specified in the financing agreement, describing the drawdown[11], financing, and renewal[12] conditions of the Cat DDO.

42. **The proposed DPF series draws on several lessons learned from the implementation of the programmatic Poverty Reduction Support Credit (PRSC 8 and 9 /P127411 and P147015), the previous DPF series (P165631 and P171080), and the first Cat DDO (P160628).** The completion report of the PRSC series highlighted that policy reforms supported by TA were more likely to succeed. It also underscored the need to align the ambition of any DPF support with the Government's capacity to deliver on the reforms. Furthermore, it highlighted the importance of acknowledging the political economy challenges associated to sensitive reforms related to SOEs. Additionally, experience from the previous DPF series indicates that greater impact can be achieved by concentrating prior actions in areas where there are ongoing World Bank investments, TA programs, and/or development partners activities. A key lesson learned for the first Cat DDO is the need to accompany the policy reform program with a comprehensive TA program which has been mobilized for the proposed operation as well as knowledge exchanges with peers and sharing good practices. The importance of including public-health-related emergencies as part of the definition of natural catastrophes was highlighted by the COVID-19 pandemic crisis.

43. **The reform program supported by this DPF series was updated during the preparation of the proposed operation to mainstream the DRM Program supported by the Cat DDO into the existing pillars.** Changes to the program of reforms were introduced across the three pillars and, consequently, on the results' framework to include two new DRM and climate adaptation related prior actions to accommodate a more ambitious reform program and strengthen the incorporation of disaster and climate-related risk management considerations into existing policy reform areas. Reforms supported by Pillar A now includes a reform to improve policy coordination and the management of fiscal risks associated to disaster and climate-related shocks. Reforms supported by Pillar B include the expansion of the scope of emergency response and recovery activities for droughts that can be funded through the FNE. The policy reform on the shock-responsive safety nets in the second pillar is designed to respond to climate-related shocks in particular droughts. The policy reform related to the Tourism sector in the Pillar C is framed under the implementation of the ENRRD, which ensures consistency and continuity to the first Cat DDO policy reform program.

Table 7: Summary of Changes from DPF2 Indicative Triggers to Prior Actions

Original (DPF1)	Revised (DPF2)	*Change*
Trigger #1: To further strengthen fiscal risk management, the Recipient has issued a ministerial resolution providing rules and processes for the evaluation and issuance of State guarantees.	**Prior Action #1:** To further increase debt transparency, the Recipient has issued a regulatory decree broadening the coverage of public debt in the annual debt bulletins to cover the nonfinancial public sector (central Government, SOEs, and municipalities).	No change. The prior action was the previous policy trigger 2. It was moved to the first reform area that focuses on debt transparency. The language was slightly adjusted to reflect better the additionality of the prior action.

[11] The proposed operation includes a deferral period of up to three years. During this time, the World Bank will monitor that the Government continues implementing the program being supported in accordance with the Letter of Development Policy (LDP).
[12] A Cat DDO may be renewed if the implementation of the program set out in the LDP remains satisfactory to the World Bank and macroeconomic policies are adequate. The IDA Cat DDO may be renewed one time for a total of six years.

Original (DPF1)	**Revised (DPF2)**	***Change***
Trigger #2: To further increase debt transparency, the Recipient has issued a ministerial resolution to broaden the coverage of public debt in the annual debt report to include the nonfinancial public sector.	**Prior Action #2:** To further strengthen FRM, the Recipient has issued a statement of the ministerial order setting out relevant criteria to assess the credit risk of guarantees' beneficiaries and the basis for charging fees, requiring collateral, and instituting a reserve fund.	No major change. The prior action was the previous policy trigger 1. It was moved to the second reform area that focuses specifically on fiscal risks. The language was slightly adjusted to reflect better the additionality of the prior action.
	Prior Action #3: To further strengthen the management of fiscal risks associated to disaster and climate-related shocks, the Recipient has issued a resolution mandating (i) the assessment of contingent liabilities associated to disaster and climate risks and (ii) its inclusion in the annual FRS.	New prior action added under the DRM program supported by the proposed operation. This prior action draws upon the implementation of Prior Action 4 supported by the previous DRM DPF with a Cat DDO (P160628).
Trigger #3: To improve the institutional coordination to respond to future shocks, including climate related; the Recipient has issued a decree laying out the framework for a shock-responsive safety net, indicating its features, implementation processes, roles and responsibilities, and delivery systems, ensuring the effective inclusion of women.	**Prior Action #4:** To increase the resilience of the most vulnerable population to external shocks, including droughts, the Recipient has enacted a decree establishing a shock-responsive safety net framework, indicating its features, implementation processes, roles, and responsibilities.	No major change. The prior action was reformulated to better capture the policy reform and link with the DRM Program supported by the proposed operation.
	Prior Action #5: To increase the resilience of vulnerable households to droughts, the Recipient has amended the decree-law establishing the FNE to expand the eligible expenditures financed by the FNE, enabling drought-related emergency response and recovery activities.	New prior action added under the DRM program. This prior action is a second-generation policy reform supported by Prior Action 5 of the DRM DPF with a Cat DDO (P160628).
Trigger #4: To broaden the use of the social registry, to improve the efficiency of targeting the poor and most vulnerable and the coordination of social programs, the Recipient has issued (i) a resolution instructing at least two additional programs to use the social registry for targeted service delivery; and (ii) a resolution requesting programs using the social registry provide feedback data.	**Prior Action #6:** To improve the coordination of social programs and the efficiency of targeting the poor and most vulnerable, the Recipient has (i) issued a regulatory decree, which amends the regulatory decree No. 7/2018 to mandate social programs using the social registry to provide feedback data; and (ii) issued a ministerial order, which instructs the PRH to focus support to households in group I and II in the CSU.	No major change. The wording has been adjusted to better reflect the policy changes
Trigger #5: To implement the energy sector restructuring, the Recipient has enacted a legal decree to incorporate new generation and distribution companies.	**Prior Action #7:** To implement the power sector restructuring, the Recipient has enacted a decree-law to (i) mandate ELECTRA's disinvestment from power sector activities; and (ii) vertically unbundle the power sector by creating a thermal electricity generation company, an electricity distribution company, and an electricity system operator company.	No major change. The wording has been adjusted to better reflect the policy changes

Original (DPF1)	Revised (DPF2)	*Change*
Trigger #6: To harmonize and streamline the tourism regulatory framework and anchor it on environmental and social sustainability criteria, the Recipient has adopted a legislative package that includes updated regulatory decrees on classification criteria and licensing requirements for tourism accommodations and all tourism service providers.	**Prior action #8:** To modernize the tourism regulatory framework and in line with the ENRRD strategy, the Recipient has adopted three decree laws stipulating (i) updated licensing requirements for tourism accommodation operators, including disaster and climate risk considerations; (ii) a legal regime for tourism and hospitality establishments in rural areas; and (iii) updated rules and norms for tourism service providers.	The focus of this prior action has been sharpened to better highlight its linkages to the DRM Program supported by the proposed operation. The proposed PA illustrates the implementation of the ENRRD in the Tourism sector. It is fully aligned with Prior Action 1 of DRM DPF with a Cat DDO (P160628).
Trigger #7: To promote a sustainable development and growth of the blue economy and the sustainable use of marine and coastal resources, the Recipient has approved Maritime Spatial Plans for at least two islands.	**Prior action #9:** To promote the development of the fisheries sector and sustainable use of marine and coastal resources, the Recipient has issued a ministerial order approving the list of eligible species for aquaculture activities.	The prior action was adjusted based on recent policy developments. The content of the reform remains unchanged.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar A: Reduce Fiscal Risks, Improve Debt Transparency, and Tackle Climate-related Shocks.

44. **This pillar aims at increasing debt transparency and strengthening FRM, particularly from SOE and climate-related shocks, to contribute to medium-term fiscal sustainability.** With a high debt level and high risk of debt distress, stronger FRM is critical to mitigate the materialization of contingent liabilities, which could put at risk the sustainability of the recovery process. Improved debt governance, anchored in a sound debt management strategy, and debt transparency, through effective reporting, will help ensure proper management of the public debt portfolio and accountability to all stakeholders. Continued scrutiny of existing and new fiscal risks from the SOE sector will help the Government anticipate the potential burden on public finances, reduce macroeconomic and fiscal vulnerabilities, and allow more flexibility in the use of fiscal policy. Additionally, enhancing the Government financial capacity to effectively respond to disasters and climate-related shocks without jeopardizing the sustainability of public finances will also be critical to safeguard fiscal consolidation efforts.

DPF1 Prior Action #1: To improve public debt transparency and strengthen FRM, the Recipient has issued a Regulatory Decree No. 5/2021, dated October 29, 2021, mandating (i) the quarterly publication of the debt bulletin; (ii) the publication of the medium-term debt management strategy; and (iii) the inclusion of a FRS in the Budget Report.

DPF2 Prior Action #1: To further increase debt transparency, the Recipient has issued a regulatory decree broadening the coverage of public debt in the annual debt bulletins to cover the nonfinancial public sector (central Government, SOEs, and municipalities).

DPF1 Prior Action #2: To manage fiscal risks from the SOE sector, the Recipient has issued a Ministerial Resolution No. 48/2021, dated October 15, 2021, mandating (i) the quarterly publication of the SOE sector bulletin; and (ii) the inclusion of a fiscal risk assessment in the quarterly and annual SOE sector bulletins.

DPF2 Prior Action #2: To further strengthen FRM, the Recipient has issued a statement of the ministerial order setting out relevant criteria to assess the credit risk of guarantees' beneficiaries and the basis for charging fees, requiring collateral, and instituting a reserve fund.

Background

45. **Fiscal vulnerabilities and risks accumulated prior to the COVID-19 and the Ukraine war shocks, and exacerbated by the crises, may undermine Cabo Verde's efforts to restore fiscal sustainability and bring back debt (as a share of GDP) to a declining trajectory over the medium term.** Reducing exposure to fiscal risks through improved monitoring, management, and increased transparency of the debt portfolio, outstanding loan guarantees and non-guaranteed debt of SOEs, and local Governments is central to ensure macroeconomic sustainability. The ability to scrutinize and monitor the evolution of key sources of risks will strengthen governance, improve accountability, and enhance debt and FRM practices. It will also improve the quality of information to allow authorities to better engage with creditors, investors, and other stakeholders on debt issues.

46. **The current FRM framework is inadequate to address the mounting macro-fiscal pressures brought upon by the economic shocks.** The main weakness of the fiscal risks' discussion in the 2021 budget report was the lack of quantification of the fiscal risks to which the country is exposed and the lack of coordination among different units responsible for fiscal risks management. The report lacked a description of the measures that the authorities could adopt to manage the fiscal risk exposure. The Government issues a significant number of loans and guarantees to SOEs and municipalities without an institutionalized framework for informed decision-making based on proper risk assessments. Furthermore, no risk management tools (e.g., charging risk-based guarantee fees, issuing partial guarantees, refining borrowing limits set by the annual budget) are used to reduce contingent liabilities. The lack of a FRM framework and coordination mechanisms may lead to moral hazard both from the SOEs and the financial sector, which have heavily relied on Government support in the past.

Prior Actions

47. **The DPF series reinforces the governance framework to enhance debt transparency and improve fiscal risk monitoring by increasing the scope, quality,** and **frequency of SOE sector information.** As a part of the first DPF, the Government made mandatory the publication of the quarterly debt bulletin, the debt management strategy, and the inclusion of a FRS in the budget report. The enhancement in the legal framework has four main benefits. First, it highlights the Government's intention to strengthen FRM through increased transparency and accountability to all stakeholders (e.g., the national assembly, the public, international organizations, credit rating agencies, creditors). Second, it embeds an analysis of fiscal risks into the budget preparation to consider various risk scenarios and ensures that fiscal risks receive the same level of scrutiny as other budget expenditures. Third, it reduces moral hazard related to implicit contingent liabilities. Fourth, it builds technical capacity at the MoF in assessing and monitoring risks.

48. **Broadening the coverage of public debt beyond budgetary central Government to include the nonfinancial public sector will bring the country closer to international standards.** *Prior Action 1* supports the publication of the consolidated debt of nonfinancial public sector in the annual debt report. This action

seeks to fill information gaps about contingent liabilities, including debts and other liabilities, held by local governments and SOEs. The objective is to publish the debt stock for the entire non-financial public sector, expanding the coverage from the central Government to capture local Governments and SOE's debt (guaranteed and non-guaranteed), aligning reporting standards to international practice.

49. **The DPF series also strengthens the governance framework for FRM.** The previous DPF supported the publication of quarterly SOE sector bulletins with the inclusion of the realized balance sheet information of all the SOEs, and the estimated size of the contingent liabilities for the six largest SOEs (ELECTRA, IFH, CVA, ASA, ENAPOR, and EMPROFAC) within three months after the end of the quarter. Additionally, it supported the inclusion of risk measures in the annual and quarterly SOE sector bulletins, adding detailed information on the guaranteed debt portfolio, including loan by loan data with terms and conditions in addition to stock and guaranteed beneficiary.

50. **The enhancement of the regulatory framework governing the evaluation, issuance, and monitoring of state guarantees is critical to control future fiscal risks.** *Prior Action 2* supports an improved fiscal policy implementation in the recovery of the economy as it provides objective criteria to conduct a proper assessment of the credit risk stemming from additional guarantees. The guarantees framework defines the method for assessing and managing credit risk stemming from guarantees beneficiaries. A scorecard that aggregates individual scores will be used to assign requestors to eight risk factors. Aggregation is done on a weighted average basis and generates a final credit rating for each corporation. Once the risk assessment is conducted, a risk-based fee is set up by the Government to partially offset the losses in the event that the guarantee is called.[13] The authorities can charge guarantee fees from the beneficiaries and deposit in a reserve fund. The fees will range between 0.1 percent and 3 percent of the credit operation and the resources will be allocated to a dedicated fund that has been created by the legislation (Ministerial Order N. 96/22), implementing the Decree-Law 48/2018 articles 22 (1) and (2). [14]

Expected Results

51. **Strengthening the FRM framework will help reduce Cabo Verde's vulnerability to external shocks, thereby contributing to enhance fiscal sustainability in the medium term.** Improved debt transparency will provide the Government with the capacity, information, and analysis to annually report on the implementation of the medium-term debt management strategy. The result indicator is the improvement in the sectoral debt coverage score in the World Bank debt reporting heat map from partial to full. The authorities' efforts to identify the main sources of fiscal risks and assessing their likelihood of materializing will allow the development of appropriate strategies to preempt risks and prepare for their eventual impact on the Government's budget. The result indicator to measure progress in the reform area is the reduction in fiscal support to SOEs above what is established in the annual budget. It is expected that the deviation about budgeted SOE support reduces from 30 percent in 2020 to 10 percent in 2023.

[13] One of the main risk measures that are produced are the annual probabilities of default per entity based on their credit rating. Those probabilities are used for the fee calculation among other measures such as expected, unexpected, and stressed losses per entity and for the entire SOE's debt portfolio.
[14] Decree-Law 36/19 supports the use of official funds for specific purposes.

DPF2 Prior Action #3: To further strengthen the management of fiscal risks associated to disaster and climate-related shocks, the Recipient has issued a resolution mandating (i) the assessment of contingent liabilities associated to disaster and climate risks and (ii) its inclusion in the annual FRS.

The Prior Action follows Prior Action 4 supported under the DRM DPF with a Cat DDO (P160628), which is *related to the creation of the Risk Management Unit in the MoF.*

Background

52. **Disaster and climate-related shocks have recurrently affected government finances in Cabo Verde on two simultaneous fronts.** First, whenever a natural catastrophe strikes, growth tends to contract, on average, by 1 percentage point.[15] Second, lower economic growth translates into lower fiscal revenue, although the overall revenue impact depends on the specific shock considered, as economic effects differ across natural hazards.[16] Early response and emergency expenditures as well as post-disaster recovery and reconstruction efforts translate into an increased fiscal financing need. To finance these unforeseen expenditures, the Government has historically resorted to ex-post financing instruments, such as ad-hoc budget reallocations, postponement of investments projects, and contracting more debt. These actions could disrupt the implementation of budgeted development and sectoral programs, crowding out other growth-enhancing spending, with potentially long-lasting effects on the economy's potential growth rate. [17]

53. **Prevailing fiscal rigidities have limited the budgetary leeway to mobilize post-disaster resources, creating significant fiscal pressures and leaving most recovery and reconstruction needs unmet.** In the case of the Fogo volcano eruption in 2014-2015, limited fiscal space forced the Government to resort to an ad-hoc increase in VAT for both immediate response and recovery. Likewise, to implement the drought contingency plan in 2017, the Government relied on international donors to raise extra-resources of around 0.5 percent of GDP. In both cases, these measures were critical to lessen the welfare and economic impacts of the shocks although part of the recovery needs was left unmet.[18] More generally, AAL from natural disasters in Cabo Verde are estimated at US$18.2 million, largely driven by climate-related shocks as flood and drought together account for more than 87 percent of this AAL.[19] The only ex-ante financing instrument is the FNE, which receives an annual allocation of around US$2 million. Therefore, a significant funding gap is likely to materialize in the aftermath of a natural catastrophe. Climate change is expected to exacerbate weather and climate-related events and introduce new hazards associated to sea-level rise and ocean warming. These events are expected to increase the current estimated AAL and therefore worsen the fiscal impacts of climate-related shocks if adaptation measures are not implemented.

[15] Source: Forthcoming World Bank Country Economic Memorandum (CEM, P177268).
[16] Drought primarily affects the agricultural sector, with limited impact for tax revenues, while floods or volcanic eruption can create large disruptions to business, trade and tourism flows, resulting in significant shortages in income taxes and/or customs duties. See upcoming CEM for a detailed discussion.
[17] These budget reallocations are generally conducted through expenditure shifts embedded within existing budget programs, rendering their tracking and quantification very challenging.
[18] In the case of the Fogo volcanic eruption, the Post-Disaster Needs and Assessment (PDNA) estimated that recovery needs amounted to approximately CVE 3,021 million (US$30,2 million), while resources mobilized reached CVE 753 million, leaving approximately 75 percent of the needs unmet.
[19] This probabilistic risk assessment has been developed by the Disaster Resilience Analytics and Solutions (DRAS) World Bank team and quantifies potential losses that floods, drought, volcanic eruption, and earthquake could generate to physical assets. The AAL is the expected value of the modeled loss distribution for each peril and corresponds to the loss that the country will experience, on average, every year.

Prior Action

54. **The Government has taken steps to strengthen the management of fiscal risks arising from disasters and climate-related shocks.** With the support of the DRM DPF with a Cat DDO (P160628 – First Cat DDO), a Risk Management Service within the Treasury Department of the MoF was created in July 2018 to manage operational risks and coordinate the overall management of fiscal risks in MoF—including those associated to disaster and climate-related shocks. Progress has been made to start identifying risks associated to disaster and climate-related shocks and include a qualitative discussion of their likely fiscal impacts in the budget guidelines. Further efforts should allow to incorporate an overall assessment of fiscal risks associated to disaster and climate-related shocks as part of the upcoming FRS within the 2023 budget report. However, these analyses so far rely on scarce historical data and lack a sound quantification methodology as well as a description of the measures that could be adopted to manage these risks. Due to their exogeneous nature and inherent complexity, contingent liabilities associated to disaster and climate-related risks are still treated separately from other sources of fiscal risks. To enhance the management of this specific source of fiscal risks, an iterative approach, entailing sustained efforts over time and across various departments –both within and outside the MoF- is required.

55. **As climate change intensifies, more severe and frequent climate-related shocks are expected, prompting the Government to further strengthen the management of these fiscal risks and incorporate them into its broader FRM framework.** Leveraging upon the efforts initiated under the first Cat DDO, *Prior Action 3* supports (i) the quantification of contingent liabilities associated to disaster and climate risks and (ii) its inclusion in the Annual FRS. To ensure that these actions efficiently inform fiscal policymaking, the newly established Fiscal Risk Committee has been explicitly tasked with them. This overarching and high-level structure for FRM, chaired by the Minister of Finance, will ensure that fiscal risks associated to disasters and climate-related shocks are incorporated into key fiscal documents such as the Fiscal Risks Statements, medium-term fiscal frameworks (MTFFs) and medium-term debt strategy (MTDS). Based on this broader and more robust identification of fiscal risks, the Government will be able to assess different fiscal measures to strengthen its capacity to respond to disasters and climate-related shocks without jeopardizing fiscal sustainability. Given very restrained fiscal space in Cabo Verde, the financial protection strategy will follow a risk-layered approach and will seek to cost-efficiently combining risk retention and risk transfers instruments.[20] The World Bank team has been continuously supporting efforts in this area and will continue to provide TA in this area to the Government over the implementation of the operation.

Expected Results

56. **The direct outcome of a strengthened management of fiscal risks associated to disasters will be the elaboration and further operationalization of a financial strategy against disasters and climate-related shocks.** This financial strategy will seek to increase the budgetary capacity of the Government to respond quickly and effectively to a natural catastrophe, while preserving the sustainability of public finances. In

[20] A risk-layered approach starts by delineating "layers of risk" based on the inverse relationship existing between frequency and severity of disasters. Acknowledging that no single financial instrument can address all risk, different instruments are then matched to different layers of risk. From a theoretical point of view, a cost-efficient combination would seek to use first the cheaper sources of money (such as risk retention instruments), while reserving the most expensive instruments only for exceptional circumstances. Ex-ante risk retention instruments available in Cabo Verde include budget contingent lines, the FNE and contingent loans such as the Cat DDO. Risk transfer instruments refer to traditional insurance or other market-based instruments such as Cat-Bonds or Cat-Swaps, which at this stage are non-existent in the country.

December 2020, the Government was relying exclusively on the FNE as an ex-ante risk financing instrument. In this setting, historic amounts mobilized to respond to disasters and climate-related shocks through ex-ante risk financing instruments represented approximately US$2.5 million annually, which is about 14 percent of the estimated AAL. The design and operationalization of an integrated financial strategy will allow to explore and further develop new financing mechanisms and instruments such as risk transfer instruments as well as strengthen the ones in place. The financial protection strategy against disaster and climate-related shocks will ensure the adequate level of risk coverage, considering the risk aversion of the Government as well as the broader macroeconomic conditions. However, irrespectively of the mix of instruments chosen (e.g., budget allocation, contingent credit, insurance, parametric instruments), this strategy should result in a more systematic use of ex-ante risk financing instruments, allowing to reach a minimum coverage against disaster risk that would represent in average over the next three years at least 50 percent of the estimated AAL.[21]

Pillar B: Strengthen the Resilience of Poor and Vulnerable Households to Shocks, particularly Droughts.

57. **This pillar supports the resilience and adaptive capacity of poor and vulnerable households to shocks, particularly those headed by women and focusing on droughts.** The program supports reforms (i) to make the social protection system more shock-responsive and better targeted and (ii) to enlarge the scope of recovery activities that can be funded under the FNE. A shock responsive safety net will be crucial for the Government to respond to increasing food insecurity because of the impact of the Ukraine war. The shock-responsive safety net helps build the resilience of poor and vulnerable households, particularly female-headed, by investing in their capacity to prepare for, cope with, and adapt to covariate shocks, protecting their wellbeing and ensuring that they do not fall into poverty or become trapped in poverty because of these shocks. The existing social protection delivery systems in Cabo Verde were essential to enable the Government's rapid response to the COVID-19 shock, but also demonstrated limitations, hampering the efficiency of the shock-response and targeting, including: (i) insufficient coverage of the temporary cash transfers to support households to cope with the negative impact of COVID-19; (ii) lack of focus on the role of safety nets to respond to exogeneous shocks; (iii) inadequate coverage of informal workers in the social registry; and (iv) inadequate feedback of data from programs using the social registry, hampering the coordination and targeting. Beyond adaptive shock-responsive safety nets, the Government is also seeking to reduce vulnerability of households to climate change through strategic response and recovery activities that seek to progressively reduce reliance on weather sensitive activities, diversify income generation sources and reduce the sensitivity of households to the adverse impacts of these shocks.

Strengthening the shock-responsiveness of the social safety net

DPF1 Prior Action #3: To support the poorest and most vulnerable population to cope with the protracted economic impact of the COVID-19 crisis, the Recipient has issued Resolution No. 14/2021, dated February 9, 2021, expanding the Social Inclusion Income for Emergency (RSIE) to households from the poorest quintile not yet covered and all households in the second poorest quintile with children under the age of 15.

[21] If the Government opts for a parametric instrument, the potential payout will be a function of the intensity of the catastrophic event and/or the modelled losses underpinning the risk transfer mechanism. The exact amount of resources that could be mobilized under such a strategy will therefore be a range depending on the payout of the parametric instrument. The RI is therefore formulated as a minimum level of coverage to be reached with support from the proposed policy reform.

DPF2 Prior Action #4: To increase the resilience of the most vulnerable population to external shocks, including droughts, the Recipient has enacted a decree establishing a shock-responsive safety net framework, indicating its features, implementation processes, roles, and responsibilities.

Background

58. **The poorest and most vulnerable families in Cabo Verde, particularly female-headed households, are bearing the burden of the impact of the Ukraine War, through increasing food insecurity, raising the need for a shock-responsive safety net.** Given that Cabo Verde imports 80 percent of consumption products, transmission of international prices to domestic prices is high, with the poor being disproportionally affected. Around 20.4 percent of the population is predicted to have insufficient food consumption in 2022, according to the UN World Food Program. The CH for Food Security and Nutrition of March 2022 showed 9 percent of the population in stages 3-5 in the March - May 2022 period (2 percent of the population faced (Integrated Food Security Phase Crisis Classification) IPC3+ conditions in 2020). The share of the population in stages 3-5 is estimated to have reached 11 percent (46,000 people) in the June - August 2022 period. Should this trend continue, and if no urgent measures are taken to address food insecurity among the most vulnerable, the population currently under stress stage 2 CH (25 percent of the population) could move to stage 3. Malnutrition levels are believed to have deteriorated given the overreliance on food imports to satisfy food consumption needs and an erosion of purchasing power. The Joint Malnutrition Estimates (UNICEF, WHO, World Bank) show 6.9 percent acute malnutrition and 21.5 percent for children under 5 in 2021. A joint UN Food and Agricultural Organization, United Nations World Food Program, and Cabo Verde Government assessment mission in April 2022 found that vulnerable families in some rural areas are reducing the number of meals and eating less, from three meals a day to sometimes one meal a day. This situation is affecting particularly female-headed households, since a large share of the poorest households are headed by a woman and a larger share of the income among the poorest households is spent on food.

59. **The Government used the existing social protection delivery systems to respond to COVID-19, but there is a need to establish a framework that also encompasses climate-related shocks**. In March 2020, the Government, through the Ministry of Family and Social Inclusion (*Ministério da Família, Inclusão e Desenvolvimento Social,* MFIDS), launched the emergency cash transfer program (*Rendimento Social de Inclusão Emergencial - RSIE*) to support households from the poorest quintile, with children under the age of 15, to cope with the COVID-19 crisis.[22] This was a first step towards making the safety net more shock-responsive, but in addition to the risks posed by COVID-19, the country is exposed to other types of shocks, such as floods and droughts as well as the impact of the Ukraine war, further threatening livelihoods and food security. Drought is one of the most prominent risks in Cabo Verde and particularly affects the poorest households, especially female- headed. Poverty in the country is more widespread among female-headed households. About 43 percent of the extremely poor people live in households where a single mother is the only breadwinner, compared to 29 percent for Cabo Verde as a whole.[23]. In response to recurring drought episodes, in the last five years, the Government approved three different plans to mitigate its impact on

[22] These households were all selected using the social registry and according to the estimate poverty level, using a proxy-means test. Households from the poorest quintile that did not already receive support from the regular RSI, with children under the age of 15 were prioritized. Payments were made using bank accounts or through post offices.
[23] World Bank Country Partnership Framework for the Republic of Cabo Verde, FY20-25, Report no. 127164-CV.

households.[24] As a complement to these programs, interventions were also implemented to support specific households with food vouchers and subsidies for gas and water. To date, the safety net has not been deployed to respond to droughts (or other climate-related shocks) and labor-constrained households are particularly lacking temporary support to cope with the impact of climate-related shocks.

Prior Actions

60. **The DPF series includes a reform agenda to strengthen the shock-responsiveness of the safety net system by supporting the continued use of the safety net to respond to the COVID-19 crisis.** Due to the protracted impact of the crisis, particularly among the poorest households, mainly female-headed, the first DPF supported the expansion of the emergency cash transfer program (RSIE) to include (i) all households in the social registry from the poorest quintile not yet covered and (ii) all households in the social registry in the second poorest quintile with children under the age of 15.[25] This support was critical to ensure basic income for some of the most affected households and help them cover their basic needs.[26] The temporary support has come to an end and some beneficiaries will receive support to strengthen their resilience, in the medium term, through the productive inclusion intervention.

61. **Further, to ensure that the safety net is better able to respond to different shocks, including droughts and rising foods insecurity driven by the impact of the Ukraine war, a broad framework for a shock-responsive safety net will be anchored in law.** *Prior Action 4* supports the establishment of such a framework indicating its features, implementation processes, roles, responsibilities, and delivery systems. The overall framework will enable an adequate response to climate-related shocks, in addition to health and economic ones (such as the impact of the Ukraine war) and ensure that it is targeted using the social registry for specific target groups (depending on the type of shock) that are particularly vulnerable and not supported by other types of interventions. The response would be financed through government and donor financing (as was the case of the previous RSIE). The envisioned Social Fund, which is to be financed through an increase in the tourism levy, will be another source of financing. The estimated cost of the response depends on the nature of the shock. The framework will, however, clearly indicate that support would only be provided on a short-term basis, to the poorest (who are traditionally the most vulnerable and exposed to shocks) and households that are not be covered by other interventions (public works, for instance). Further refined targeting criteria depending on the type of shock, including specific geographic targeting would also be applied. This reform area would particularly benefit women, since 74 percent of households in the social registry are female-headed households, from which the future beneficiaries of a shock-responsive safety net would be selected.

Expected Results

62. **Strengthening the shock-responsiveness of the safety net will increase the resilience of the most vulnerable households, particularly female-headed, by better supporting them to cope with the impacts**

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[24] In the last five years, the Government approved three different plans to mitigate the impact of drought on households: (i) the emergency program for mitigation of drought and bad agricultural year (PEMSMAA) 2017/2018; (ii) the drought mitigation and resilience program in 2019; and (iii) the program for mitigating the results of the bad agricultural year 2021/2022.

[25] Resolution No. 14/2021, dated February 9, 2021.

[26] A beneficiary survey, undertaken through a phone survey by the UGPE in collaboration with the MFIDS in 2021, of the RSI and RSIE reported that 72 percent of households spent the cash on food, indicating the important role of the program to contribute towards food security.

of climate shocks, including droughts, thereby contributing to the overall climate adaptation efforts of the Government. Shock-responsive safety net programs are triggered by covariate shocks, such as economic, public health-related or climate-related (mainly droughts and floods) and aim at providing rapid cash support to affected households. In Cabo Verde, more than half of all households are female headed (55 percent) and they tend to be larger. Similarly, households at the lower end of the welfare distribution have more female members (3.6 female household members in the poorest quintile compared to 1.75 in the richest quintile) and more children. The result indicator of this reform area is the number of female-headed households benefitting from temporary income support in response to shocks, through emergency cash transfer programs. It is expected that 20,600 female-headed households are covered by 2023. By December 2021, the total number of female-households covered by the RSIE was 17,872. A shock-responsive safety net would also complement other ongoing interventions to strengthen vulnerable households' self-sufficiency and build resilience to shocks, including a productive inclusion intervention, particularly targeted to women, that provides poor households with entrepreneurship training coupled with support for improving or starting small businesses.[27]

Broadening the set of interventions in response to disaster and climate-related shocks to increase adaptive capacity of vulnerable households

DPF2 Prior Action #5: To increase the resilience of vulnerable households to droughts, the Recipient has amended the decree-law establishing the FNE to expand the eligible expenditures financed by the FNE, enabling drought-related emergency response and recovery activities.

This Prior Action follows Cat DDO Prior Action 5, which was related to the creation of the FNE.

Background

63. **The creation of the FNE has enhanced a swift and transparent execution of emergency response and recovery expenditures although, based on the audits associated to its first years of operation and the response to the COVID-19 pandemic, authorities have identified key areas to improve its functioning**. In 2018, under a reform supported by the previous DRM DPF with a Cat DDO (P160628), the Government created the FNE to cover emergency response and recovery expenditures for rapid onset events and established its funding mechanism through a pre-defined annual budget allocation, ensuring greater predictability of inflows.[28] The bylaws and operation manual established a rule-based disbursement mechanism through the definition of a set of eligible expenditures and norms to trigger its activation. As a result, over the last four years, public resources have been effectively allocated to targeted priority emergency response activities. The institutional supervision of the FNE also allowed to identify three bottlenecks to improve its operation and efficiency in financing emergency response and recovery. First, the composition of FNE's advisory board needed to be streamlined to make it more agile and facilitate the timely approval for disbursement of financial support in the case of an emergency. Second, the criteria to access FNE resources needed to be adjusted to strengthen the ability of the central Government to develop an

[27] The productive inclusion intervention is supported through the Social Inclusion Project – P165267 and the Human Capital Project – P175828).
[28] This budget allocation is set at 0.5 percent of non-earmarked revenues collected the year prior to the one for which the budget is prepared.

integrated and centralized approach to post-disaster spending.[29] Third, while recurrent droughts are putting additional pressure on the already limited fiscal space of the Government, FNE's eligible expenditures are limited to just-in-time emergency response. These expenditures are needed to confront emergency situations quickly and efficiently in case of floods or other rapid onset disasters but are not relevant to respond to slow onset events such as droughts. As climate change is expected to further worsen the frequency and intensity of rain deficit episodes, the Government is seeking innovative ways to broaden emergency response activities traditionally covered by the FNE to address the well-being impacts of droughts through recovery activities and projects aimed at reducing drought impacts on the livelihoods of the most vulnerable population. These recovery projects could, for example, include the construction of water tanks or temporal irrigation canals to enhance the capacity to manage water resources in rural areas.

Prior Action

64. **To align the FNE to this changing environment and revamp its role in fostering climate adaptation, the Government expanded the scope of activities that could be financed.** *Prior Action 5* supports these changes through the modifications to the FNE bylaws; indicating that beyond emergency response, rescue, and preparedness activities already covered (e.g., purchase of essential goods for emergency management, provision of shelters or services to help resume basic essential public services), activities aimed at mitigating the adverse impacts of droughts will be now eligible. These activities are essential to respond to slow onset events such as drought and increase the adaptive capacity of vulnerable households and subsistence farmers as they contribute to (i) diversifying earning opportunities and broadening households coping strategies and (ii) reducing climate vulnerability by providing facilities that help better managing water resources, therefore mitigating the adverse impacts of droughts. Another major modification to the Funds bylaws and operational manual is to officialize its activation in case of a natural catastrophe, which implies the possibility to mobilize the FNE in case of public health-related events as it was done for COVID-19 pandemic.[30] The advisory board composition of the FNE will also be nimbler and made exclusively of key actors for emergency response (Civil Protection, Cabo Verdean Red Cross, and Association of Municipalities) to ensure a timely decision-making process as well as alignment of contingency planning in case of emergency. Finally, a "situation of contingency" issued by the central Government (as opposed to a lower level "situation of alert" used previously) will now be required to access funds of the FNE, concentrating decision making at the central Government level and facilitating an optimized and more transparent management of resources.

65. **As climate change unfolds, the Government is broadening the set of public policies that help increasing resilience to respond to current climate-related risks while simultaneously enhancing the long-term adaptive capacity of households.** This reform complements *Prior Action 4* and help to fulfill this ambitious vision. While cash-transfers in the aftermath of a shock will be required to limit adverse poverty and distributional impacts, the activities funded through the FNE aim at mitigating the impacts of climate-related shocks on vulnerable households through a progressive reduction of exposure to weather-sensitive activities and a diversification of income generation sources in rural areas.

[29] Previously, municipalities can directly request support from the FNE by self-declaring a "situation of alert" for their respective administrative areas
[30] A natural catastrophe is defined in the Civil protection base law: "*a significant accident or series of significant accidents capable of causing heavy material damage and, eventually, casualties, severely affecting living conditions and the socio-economic fabric in the whole or part of the national territory*".

Expected Results

66. **Under this reform, all related emergency and early recovery funds, including those responding to droughts, will now be channeled through the FNE, ensuring greater efficiency and transparency of drought response spending**. Allocation and execution of these expenditures will follow the rule-based mechanism established under the FNE and facilitate the provision of targeted activities and projects aimed at reducing climate vulnerability of affected households. This will increase accountability and transparency of all emergency response spending vis-à-vis citizens and donors, which have played an important role in financing the response to medium-sized and large events in Cabo Verde, in particular droughts. Information on spending is collected and analyzed in reports produced by the FNE and will be the main source for an annual audit report produced and published by the Court of Account.

Strengthening the social registry

DPF1 Prior Action #4: To improve the usability and the crisis response capabilities of the social protection system, the Recipient's Ministry of Family and Social Inclusion has issued Directive No. 34/2021, dated April 15, 2021, requiring municipalities to register informal workers, identified through the COVID-19 Emergency Cash Transfer Program for Informal Workers (RSO), into the CSU.

DPF2 Prior Action #6: To improve the coordination of social programs and the efficiency of targeting the poor and most vulnerable, the Recipient has (i) issued a regulatory decree, which amends the regulatory decree No. 7/2018 to mandate social programs using the social registry to provide feedback data; and (ii) issued a ministerial order, which instructs the PRH to focus support to households in group I and II in the CSU.

Background

67. **With support from the World Bank and other development partners, the Government established a social registry and anchored it in law in 2018**.[31] As of July 2022, the registry contains comprehensive data of over 80,000 households (over 310,000 people; 62 percent of Cabo Verde's population) from across the country and ranks them according to their estimated welfare status (using a proxy-means test).[32] The system is already contributing to improved targeting and coordination of social protection interventions since it is being used to target the main cash transfer program (RSI), the emergency cash transfer program (RSIE), and

[31] Decreto Regulamentar no. 7/2018. Since the social registry implies the management of personal data, Cabo Verde's personal data protection law has to be observed. Agencies using data from the social registry need to ask permission from the data protection authority prior to seeking permission to use the social registry data. Further, the social registry is a statistical source and therefore needs to observe the National Statistics System Law.

[32] The MFIDS is using a comprehensive manual for the registration of households in the social registry. For the registration of households in the social registry, community associations and civil society organizations were involved to help with the outreach and communication at community level. Every two years the data in the social registry will be updated to ensure adequate and up to date information. The MFIDS is currently undertaking the first such data update process from early 2021. At any time, any household who is not already registered in the social registry can register on-demand at the municipal office. In addition, technical officers visit communities on a regular basis, including for collecting missing information of households already registered. In that process, households who have not been registered, but who want to, can also register through these officers. A recent review of the PMT confirms that it is the best approach with the existing data (Household Income and Expenditure Survey (*Inquérito às Despesas e Receitas das Famílias*, IDRF 2015) and the Government will update the PMT using the new household budget survey data (IDRF 2022/23) when it becomes available.

energy subsidies, among others. The social registry also helps the MFIDS to better coordinate social protection programs and responses. The use of the registry, however, differs across programs and there is inadequate feedback of data from these programs. This hampers coordination and the ability of the MFIDS to have a comprehensive overview of support provided to specific individuals and households. To ensure continued increased use of the social registry for targeted service delivery, the Government is also committed to continue to formalize the use of the social registry for specific programs.

68. **Through its National Strategy for Disaster Risk Reduction 2018-2030, and as re-emphasized in the NDC, the Government is also committed to expanding livelihood protection policies to respond to climate-related shocks.** The social registry is envisioned as the main policy tool to target support to the most vulnerable to recover from damages associated with extreme weather events.[33] As an example, in 2018, the social registry was used during its test phase, to target families affected by the drought and the bad agricultural year under the Emergency program for agriculture (PEMSMAA).

Prior Actions

69. **The DPF series reinforces the social registry by broadening its coverage and usability, including to respond to climate-related shocks.** In addition to the RSIE, the Government's COVID-19 response included an emergency cash transfer to informal workers (*Rendimento Solidário,* RSO). The Government used the existing social registry and social protection delivery systems to channel support, but a temporary registration solution was put in place for informal workers (around 20,000 people) who were not registered in the social registry. The previous DPF supported the registration of these informal workers into the social registry, collecting additional information required for the system.[34] *Prior Action 6* further supports a broader and better use of the social registry, contributing to better targeting, coordination, and increased fiscal efficiency. Specifically, it supports (i) the implementation of feedback data for programs using the social registry and (ii) the mandate for the PRH to employ the social registry for target support.[35] The reform is expected to improve targeting, contributing to improving fiscal efficiency because of better coordination and better targeted programs. Finally, the new feedback requirement is important to keep track of the households already receiving social benefits with the aim of minimizing duplication of benefits.

Expected Results

70. **As a result of the reform area, it is expected that Cabo Verde has a more shock-responsive social registry, strengthening its usability to respond to climate-related and other covariate shocks, including the impact of the Ukraine war**. The investment in the social registry would raise the adaptation and mitigation potential of the social safety nets since it underpins the ability of programs to expand coverage to more households in response to shocks, including climate-related ones. It would also support a broader use of the data, ensuring that a key program uses the updated data from the social registry. The reform would particularly benefit women, since 74 percent of households in the social registry are female-headed

[33] Cabo Verde 2020 Update to the first Nationally Determined Contribution (NDC) Praia, February 2021, page 43, bullet 6.
[34] Directive No. 34/2021, dated April 15, 2021.
[35] The PRH is an intervention that will provide support for housing rehabilitation for targeted households in selected neighborhoods in Praia. The intervention will not only improve access to basic services and living conditions for vulnerable households but will also help protect them from climate impacts. The PRH is supported through the recently approved IPF for the Cabo Verde Human Capital Project (P175828).

households and around 67 percent of the RSO beneficiaries are women. Out of the additional households identified using the social registry, it is expected that 50 percent are from the two poorest quintiles.[36] This will ensure that the expansion continues to increase the number of households in the social registry that are most likely to need targeted support. Between January 2021 and December 2021, an additional 18,524 households were registered into the social registry, of which 14,439 (78 percent) were female-headed and 10,262 (55 percent) belong to the two poorest quintiles.[37]

Pillar C: Enable a Sustainable Private Sector-Led Recovery

71. **This pillar seeks to maximize the sustainability of the recovery and diversification reforms.** It supports reforms promoting sustainable private sector investment in key sectors –electricity, tourism, and the blue economy– to accelerate recovery, unlock economic diversification and growth, and strengthen resilience to disasters and climate-related shocks. The reforms will result in attracting an environmentally responsible investment, promoting the efficient use and conservation of natural resources, low environmental footprint, and contributing to both climate mitigation and adaptation efforts.

Enable private investment in the electricity sector

DPF1 Prior Action #5: To promote private investment, improve operational performance, and reduce GHG emissions in the electricity sector; the Recipient has approved the restructuring and public divesture of the electricity utility company through the Decree-Law No. 52/2021, dated July 21, 2021.

DPF2 Prior Action #7: To implement the power sector restructuring, the Recipient has enacted a decree-law to (i) mandate ELECTRA's disinvestment from power sector activities; and (ii) vertically unbundle the power sector by creating a thermal electricity generation company, an electricity distribution company, and an electricity system operator company.

Background

72. **Cabo Verde's electricity sector is dominated by ELECTRA, the vertically integrated electricity and water public utility company.** ELECTRA is responsible for power generation, transmission, and distribution. In 2020, ELECTRA produced 419.2 GWh of electricity from an installed capacity of 154 MW (of which 6.5 MW of solar and 0.9 MW and wind). ELECTRA's operational performance is weak and characterized by high system losses, well above global and regional averages. Total losses (technical and commercial) in electricity supply amounted to 25.5 percent of production in 2021. Losses in the largest island of Santiago have been reduced, driven by the implementation of the Revenue Protection Program (RPP). However, they have increased in the island of Sal due to the significant slowdown in commercial activities due to the negative impact the COVID-19 pandemic had on tourism. Since the network infrastructure condition are satisfactory, most losses are commercial, due to meter tampering and bypassing, direct clandestine connections to the grid and other circumstances.

[36] As the coverage of the social registry increases, the RI is expected to reduce from 55 percent in 2021 to 50 percent in 2023 because the number of people not registered from the two poorest quintiles will decrease since the SR will start enrolling households from other quintiles.
[37] 4,987 households belong to the poorest quintile and 5,275 to the second poorest quintile.

73. **High electricity tariffs limit energy affordability for households, impacting the competitiveness of the private sector, and are a contributing factor to the high level of electricity fraud.** At approximately 95 percent, access to electricity in Cabo Verde is among the highest in SSA. However, electricity prices are also amongst the highest. Residential tariffs average US$0.26/kWh over the past four years but have fluctuated as high as US$0.36/kWh in March 2019 for higher-consuming residential users (>60kWh/month). The implementation of the RPP, based on incorporation of Advanced Metering Infrastructure (AMI) to all customers with monthly consumption exceeding 800 kWh to systematically monitor their consumption and eliminate commercial losses in supply to this high-value segment, has delivered mixed results. The main reason explaining this circumstance is the delay defining and putting in place the operational procedures to detect and correct abnormal situations in consumption using the powerful functionalities of AMI.

74. **ELECTRA's financial performance is weak, despite cost reflective tariffs at an efficient level of losses, mainly due to high commercial losses and non-payment from public entities.** The 2020 audited financial statements indicate that result was a net loss of US$5.3 million and retained losses of US$114 million, resulting in negative equity of US$53 million. Tariffs allow for cost recovery but are capped at the recovery of an efficient level of losses, and not the actual high losses faced by the utility.[38] To improve its financial situation and improve service delivery, ELECTRA must reduce commercial losses to improve its financial performance through increases in sales and revenues, and a reduction in its cost of energy purchases.

Prior Action

75. **The DPF series support the restructuring of the electricity sector.** The previous operation supported the approval of the electricity sector Decree-Law 52/2021, which establishes the restructuring and public divesture of ELECTRA. The Decree Law codifies the government's action plan for restructuring the electricity sector by vertically unbundling ELECTRA and creating one generation company (Genco), one transmission and system operation company (TSO) and one distribution utility (Disco) to own and operate its assets in the respective segments of the electricity supply chain, with the objective to improve efficiency in operations. The law specifies that a minimum of 75 percent of the shares of each of the Genco and the Disco will be privately held, and that shares will be sold through competitive tenders. The distribution company will have a concession contract with Government, which will specify the main regulatory (economic and service quality) issues characterizing the provision of distribution and retail services over its duration, including a performance based regulatory regime specifying the allowance of losses in tariff revenues for the initial tariff period following handover to private owners. This regime will provide strong monetary incentives for the private concessionaire to achieve and eventually exceed the Government's loss reduction targets, to be set based on international best practice relevant to Cabo Verde. The proposed *Policy Action 7* supports the separation disinvestment of ELECTRA'S from water and electricity activities and the formal incorporation of the future distribution and power generation companies. These are key actions to implement the unbundling of the vertically integrated utility, which will make possible to strengthen systematic power sector planning and to implement its policy to tilt the power generation matrix towards cheaper and cleaner renewable energy resources.[39]

[38] As of February 2020, the regulatory cap for recovery of losses (commercial and technical combined) is 23.3 percent.
[39] The World Bank has provided advisory services support to prepare the privatization action plan under the SOE Related Fiscal Management Project (P160796) and intends to also support implementation of the restructuring and privatization of ELECTRA through transaction advisory services under the Renewable Energy and Improved Utility Performance Project (P170236).

Expected Results

76. **Improving the operational performance of a restructured and privatized electricity distribution and retail utility will contribute to reducing commercial losses, which will in turn lower the overall cost of electricity generation, improve energy efficiency and reduce GHG emissions,** and **strengthen energy independence.** The expected improvement in the company's operational efficiency and management with a private entity is expected to result in a significant reduction of electricity system losses, which would decline from 26.1 percent in 2020 to 25 percent in 2023 and reach 21 percent in 2025.[40] Evidence suggests that the impact of the reduction in commercial losses by regularizing consumers conditions is split between higher sales for the utility (a fraction of formerly unmetered usage that is now billed) and lower demand (consumers exposed to billing as per full demand adjust it to their ability to pay). This implies lower generation which, in power systems strongly relying on thermal production such as Cabo Verde's, will result in reduced CO2 emissions. Reducing losses will also improve the utility's financial performance through higher sales and a reduction in the costs of energy purchases. The allowance on losses set by the regulator to provide efficiency incentives to Disco's private owner will also imply future reductions in end-user tariffs. Another indirect climate benefit of this reform will arise from the newly separated management of water resources, which will allow to enhance an efficient and integrated water management strategy. This improved water management constitutes a key element to adapt to a changing climate and increase resilience to climate-related shocks, such as drought and floods.

Enhancing sustainable tourism planning and regulation to support diversification.

DPF1 Prior Action #6: To promote environmentally sustainable investments in the tourism sector, the Recipient has approved Decree-Law No. 87/2020, dated December 18, 2020, regulating the process to approve construction projects in Integrated Tourism Development Zones (Zonas de Desenvolvimento Turístico Integrado, ZDTIs) and the relevant licensing process.

DPF2 Prior Action #8: To modernize the tourism regulatory framework and in line with the ENRRD strategy, the Recipient has adopted three decree laws stipulating (i) updated licensing requirements for tourism accommodation operators, including disaster and climate risk considerations; (ii) a legal regime for tourism and hospitality establishments in rural areas; and (iii) updated rules and norms for tourism service providers.

Background

77. **After the unparalleled shock to tourism brought upon by the COVID-19 pandemic, the authorities are looking to pursue a "build-back better" vision anchored on streamlined regulations and procedures for tourism investors, hospitality, and service operators as well as increased resilience of the sector to climate**

[40] As per current timeline of the privatization process, handover of management of operations of distribution company to new shareholders is likely to happen early 2023. Experience in similar situations shows it takes some 6-8 months for new management team to change how operations are conducted in key business areas, as this in general includes organizational restructuring, process reengineering and outsourcing of some activities, replacement of staff not meeting qualification requirements, incorporation of supporting tools, etc. This implies improvements in values of key performance indicators (KPIs) in the first year (including losses) will be limited. However, once the new approaches for operations reach "steady state" significant improvements in KPIs are achieved in short periods.

shocks. As a part of the Cabo Verde 2030 Ambition vision and the Grand Options for the Sustainable Tourism Development Strategy (GoPEDS), the Government officially approved and published a new Tourism Operational Plan 2022-2026 (*Plano Operacional do Turismo*) in April 2022. [41,42] The Plan seeks to accelerate investments and reforms that promote tourism diversification across more demand niches and islands, stimulating sustainable tourism and the conservation of existing natural and cultural assets. To ensure the orderly and harmonized use of spaces in full convergence with environmental and social national safeguards and sustainability, authorities have already updated important planning instruments, notably: (i) a revamped ZDTIs framework Law in 2018 (Law 35/IX/2018) that requires each zone to have a legally binding tourism zoning plan (*Plano de Ordenamento Turístico,* POT) that includes climate and DRM considerations; (ii) an update to the decree-law on guidelines for territorial and urban planning (Decree-Law 4/2018), which streamlined the different layers of territorial planning instruments, including the POT, and introduced requirements to incorporate the use of disaster and climate-related risk aspects;[43] and (iii) a revamped decree-law governing the Environmental Impact Assessment (EIA) (Decree-Law 27/2020), which provided a key comprehensive upgrade on the types of evaluations and projects classifications as well as enforcement mechanisms (the previous EIA Law was from 2006).

Prior Actions

78. **The previous operation supported the implementation procedures and requirements for the revamped framework-law governing ZDTIs.** It supported the decree-law establishing due process and timelines for approval of investment projects inside the ZDTIs. The reform ensured the necessary environmental and social assessments as well as the incorporation of disaster and climate-risk information into territorial planning instruments as stated in the Territorial Planning Law approved in 2018 and supported by the first DRM DPF with a Cat DDO (P160628). The process-flow regulates the review, within a given timeframe, by all relevant public agencies, including the investment promotion agency, the Office for Management of Special Tourism Zones, the National Institute for the Management of the Territory, the General Directorate of Environment, and the local Municipalities. These line agencies ensure the application of the recently updated national legal guidelines.

79. **The current DPF supports further critical reforms to the regulatory framework governing tourism accommodations and service providers**. *Prior Action 8* upgrades and simplifies the regulatory framework governing tourism accommodations and service provision through three complementary legal decrees. The first one upgrades the regulations governing licensing, installation, management, and operation of tourism accommodations, including hazard and risk considerations as part of the screening process required to obtain the license. The second one revamps the regulations on principles, rules, and norms to access and operate for tourism service providers (from tour operators to event companies, inter alia). The third one sets specific guidelines on installation, management, and operations of tourism accommodations in rural spaces, stimulating the development of new niche offerings such as rural and community-based family lodgings. Fostering rural tourism is also a key component of the strategy of the Government to increase the resilience

[41] The GoPEDS covers the period from 2018-2030 and sets out the vision and goals for tourism development in the country, particularly anchored on amplified geographic and niche diversification across all islands as well as increased participation by local operators in the tourism value chain.

[42] The Tourism Operational Plan (POT) was developed based on island tourism masterplans (7 of which supported through the World Bank funded Competitiveness for Tourism Development Project) and approved and published through a Council of Ministers resolution 31/2022 from March 31, published thereafter in the Official Bulletin on April 5, 2022.

[43] These two planning instruments were supported through the PA#2 of the first DRM DPF with a Cat DDO (P160628).

of rural households through the provision of alternative sources of income, reducing their over-reliance on agricultural activities. These decrees are updated in accordance with best practices on the different tiers of classification and quality criteria, promote high-quality tourism services and ensure environmental sustainability and social inclusion. Each decree is in line with the ENRRD, embedding contingency measures for disaster and climate-related shocks into the business continuity practices of these enterprises and promoting risk reduction measures to limit the impact of climate-related shocks, therefore contributing to the overall climate change adaptation efforts promoted by the Government across tourism hospitality businesses.

Expected Results

80. **As a result of the reforms, it is expected that the tourism sector becomes more sustainable, resilient, and diversified across niches and islands, and better linked to the country's natural and cultural assets.** The reforms will enable a streamlined, climate resilient, sustainable, and more predictable investment framework, which will catalyze projects in untapped ZDTIs on islands outside Sal and Boavista. The upgraded regulatory framework will also support other tourism segments outside all-inclusive hotels, such as culture, nature, nautical, diving, and trekking, and overall promote more sustainable investments in tourism. The upgraded regulatory framework will also help increase the resilience of the sector to disaster and climate-related shocks by (i) incorporating hazard and climate risk considerations in the screening process conducted to deliver hospitality licenses (ii) diversifying tourism locations across islands -therefore reducing the overall exposure of the sector to a single disaster- and providing alternative source of income in rural areas severely affected by drought and other climate-related shocks. It is expected that all investments projects approved in ZDTIs by 2023 occur under the revamped legal framework for ZDTIs, under approved POTs which incorporate disaster and climate-related risk management considerations and with officially approved EIA Studies.

Support the sustainable development of the fishery sector to attract investment

DPF1 Prior Action #7: To attract sustainable and environmentally responsible private sector investment in fisheries, the Recipient has approved Decree-Law No. 15/2021, dated February 9, 2021, regulating aquaculture.

DPF2 Prior Action #9: To promote the development of the fisheries sector and sustainable use of marine and coastal resources, the Recipient has issued a ministerial order approving the list of eligible species for aquaculture activities.

Background

81. **Cabo Verde's new development strategy recognizes the importance of developing the aquaculture sector to support diversification, increasing the value added of exports, and addressing the unsustainable exploitation of some fish stocks.** Similarly, the Unified Strategic Framework for the Blue Economy (*Quadro Estratégico Unificado para a Economia Azul*, CASUEB) gives central space to aquaculture (both mariculture, including offshore, and aquaculture, including in reservoirs) to operationalize the Government's Blue Economy vision. The need to provide a suitable framework for the development of the sector is also aligned with the Sustainable Development Goals (SDG 14). Additionally, the 2015 NDC and the corresponding 2020

update recognize the development of aquaculture as a climate change adaptation option to mitigate the volatility in marine fisheries' productivity. These documents also emphasize the need to put in place a regulatory framework to manage the environmental impacts of aquaculture and provide clarity for investors. Cabo Verde's marine fisheries are considered under very high ecological risk from climate change, and among those most vulnerable in Africa (World Bank 2019).[44] The development of aquaculture is one option to mitigate this negative impact from climate change on marine fisheries, by diversifying the source of fish for consumption as well as reducing the pressure on marine resources. For these reasons, the 2020 update of the NDC recognizes the development of sustainable aquaculture as a key measure to contribute to its climate adaptation objective number 4, namely "*increasing and sustaining ocean-based food security through regenerative fishing*".

82. **Recent aquaculture activities, including shrimp farming, are demonstrating positive results**. With its favorable and stable climate throughout the year, Cabo Verde has the endowments for the sustainable development of aquaculture, which would lessen the dependence on maritime fishing and create synergies with industrial fishing, whose development is strongly limited by the supply of baits. To support the development of aquaculture and the associated mobilization of private investment, progress is needed in the following areas: (i) scientific and technological capabilities (for more efficient production, adapted to local conditions and more suitable species); (ii) zoning (to delimit the most promising areas for aqua-/marine-culture and protect these areas in the context of spatial planning); and (iii) an improved strategic and regulatory environment (to build a regulatory framework to support the development of the activity in line with best international standards, avoid the informality of the piloting stage, and ensure more safety and quality in the production chain). These topics are supported by the DPF series and will also benefit from World Bank TA and investment support, particularly from the Aquabusiness Advisory Platform (P175786) and the Sustainable Tourism and Blue Economy Development in Cabo Verde (P176981).

Prior Actions

83. **The first DPF series supported the establishment of the base regulatory framework for aquaculture in Cabo Verde to attract sustainable private investment while adapting to climate change**. It supported the aquaculture decree-law that covers the various aspects of starting and operating an aquaculture-related business, including establishment authorizations, licensing, authorized species, hygiene and safety, and environmental aspects (both on pollution and biodiversity considerations). The decree-law is critical to prevent the problem of pollution that may be caused by aquaculture as well as providing a diversification option away from artisanal and coastal fisheries. The regulation also provides clear procedures for the establishment and operation of aquaculture production units, thus providing legal certainty to stakeholders. Regarding the holding, breeding, or cultivation of species, a system of authorization and licensing is being established, based on the verification of certain assumptions that exclude the risk of circumvention, dissemination, and proliferation of species that may threaten ecosystems and biodiversity.

84. **The current DPF series supports the effective establishment of the required legal framework for the aquaculture sector**. *Prior Action 9* supports a key follow-on ministerial decree associated with the macro aquaculture decree-law supported in the previous DPF, notably the denomination of the eligible list of species for aquaculture activities. The long list was determined by National Directorate of Fisheries and Aquaculture in collaboration with the Maritime Research Institute (*Instituto do Mar*, IMAR), and it provides

[44] Climate Change and Marine Fisheries in Africa: Assessing Vulnerability and Strengthening Adaptation Capacity.

a broad overview of species deemed viable in the context of Cabo Verde, which can be further adjusted after additional project-specific due diligence. This reform will subsequently be complemented with a decree-law establishing the specifications and fees for aquaculture licenses, to be supported by the Aquabusiness Advisory Platform (P175786) and expected to be approved by the end of 2022. To implement the new regulatory framework, the Ministry of Sea also created in September of 2021, for the first time, a dedicated national service directorate to license and supervise aquaculture activities. These concurrent policy and administrative follow-on reforms are important enablers towards creating a functioning and conducive framework for investment in the aquaculture sector, spurring additional projects whilst also providing the necessary legal umbrella for already ongoing activities.

Expected Results

85. **The reforms area is expected to generate a more sustainable and resilient private investment into aquaculture.** With the adoption of the first regulatory framework on aquaculture and the subsequent establishment of the eligible species and associated fees, an increase in sustainable investments flows into aquaculture is expected. The target indicator is to increase the cumulative investment into the aquaculture sector from US$6 million in 2020 to at least US$9 million in 2023. This reform is also key to advance towards the adaptation contribution #4 under the 2020 update of the NDC: *Increasing and sustaining ocean-based food security through regenerative fishing*.

86. **The analytical underpinning of each Prior Action is presented in Annex 5.**

4.3. LINK TO CPF, OTHER WORLD BANK OPERATIONS AND THE WBG STRATEGY

87. **The reform program supported by the DPF is consistent with the objectives of the WBG Cabo Verde 2020-2025 CPF (report number 127164-CV)**. The CPF was 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 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.

88. **This operation builds upon the achievements of several World Bank Investment Project Financing (IPF), DPF and TA projects, underpinned by the World Bank’s approach to respond to the COVID-19 crisis.** The operation implements Pillars 2 and 4 of the WBG COVID-19 response, which seek to protect the poor and vulnerable people as well as strengthening policies, institutions, and investments for rebuilding better. Operations underpinning this operation include: (i) the first Cat DDO (P160628), which has been instrumental in supporting GoCV’s reform program to strengthen the capacity to effectively manage disaster and climate-related risks in the country and increasing its resilience to socioeconomic and fiscal impacts of natural catastrophes; (ii) the SOE Related Fiscal Management Project – Additional Financing (P172528) that supports strengthening the legal and policy framework and institutional capacity for SOE oversight, monitoring and reporting; (iii) the Resilient Tourism and Blue Economy Development in Cabo Verde Project (P176981) that supports Government efforts to increase diversity and resilience in the tourism offering by tapping into the

combined potential of tourism and blue economy activities and promotes local small and medium enterprise participation across the value chain; (iv) the Social Inclusion Project (P165267) that support the Government efforts to build an effective social protection system that promotes social and productive inclusion and its additional financing (P175946) that supports regular and emergency cash transfer to the poorest and most vulnerable affected by the COVID-19 crisis; and (v) the renewable energy and improved utility performance project (P170236) that supports the increase of renewable energy generation and the attraction of private finance to improve the performance of the utility company. Other ongoing important operations include the ongoing CEM (P177268), informing policies to increase the resilience of economy to external shocks; the Debt Performance Management Assessment (P177981), reviewing debt management policies and identified reforms; and the Programmatic *Aquabusiness Advisory Platform* (P175786), supporting best practices for economic and environmental sustainability in aquaculture.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

89. **The design of the DPF series is informed by the PEDS and the Cabo Verde Ambition 2030, completed in 2020, and benefitted from wide-scale consultations.** The consultations were conducted on several levels, including with line Ministries, public agencies, private sector representatives, and other key stakeholders. The World Bank team participated in the Cabo Verde Ambition 2030 discussion meetings related to fiscal policy and private sector development, where the criticality of the reforms supported by the operation were debated with the stakeholders. Key feedback from consultations was the importance of revamping the regulatory framework for aquaculture, to reduce regulatory uncertainty and attract foreign investment to leverage the blue economy for economic diversification.

90. **The World Bank has been working closely with main development partners leveraging its role in the six-member Budget Support Group (BSG), which includes the Luxembourg, Portugal, Spain, the EU, and the AfDB.** The BSG provides a framework for semi-annual joint reviews of the Government's development program. The joint missions enhance donor coordination and harmonization of DPF support for greater impact. The World Bank leads the technical discussion around the macroeconomic framework. The reform program supported by this DPF series was discussed with partners to ensure complementary in planned interventions, notably in the areas of macro and debt management, energy, social protection, and COVID-19 and Ukraine war policy responses. The World Bank has coordinated closely with the IMF during the series preparation, including through participation in decision meetings of both institutions, joint debt management missions, and joint discussion with Government on policy priorities for returning to macro-fiscal sustainability and structural reforms in the aftermath of the crisis.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

91. **Although poverty in 2022 is envisioned to decline, the pace of the decline is slower than anticipated because of the war in Ukraine.** Poverty is projected to reach 26.9 percent in 2022, compared to the 26.2 percent expected before the war. The slight increase in poverty is driven by the increase in food prices, adversely affecting household wellbeing. Furthermore, recent data collected through the World Bank High Frequency Phone Survey (HFPS) series in January 2022 showed that over 45 percent of households reported

a decline in their regular income relative to the period before March 2020 (the start of the COVID-19 pandemic). This shows that although the labor market appears to be recovering from the COVID-19 pandemic, income levels of households remain volatile. In addition, agriculture (which is the main source of livelihood for 18 percent of households; and over 30 percent in rural areas) faces greater risk as, in addition to the ongoing drought, prices of animal feed and fertilizer are increasing. The HFPS data also shows that more than half of households who rely on agriculture reported decline in income levels in January 2022 relative to pre-pandemic levels. The effects of the war are likely to exacerbate these effects, increasing their risk of sliding back or deeper into poverty.

92. **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 the medium term.** The DPF focus on reducing fiscal risks and increasing debt transparency contributes to establishing an enabling environment for prudent fiscal management and sustained economic growth. An adequate management of fiscal risks will create fiscal space to scale up pro-poor spending and provide more resources to finance the shock-response safety net framework. Strengthening the resilience of the poor to external shocks will contribute to prevent vulnerable households, particularly women-led, from falling into poverty due to systemic or idiosyncratic shocks. 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. The expected poverty impacts of the prior actions are reported in Annex 4.

93. **Reforms under Pillar B would contribute to prevent vulnerable household from falling into poverty, particularly women, due to external shocks, particularly droughts.** These actions will ensure that the purchasing power of targeted poor households is protected in the face of systemic shocks. These reform areas would also prevent households from resorting to negative coping mechanisms and, therefore, avoiding worsening human capital development. The implementation of a shock-responsive safety net program (*Prior Action 4*) would allow the rapid activation of RSIs for vulnerable households, particularly female-headed households, affected by external shocks, including droughts. To target beneficiaries, this program will use the social registry as a basis in conjunction with specific vulnerability considerations depending on the type of shock, which will allow to ensure that the poorest and most affected households are supported. Equally, the increase in the scope of the eligibility criteria to access the FNE to finance drought-related and public-health emergency response activities (*Prior Action 5*) increases the flexibility of the social protection framework and broaden the scope of coping strategies that vulnerable households can adopt to avoid falling in poverty in the case of negative shocks. While the fund is not relying on a specific household-targeting mechanism, it focuses exclusively on areas affected by a shock and finance emergency, humanitarian, and response activities with a track record of ensuring equal access to all vulnerable groups. Finally, enhancing the feedback data and ensuring that the PRH uses the social registry ensures a common approach to the social protection system, thereby contributing to a better public response to prevent increases in poverty in the face of exogeneous shocks. The reforms areas would particularly benefit women, since they constitute a large portion of the extreme poor of which 43 percent are households where a single mother is the only breadwinner.

94. **Prior Action 7, which supports the power sector reforms, is expected to have positive poverty impacts through the reduction of electricity tariffs over the medium term.** The privatization of the electric utility will improve its financial situation 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. Over the short term, however, high international oil prices may increase energy prices impacting disproportionally the poor. This impact is expected to be transitory and will be mitigated in future by the rise of renewable generation, which is expected to increase, reducing generation costs and GHG emissions. The Master Plan for the Power Sector (2018–2030) envisages renewable generation installed capacity increasing to 251 MW by 2030, at which time renewables would comprise 54 percent of the energy mix versus 16.8 percent in 2020. The restructuring of ELECTRA will not include a retrenchment plan in the short term. After the vertical unbundling of the three companies, operating staff of ELECTRA will be allocated to the respective companies according to their specific functions. Following the takeover of the generations and transmission companies by private investors, the staff that is not retained will be transferred to ELECTRA holdings. Afterwards, the Government will evaluate redundant staff and be able to design workforce rightsizing. The adverse distributional and social impacts will be mitigated with compensation measures comprising severance packages for retrenched workers. Lessons learned from the retrenchment of CVA staff will be implemented, particularly the improvement of the communication flow between the Government and employees, the early established of a grievance redress mechanism, and the implementation of job assistance programs to re-enter the labor market.

95. **Prior Action 8, which supports the regulation of tourism accommodations in rural areas will have positive direct impacts on poverty reduction through the development of rural and community-based family lodgings.** Tourism diversification across demand niches and islands will provide new sources of income in rural areas and increase the participation of vulnerable households to these activities. Moving away from an enclave touristic model will also mitigate the risks of social conflicts, inequalities and adverse repercussions for local communities by fostering backward linkages with the domestic economy and increasing local employment opportunities.

96. **Prior Action 9, which support the aquaculture regulatory framework, will have a positive direct poverty impact through job creation and food security.** Aquaculture has been shown to have a high economic return in terms of water use relative to other food systems, particularly in the context of dry lands such as that of Cabo Verde. Considering the global trend towards culture instead of capture, as well as the stagnation or reduction of economic opportunities in the over-exploited coastal capture fisheries, aquaculture may provide an important source of diversification and complementarity. Women, who dominate seafood value chains, are particularly dependent on a reliable supply of product that capture fisheries may struggle to produce in the medium long term. In this context, new and sustainable investments in aquaculture are expected to bring important private sector investments and create jobs. In addition to providing employment opportunities and income generation to local communities, the provision of a regulatory framework for aquaculture is expected to provide new reliable and affordable supply of food products. Finally, impacts on small scale fishermen are expected to be limited to some navigational inconvenience as fishing boats need to share space with offshore cage installations. Actual fishing success and local biodiversity are expected to increase, driven by nutrient outfalls and the animals and plants that grow on submerged structures.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

97. **The Government has made significant strides in developing a framework for environmental management and mainstreaming environmental sustainability in projects**. Article 30 of the environmental protection law no. 86/IV/93 imposes EIA on all projects and Article 33 imposes environmental licensing. The

Cabo Verdean regulatory framework does not include scoping, but the Environmental Information System provides guidance on the structure of the EIA, and law no.14/1997 determines the content of an EIA report. Decree-Law no. 27/2020 provides a key comprehensive upgrade on the types of evaluations and projects classifications as well as enforcement mechanisms. The National Directorate of Environment (*Direcção Nacional do Ambiente,* DNA) in the Ministry of Agriculture and Environment reviews and clears EIA documents. The DNA has been improving in its capacity to enforce and monitor implementation of EIA recommendations.

98. **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 strengthening of the social protection system to respond to climate shocks, the expansion of the FNE mandate, 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.

99. **The strengthening of the social protection system to respond to climate shocks, the expansion of the FNE mandate, 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 establishment of a shock-response safety net framework (*Prior Action 4*) would raise the resilience of vulnerable households to climate-related shocks. Targeted drought response activities funded through the FNE (*Prior Action 5*) would provide small scale water management facilities such as irrigation canals and water tanks and ultimately improve water management capacities. The power sector reform plan (*Prior Action 7*) would improve operational efficiency of the utility and reduce electricity system losses, which would decline from 26.1 percent in 2020 to 25 percent in 2023 and reach 23 percent in 2024. The reduction in commercial losses is split between higher sales for the utility (by regularizing customers) and reduced demand (by providing a price signal for electricity consumption). This implies lower generation which, in power systems strongly relying on thermal generation such as Cabo Verde's, will result in reduced GHG emissions. Although the expansion of tourism might impact water demand (and availability), energy demand (and sourcing), and waste generation, among others, support to the decrees regulating licensing of tourism accommodations and service providers (*Prior Action 8*) will require the use of the environmental management framework in the expansion of the tourism activities, thereby ensuring a sustainable use of natural resources while enhancing climate adaptation in line with the ENRRD. Finally, the development of the regulatory framework for Aquaculture (*Prior Action 9*) will also contribute to climate adaptation, as recognized in the country's 2020 updated NDC, noting that aquaculture is to provide a buffer to mitigate the volatility that climate change could impose on marine fisheries. The specific list of eligible fisheries for aquaculture listed in the PA enables the exploration of mostly endogenous species deemed viable in the Cabo Verde context, thereby supporting the adaptation contribution #4 under the NDC, notably on the topic of reduction of local overfishing pressure in addition to tapping into overall import fisheries substitution potential as well as corresponding employment generation and food security gains.

100. **The remaining prior actions supported by the operation are not likely to have negative impacts on Cabo Verde's environment, natural resources and forests.** They do not support direct investment in environmentally impactful areas and do not involve policy actions with significant environmental consequences.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

101. **The significant strengths in Cabo Verde Public Financial Management (PFM) system have been maintained and reinforced to date.** Strong progresses documented in the Public Expenditure and Financial Accountability (PEFA, 2015) report with respect to the comprehensiveness and transparency of the budget, policy-based budgeting, internal controls, as well as accounting and reporting has been maintained in 2021. The authorities continue to make significant efforts in devolving some budget responsibilities to line ministries. General Directorates of Planning, Budget and Management *(Direcção Geral de Planeamento, Orçamento e Gestão,* DGPOG) are in placed in sectoral ministries to support the decentralization of PFM and manage the control aspects for proper budget execution. The Financial Management Information System (FMIS) has been revamped through the introduction of Integrated Budget and Financial Management System (*Sistema Integrado de Gestão Orçamental e Financeira*, SIGOF). This has given authorities a strong management tool that has the potential to speed up budget execution, develop accountability mechanisms and boost the quality of reporting. In addition to the law detailing the rules and procedures for budget execution, SIGOF has its own set of controls in place contributing to better expenditures commitment control. As a result, no expenditure can be placed in the system if it is not budgeted for and treasury cash available. The secondary controllers also play an important role as authorizers within the expenditure processing system (i.e., acting as an internal control function). Internal audit is done by the General Inspectorate of Finance (*Inspeção Geral das Finanças,* IGF), a unit under the MoF organizational structure. A risk- based approach has been adopted and ex-post reviews of transactions are regularly performed.

102. **The Government's budget is now publicly available on the MoF's website, as are quarterly budget-execution reports.** The merger of the Ministries of finance and planning and the introduction of program-based budgeting enhanced the linkage between the national plans and strategies and the budget, which is being continually reinforced. Significant progress has also been made over the last few years in implementing a Treasury Single Account (TSA). Several bank accounts have been closed, and payment systems have been modernized through near-full automation. Cash and debt management have also been reinforced.

103. **The national budget credibility that has been weakened by the COVID-19 crisis should be improved to strengthen the alignment between actual spending and the government's development agenda.** Minimizing the budget execution deviations, increasing the transparency in the in-year reallocation of funds, and effective enforcing of recommendations of the auditor general highlighted in the PEFA assessment are areas requiring strengthening.

104. **The foreign exchange control environment:** The review of the 2019, 2020 and 2021 audited financial statements of the Central Bank of Cabo Verde (*Banco de Cabo Verde,* BCV) revealed that there is an acceptable foreign exchange control environment. The BCV financial statements are annually audited by external auditors and the report published on the external website. The external auditor issued an unqualified opinion on the 2019, 2020 and 2021 financial statements. According to the external auditor, the accompanying financial statements are fairly and appropriately presented, in all material respects. The BCV's financial position on December 31, 2021, ended in accordance with the accounting principles applicable to the BCV. However, the auditor highlighted capital losses leading to negative equity. The auditor has recommended that the Government provide the BCV the amount necessary to correct the deficit.

105. **Procurement**: Cabo Verde has a long history of good governance, including its procurement system

currently regulated by the procurement code of April 2015. The legal framework, based on international standards, is supported by a solid institutional arrangement, with an independent public procurement regulatory authority (*Autoridade de Regulação das Aquisições Públicas* – ARAP) which certifies and oversees the procurement units (*Unidades de Gestão das Aquisições* – UGA) established in all procuring entities (central and local governments, public institutions). A control body is in place at the MoF, where there is also a centralized procurement management unit for procurement of goods and services for a group of procuring entities (vehicles, IT equipment, maintenance, cleaning and security services). The system is complemented by an independent complaint review body (*Comissão de Resolução de Conflitos* – CRC). ARAP has a website easily and freely accessible (www.arap.cv) where all information, legislation, standard bidding documents, standard form of contracts, decisions by CRC are posted. ARAP also provides procurement training for the procuring units (UGAs, UGAC) and for the private sector. A strategic plan for the period 2022 to 2026 can also be found in ARAP's website. Cabo Verde has developed an in-house e-Procurement platform. The platform is ready for deployment, and this will be supported by a project funded by the AfDB. The World Bank is working in close collaboration with local authorities and the AfDB in the follow-up of procurement reforms.

106. **The proposed operation would consist of a single tranche of US$42.5 million equivalent, of which US$20 million equivalent will be from the SUW-SML, to be made available upon effectiveness and disbursed based on a withdrawal application and a US$10 million equivalent Cat-DDO which disbursement will be triggered by the achievement of the condition specified in the financing agreement**.

107. **The proposed DPF portion of the credit will be disbursed following the standard IDA procedures for DPF operations**: The credit will follow the World Bank's disbursement procedures for DPF. Once the credit becomes effective and provided IDA is satisfied with the country's macroeconomic framework and with the program being carried out by the Recipient, the credit will be deposited at the BCV into an account that forms part of the country's official foreign-exchange reserves. The recipient shall ensure that upon the deposit of the credit into said account an equivalent amount in Cabo Verdean Escudos (CVE) is credited in the Recipient's budget management system in a manner acceptable to IDA. The Recipient will report to IDA on the amounts deposited in the foreign-currency account and credited to the budget-management system. If the proceeds of the credit are used for the ineligible purposes, as defined in the General Conditions (as revised on July 14, 2017), IDA will require the Recipient to refund an amount equal to the amount of said payment to IDA promptly upon notice from IDA. Amounts refunded to the World Bank upon request shall be cancelled.

108. **The MoF will follow disbursement procedures of the World Bank to handle the DPF with Cat DDO proceeds.** Credit proceeds will be disbursed if the pre-specified trigger defined in the financing agreement is met and will not be tied to any specific purchase. Once the operation is declared effective, if drawdown conditions for a natural catastrophe are met and a "*State of Calamity"* is declared, MoF may submit a withdrawal application requesting the World Bank to deposit the proceeds of the Credit into the budget account that forms part of the country's official foreign exchange reserves held with the Central Bank and acceptable to the World Bank. Further information of the drawdown triggers, financial features, drawdown period, and renewals are detailed in the financing and loan agreements. The Government will ensure that upon receipt of the Credit proceeds, an equivalent amount will be credited in the Government's budget management system to finance budgeted expenditures.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

109. **The National Directorate of Planning (*Direção Nacional de Planeamento,* DNP) at the MoF will be responsible for the overall implementation of the proposed operation and for reporting on its progress.** The World Bank will review the prior conditions for effectiveness and disbursement. It will be the responsibility of the DNP to present this information in a timely manner and in a format satisfactory to the World Bank.

110. **The monitoring and evaluation (M&E) system remains the same as in previous DPF operations.** M&E activities will be anchored in the attached policy matrix (Annex 1). Since the previous DPF series, the World Bank team has worked in close collaboration with the Government and its budget support partners to ensure adequate M&E 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 result information. The collection, quality control and sharing of administrative data across Government agencies is problematic and household surveys are not designed to track the results of Government programs. 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 in ensuring 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.

111. ***Grievance Redress.*** Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a World Bank Development Policy Financing may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Project affected communities and individuals may submit their complaint to the Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, as a result of Bank non-compliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit *http://www.worldbank.org/GRS*. For information on how to submit complaints to the Bank's Accountability Mechanism, please visit *https://accountability.worldbank.org*.

6. SUMMARY OF RISKS AND MITIGATION

112. **The overall risk rating for the DPF series is substantial.** This reflects a range of macroeconomic, sectoral, and implementation capacity risks, all of which could compromise the success of the proposed operation (Table 8). The following sections describe risks that are considered high and substantial, after proper mitigation measures have been put in place.

113. **Macroeconomic risks are high and depend primarily on the surge of new COVID-19 variants, the Ukraine war, and disaster and climate-related shocks**. Fiscal and debt sustainability may deteriorate with an increase in the duration or scope of the Ukraine war, which could intensify inflationary pressures in food and energy, thereby increasing food insecurity and leading to the extension of policy support to ameliorate its impact on the most vulnerable. In this scenario, the projected start of the fiscal consolidation process could be delayed. Risks are compounded by potential delays in SOE reform efforts due to political pressures against fiscal consolidation. Financial support to the SOE sector could also increase, leading to a further deterioration in the fiscal deficit and delaying the projected decline in public debt. Natural shocks, such as drought, floods, or volcanic eruptions, remain an important source of risks, which could increase fiscal pressures and result in fiscal slippages. The impact of such a scenario would be compounded as fiscal buffers have been exhausted. However, the authorities remain committed to continuing to improve fiscal and debt management, with a view to lowering the debt burden and enhancing the provision of public services over the medium term. 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. Authorities are committed to restructuring SOEs over the medium term.

114. **Risks related sector strategies and policies are substantial.** Cabo Verde has made important strides in raising the capacity of the public service. However, significant deficiencies exist in some areas. Achieving the objectives supported by this operation will require strict fiscal discipline and sustained implementation of complex reforms. In the past, limited technical capacity and insufficient proactivity have allowed key SOEs to set the pace for reforms, but the establishment of a relatively strong SOE unit has proved effective in supporting recent achievements. Furthermore, the design of the proposed operation seeks to mitigate capacity risks by: (i) concentrating on policy reforms that have benefitted from or are the subject of ongoing policy dialogue with the WBG; (ii) supporting policy reforms that leverage other WBG operations; and (iii) providing TA either directly or jointly with other development partners in selected areas.

115. **Institutional capacity for implementation risks is high.** The Government has shown its commitment to the DPF-supported reform agenda. However, the effectiveness of this commitment and the Government's ability to manage political and institutional pressures going forward are not assured. The reforms undertaken by the Government may be politically sensitive. Overall, the history of SOE reforms in Cabo Verde is long and complex and previous reforms have been derailed by inaction or powerful interest groups. Political interference also remains a substantial risk to the success of this operation as it may undermine Government willingness to sustain reforms. To mitigate these risks, the World Bank is supporting reforms which, while difficult, benefit clearly from strong champions in the current administration and a strong momentum. Significant technical support has already been provided by the World Bank to inform the reform agenda with strong involvement of the national counterparts. The Government has also adopted a consultative approach to build consensus around the reforms being pursued. Regular consultations, including through the semiannual BSG coordination meetings, ensure proper coordination.

Table 8: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Moderate
2. Macroeconomic	High
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	High
6. Fiduciary	Moderate
7. Environment and Social	Moderate
8. Stakeholders	Low
9. Other	
Overall	Substantial

ANNEX 1: POLICY AND RESULTS MATRIX

Prior Actions under DPF 1	Prior Action under DPF 2	Result Indicator	Baseline (2020)	Target (year)
Pillar A: Reduce Fiscal Risks, Improve Debt Transparency, and Tackle Climate-related Shocks.				
Prior Action #1: To improve public debt transparency and strengthen FRM, the Recipient has issued a Regulatory Decree No. 5/2021, dated October 29, 2021, mandating (i) the quarterly publication of the debt bulletin; (ii) the publication of the medium-term debt management strategy; and (iii) the inclusion of a FRS in the Budget Report.	**Prior Action #1:** To further increase debt transparency, the Recipient has issued a regulatory decree broadening the coverage of public debt in the annual debt bulletins to cover the nonfinancial public sector (central Government, SOEs, and municipalities).	**Result Indicator #1:** Sectoral coverage score in the World Bank debt reporting heat map (text).	Partial	Full (2023)
Prior Action #2: To manage fiscal risks from the SOE sector, the Recipient has issued a Ministerial Resolution No. 48/2021, dated October 15, 2021, mandating (i) the quarterly publication of the SOE sector bulletin; and (ii) the inclusion of a fiscal risk assessment in the quarterly and annual SOE sector bulletins.	**Prior Action #2:** To further strengthen FRM, the Recipient has issued a statement of the ministerial order setting out relevant criteria to assess the credit risk of guarantees' beneficiaries and the basis for charging fees, requiring collateral, and instituting a reserve fund.	**Result Indicator #2:** Support to SOEs (capitalization, guarantees, on-lending) above what is established in the annual budget (percentage).	30	10 (2023)
	Prior Action #3: To further strengthen the management of fiscal risks associated to disaster and climate-related shocks, the Recipient has issued a resolution mandating (i) the assessment of contingent liabilities associated to disaster and climate risks and (ii) its inclusion in the annual FRS.	**Result Indicator #3:** Share of annual average loss from disaster and climate-related risks covered under the existing risk financing instruments (percentage).	14	>50 (2025)
Pillar B: Strengthen the Resilience of Poor and Vulnerable Households to shocks, particularly droughts.				
Prior Action #3: To support the poorest and most vulnerable population to cope with the protracted economic impact of the COVID-19 crisis, the Recipient has issued Resolution No. 14/2021, dated February 9, 2021, expanding the Social Inclusion Income for Emergency (RSIE) to households from the poorest quintile not yet covered and all households in the second poorest quintile with children under the age of 15.	**Prior Action #4:** To increase the resilience of the most vulnerable population to external shocks, including droughts, the Recipient has enacted a decree establishing a shock-responsive safety net framework, indicating its features, implementation processes, roles, and responsibilities.	**Result Indicator #4:** Female-headed households benefitting from temporary income support in response to shocks, including climate-related, through emergency cash transfer programs (cumulative number).	4,578	20,800 (2023)

Prior Actions under DPF 1	Prior Action under DPF 2	Result Indicator	Baseline (2020)	Target (year)
	Prior Action #5: To increase the resilience of vulnerable households to droughts, the Recipient has amended the decree-law establishing the FNE to expand the eligible expenditures financed by the FNE, enabling drought-related emergency response and recovery activities.	**Result Indicator #5:** FNE audit report produced and published by the Court of Account including evaluation of drought response expenditures (yes/no).	N/A	Yes (2025)
Prior Action #4: To improve the usability and the crisis response capabilities of the social protection system, the Recipient's Ministry of Family and Social Inclusion has issued Directive No. 34/2021, dated April 15, 2021, requiring municipalities to register informal workers, identified through the COVID-19 Emergency Cash Transfer Program for Informal Workers (RSO), into the CSU.	**Prior Action #6:** To improve the coordination of social programs and the efficiency of targeting the poor and most vulnerable, the Recipient has (i) issued a regulatory decree, which amends the regulatory decree No. 7/2018 to mandate social programs using the social registry to provide feedback data; and (ii) issued a ministerial order, which instructs the PRH to focus support to households in group I and II in the CSU.	**Result Indicator #6:** Additional households identified using the social registry that are from the two poorest quintiles (percentage).	0	50 (2023)
Pillar C: Enable a Sustainable Private Sector-Led Recovery				
Prior Action #5: To promote private investment, improve operational performance, and reduce GHG emissions in the electricity sector; the Recipient has approved the restructuring and public divesture of the electricity utility company through the Decree-Law No. 52/2021, dated July 21, 2021.	**Prior Action #7:** To implement the power sector restructuring, the Recipient has enacted a decree-law to (i) mandate ELECTRA's disinvestment from power sector activities; and (ii) vertically unbundle the power sector by creating a thermal electricity generation company, an electricity distribution company, and an electricity system operator company.	**Result Indicator #7:** Improved ELECTRA's commercial operational performance: Overall system losses (percentage).	26.1	21 (2025)
Prior action #6: To promote environmentally sustainable investments in the tourism sector, the Recipient has approved Decree-Law No. 87/2020, dated December 18, 2020, regulating the process to approve construction projects in Integrated Tourism Development Zones (*Zonas de Desenvolvimento Turístico Integrado*, ZDTIs) and the relevant licensing process.	**Prior action #8:** To modernize the tourism regulatory framework and in line with the ENRRD strategy, the Recipient has adopted three decree laws stipulating (i) updated licensing requirements for tourism accommodation operators, including disaster and climate risk considerations; (ii) a legal regime for tourism and hospitality establishments in rural areas; and (iii) updated rules and norms for tourism service providers.	**Result Indicator #8:** New tourism investment projects approved in ZDTIs, in compliance with the corresponding *POTs* and with approved environmental impact assessments (percentage of total number of new investments in ZDTIs).	N/A	100 (2023)
Prior action #7: To attract sustainable and environmentally responsible private sector investment in fisheries, the Recipient has approved Decree-Law No. 15/2021, dated February 9, 2021, regulating aquaculture.	**Prior action #9:** To promote the development of the fisheries sector and sustainable use of marine and coastal resources, the Recipient has issued a ministerial order approving the list of eligible species for aquaculture activities.	**Result Indicator #9:** Total investments generated in aquaculture – cumulative (US$ million).	6	9 (2023)

ANNEX 2: IMF RELATIONS

IMF Executive Board Approves US$60 Million Extended Credit Facility Arrangement for Cabo Verde

June 15, 2022

- IMF Board approves SDR 45.03 million (about US$60 million) three-year ECF arrangement for Cabo Verde, with SDR 11.26 million (about US$15 million) available for immediate disbursement.
- The financing package will help mitigate the lingering impact of the COVID-19 pandemic and the spillover effects of the war in Ukraine; reduce the fiscal deficit and preserve debt sustainability; protect vulnerable groups; and support a reform agenda that leads to higher and more inclusive growth.
- Key policy actions under the program include measures to boost revenue and improve the efficiency of spending, strengthen state-owned enterprises to mitigate fiscal risks, as well as measures to continue modernizing the monetary policy framework and safeguarding financial stability.

Washington, DC: On June 15, 2022, the Executive Board of the International Monetary Fund (IMF) approved a 36-month arrangement under the Extended Credit Facility (ECF) for Cabo Verde in an amount equivalent to SDR 45.03 million (190 percent of quota or about US$60 million). The ECF arrangement will help shore up international reserves, preserve debt sustainability, increase resilience to shocks, including from climate change, and make growth more inclusive. The program will help fill financing gaps together with the support of continued financing from Cabo Verde's development partners.

Approval of the ECF arrangement enables immediate disbursement of SDR11.26 million (47.5 percent of quota, about US$15 million), fully usable for budget financing, in order to support the implementation of the reforms. This follows Fund emergency support to Cabo Verde in April 2020 under the Rapid Credit Facility (100 percent of quota, SDR 23.7 million, equivalent to US$32.3 million at the time of approval).

Cabo Verde's economy is facing significant challenges associated with the lingering effects of the global pandemic, as well as rising food and fuel prices due to the war in Ukraine and the impact of the ongoing five-year drought. The economy rebounded strongly in 2021 following the COVID-19 induced sharp recession in 2020 (about 15 percent contraction), and recorded growth of 7 percent, which was supported by the easing of international travel restrictions, and the country's highly successful vaccination program (one of the most successful in Africa). However, the spillover effects of the war in Ukraine are expected to weaken the economic recovery and the growth forecast has been revised downward from 6 percent to 4 percent in 2022. Higher commodity prices and weaker than earlier expected prospects for the tourism sector are projected to result in a significant widening of the current account deficit to about 14.1 percent of GDP in 2022, as well as lower international reserves. The overall fiscal deficit is expected to continue to improve to 6.3 percent of GDP in 2022, from 7.3 percent of GDP in 2021.

The ECF arrangement has four main objectives that are aligned with the government's medium-term economic development plan (PEDS). First, strengthening public finances to preserve public debt sustainability and expand social safety nets. Second, reducing fiscal risks from public enterprises and improving their financial management and transparency. Third, modernizing the monetary policy framework and improving the resilience of the financial system. Fourth, raising growth potential and building resilience to shocks through structural reforms and economic diversification.

At the conclusion of the Executive Board's discussion, Mr. Bo Li, Deputy Managing Director and Acting Chair, made the following statement:

"Cabo Verde showed a strong track record of commitment to reforms and macroeconomic stability before and during the pandemic, which contributed to a strong rebound of the economy following the COVID-19 induced recession. However, the spillover effects of the war in Ukraine, the lingering effects of the pandemic, and the impact of the ongoing five-year drought have weakened economic recovery and resulted in increasing financing needs.

"The new Fund-supported arrangement will support the authorities' priorities to preserve debt sustainability, shore up international reserves, increase resilience to shocks, including from climate change, and make growth more inclusive. The reform agenda will be supported by a well-tailored capacity development strategy which is aligned with the program.

"The key strategy focuses on gradual and growth-friendly fiscal consolidation to place public debt on a decisive downward path and maintain debt sustainability. Fiscal policy will also be guided by the need to increase social spending to protect vulnerable groups. Implementing fiscal structural reforms, including strengthening the tax administration, enhancing public financial management, and reforming state-owned enterprises, will help boost revenue, enhance the efficiency of public spending, and reduce fiscal risks. The authorities' initiatives to further enhance fiscal transparency and governance should continue.

"Modernizing the monetary framework and strengthening the financial sector will help safeguard financial stability and the peg. Bolstering international reserves, carefully unwinding crisis-related support measures, closely monitoring non-performing loans, and further strengthening the AML/CFT framework, will be critical measures in this regard.

"Steadfastly implementing the authorities' development plan will improve the business environment and help support private sector-led growth. Considering Cabo Verde's high vulnerability to the effects of climate change, the planned bold steps to climate adaptation will be key to boost the economy's resilience and growth potential."

ANNEX 3: LETTER OF DEVELOPMENT POLICY

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Mr. David Robert Malpass
President of the World Bank Group
Washington, DC

N. Ref: 339 /GVPMMFFE/2022
Praia, September 27th, 2022

Subject: Policy Development Letter - "Second Resilient and Equitable Recovery DPF with a CAT DDO"

Excellency,

In the course of implementing the Strategic Plan for Sustainable Development (PEDS) 2017-2021, and prior to the COVID-19 pandemic, Cabo Verde had made great strides in completing reforms, with considerable gains at the economic, social, and at the management level of public finances. The results of this trajectory had placed social and macroeconomic indicators at historically high levels.

At the same time, considerable achievements under the Government's ambitious reform agenda reduced our country's vulnerabilities and improved its prospects for sustainable, inclusive, and private sector-led growth. In fact, economic growth was robust, fiscal deficits and public debt were on a clear downward trend, the external position improved, **inflation was moderate** and international reserves were at a comfortable level. Led by the fast-growing tourism sector, with the implementation of the PEDS, annual average growth of about 4.7 percent was recorded during the period 2016-2019. Sound fiscal policies, supported by reforms, resulted in a gradual improvement in the fiscal position

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and debt was placed on a downward path. The balance of payments improved, as FDI into the tourism sector increased, tourism receipts improved, and remittances emerged as a stable source of foreign exchange. As a result, gross official reserves increased to 9.0 months of prospective import cover by end 2019.

The global pandemic reversed some of these gains and delayed the implementation of some reforms, as the Government had to focus its attention on responding to the health and economic consequences of the pandemic. Output contracted by about 15 percent in 2020, the largest contraction in Cabo Verde's post-colonial history. Stringent travel restrictions and other COVID-19 containment measures reduced activity in the critical tourism and transportation sectors, and generated negative spillovers to other domestic sectors. This was accompanied by a large deterioration in the fiscal account partly due to increased spending in response to the pandemic, from a deficit of 1.7 percent of GDP in 2019 to 9.1 percent of GDP in 2020 and with public debt rising to 143 percent of GDP in 2021, although a significant share of it is at highly favorable concessional terms. The external current account weakened sharply to a deficit of 15 percent of GDP in 2020, despite the decline in imports and stable remittances, because of the unprecedented contraction in tourism receipts.

In response to the global pandemic, a series of fiscal and monetary policy measures were introduced in Cabo Verde to preserve lives and support livelihoods. The first Cat DDO was fully disbursed in May 2020 representing the first source of external financing received to support the Government's early response to the COVID-19 pandemic. In addition, we had one of the most successful vaccination programs in sub-Saharan Africa, with over 95 percent of the adult population having received one dose, and about 85 percent fully vaccinated having received two doses of the vaccine. These actions have set the stage for the ongoing recovery in economic activity and paved the way for an acceleration of reforms.

The external current account deficit is estimated to have narrowed from 15 percent of GDP in 2020 to 11.3 percent of GDP in 2021 as exports increased and recovered from

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the contraction recorded in 2020. The strong rebound in exports more than offset the 10 percent increase in the imports of goods and services that supported the economic rebound. Gross international reserves increased from €582.4 million in 2020 to €591.3 million in 2021 (about 6.3 months of prospected imports) supported by the SDR allocation, external loan disbursements, and financial flows associated with the recovery in tourism receipts.

However, Cabo Verde's robust recovery, which started in 2021, is under threat due to the spillover effects of the war in Ukraine. The steep increase in international energy and food prices and weakened growth outlook for the world economy, including the euro area, is expected to affect Cabo Verde's near-term growth prospects, and weaken our fiscal and external positions. As a result, international reserves will come under pressure and challenge the pegged exchange rate regime that has served the country well.

In May, the average annual inflation increased to 4.9% (year-on-year 7.8%), reaching the highest rate since December 2007. In terms of the main essential food products, prices in the month of May, in annual terms, suffered significant increases, especially in cooking oil (92%), sugar (40%), corn (27%), rice (21%), wheat flour (28%) and bread (28%).

As a result of disruptions to international supply chains and repeated drought episodes that limited domestic production in recent years, Cape Verdean families are faced with a drastic fall on essential food purchasing power, i.e., there is a considerable decrease in financial access to food, especially by the segments of the population living in poverty and extreme poverty. Consequently, the country is facing a deteriorating food and nutrition security situation. The latest analysis made in March 2022 and summarized in the Harmonized Framework for Food and Nutritional Security, shows that due to this situation, 9% of the Cabo Verdean population (30,497 people, which corresponds to about 7,624 households) are in stage 3 (population in a food crisis situation), when in 2020 the data indicated that only 2% of the population (10,995 people) was in this situation. The same analysis indicates that if mitigating measures are not taken, the situation will worsen,

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projecting that for the month of August/2022, 11% of the population will be in a food crisis phase (46,000 people).

Concerns about rising energy costs and food security have led the government to strengthen Cabo Verde's resilience and reduce energy and food prices for families, leading to a higher pressure on public expenditures at a time of a very restrained fiscal space and budget inflexibility. The total estimated cost of the measures to be implemented for the mitigation of the impacts derived from the rise in fuel and food prices due to the Russian-Ukrainian war amounts to EUR 80 million, corresponding to 4.15% of the GDP. Among the main measures to mitigate the effects of the external market prices are measures targeting the most vulnerable groups and aimed at strengthening the food system (including maintaining the price level of essential goods), measures to contain the rise of energy prices, the increase of beneficiaries on social pension and Social Integration Income.

Mr. President,

Before the pandemic crisis, the Government was also pursuing efforts to improve the investment climate, facilitating access to finance for Micro Small and Medium Enterprises (MSME), and increasing the productivity and the competitiveness of the economy. For such, the Government created a financial eco-system to address and overcome market failures for successful MSME funding. The three institutions created (Proempresa, ProCapital and Progarante) manage programs of technical assistance, venture capital, and partial guarantee schemes to ease access to finance for the MSME. These institutions complement each other to offer a holistic solution to MSME, which are agents of growth and job creation. This financial ecosystem institution has gained consistency and adherence, having eased access to lines of credit with disbursement of over CVE 1 billion by the end of 2019.

The Government also improved the efficiency and rigorous management of the State-Owned (SOE) sector and accelerated the implementation of privatizations, concessions, and public-private partnerships. Before the pandemic, and with the support of the World

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Bank, the SOE sector had recovered significantly from negative net results in 2015 to positive net results.

Furthermore, Cabo Verde has consolidated tourism as the engine of economic growth. Tourism's direct contribution to GDP reached 22% in 2019. Despite its importance, as shown during this pandemic crisis, tourism needs to be diversified with a larger number of operators, a more diverse set of tourists, and greater linkages to the economy. These challenges are being addressed. The country's high level performance is well captured in the evaluation report of the Policy Coordination Instrument (PCI) of the International Monetary Fund. It notes that "Cabo Verde's macroeconomic performance has been impressive under the implementation of the authorities' PEDS. In order to strengthen the improvement in the management of public finances, the government has agreed on a new program with the IMF for 2022 to 2025.

The Government has implemented sound macroeconomic policies. While priority was given to addressing the impact of the health crisis, policies and reforms remained also focused on maintaining medium-term fiscal and debt sustainability and enhancing further the country's growth potential and resilience to shocks. In this context, the Government produced a long-term development agenda (Cabo Verde Ambition 2030, CVA 2030) highlighting the main strategies for the 2030 horizon, aligned with the Sustainable Development Goals (SDGs). The CVA 2030 will underpin the preparation of five-year strategies (Strategic Plan for Sustainable Development, PEDS II and III) in support of the SDGs for Cabo Verde. The last PEDS expired in 2021, and PEDS II (which will be a continuation of the previous PEDS) will be in effect from 2022 to 2026 and will be completed in August 2022. The Government's policy and reform agenda will be driven by priorities under the PEDS and the Cabo Verde Ambition 2030. In the near term, economic policies will aim at minimizing the impacts of the pandemic, protecting employment and vulnerable groups, and supporting the economic recovery. In this context, the implementation of COVID-19 relief measures will continue to be carefully monitored. Over the medium term, the second Strategy for Sustainable Development

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(PEDS II, 2022-26) will guide the implementation of policies and reforms building on progress made in the last five years, with the following priority areas: (i) enhancing domestic revenue mobilization to rebuild the revenue base eroded by the global pandemic and improve performance; (ii) strengthening expenditure management and improving the execution of public investment projects; (iii) strengthen the E-Governance and modernization of public administration to increase efficiency and effectiveness in relations with families and the private sector and promote the productivity of public services (iv) advancing SOEs reforms to reduce fiscal risks and support medium-term fiscal and debt sustainability; (v) improving the monetary policy transmission mechanism; (vi) strengthening the financial system; (vii) increasing access to finance and improving the business environment to support private sector development and boost inclusive growth. In addition to these priority areas, PEDS II aims to put a particular focus on the development of human capital; diversification of the tourism sector and improvement of its linkages with non-tourism sectors, particularly agriculture and fishery; development of the blue and digital economy; and enhanced productivity in the agriculture sector.

A transversal priority since the PEDS I and strengthen in the upcoming PEDS II is building resilience of Cabo Verde to disasters and climate-related shocks. Due to its location and geography, our country is exposed to a wide range of hazards including volcanic eruptions, droughts, hurricanes, tropical storms, landslides, and flash floods. As a Small Island Developing State (SIDS), Cabo Verde is also highly vulnerable to these adverse natural events, which disproportionately affect the poorest and recurrently disrupt key productive sectors. Looking forward, climate change is expected to further intensify hydrometeorological hazards such as floods and droughts. Climate change will also bring unprecedent threats associated to sea-level rise, and ocean warming, which could undermine our natural capital upon which the main growth drivers, the tourism and blue economy sectors, rely upon. More frequent and intense disruptions to transportation networks could also further aggravate connectivity challenges. If no action is taken, these trends could undermine the country's sustainable developments prospects.

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Considering the above, the Government of Cabo Verde has embarked with the support of the World Bank since the first Cat DDO and with other development partners on a comprehensive reform agenda to increase the country's resilience to disasters and climate-related shocks. A first set of policy reforms is implemented at the sectoral level with the objective of ensuring risk-informed development planning and reducing exposure and vulnerability of physical assets to adverse natural events. Sectoral measures also focus on establishing a shock-responsive social protection system to support the poorest households to respond to climate-related shocks as well as expanding the mandate of the existing National Emergency Fund to support drought emergency response and recovery. A second set of measures seek to strengthen the management of fiscal risks associated to disasters and climate-related shocks. Leveraging upon the progress recorded during the first Cat DDO, the Government is focusing on incorporating these shocks to the overall fiscal risk management framework and increasing the Government's financial response capacity, while ensuring that the impacts of such shocks would not derail fiscal consolidation efforts.

In addition to increasing resilience to disasters and climate-related shocks and boosting the economy through the diversification of economic activities, Cabo Verde's development will be very much anchored in the development of human capital and in the efficiency of the Public Administration to respond to the demands of the private sector. In this sense, it is essential to implement a set of reforms in the Public Administration, which are unavoidable, in order to strengthen the economic recovery and increase the response capacity of the Government and local authorities. Therefore, it is essential to invest in new technologies, in order to increase government efficiency and promote transparency in the management of public resources.

In light of the above, Mr. President, World Bank budget support is of crucial significance to help mitigate triple crises (climate, COVID-19 and Ukraine war) effects on the Cabo Verdean economy and society. Moreover, the reforms supported by the budget support program will help the country relaunch the bases for economic recovery in the short term,

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by reinforcing the competitiveness of the economy, the efficiency of investments, supporting the promotion of private sector development and accompanying local economic development and decentralization.

Therefore, on behalf of the Government of Cabo Verde, I hereby request a budget support in the amount of US$42.5 million from the World Bank for 2022. Based on the successful experience of the first Cat DDO and the robustness of the climate resilience agenda in the proposed reform Program, we request to include a US$10 million Cat DDO option in this budget support operation to ensure having the possibility to quickly and efficiently mobilized resources in case of future natural catastrophes, including public health-related events.

To increase the readiness to respond effectively to future episodes of food insecurity, and in line with the requirements under the IDA Crisis Response Window for early response financing assigned to this operation, the Government hereby commits to develop a Food Security Crisis Preparedness Plan (FSCPP) within the next 12 months. The FSCPP will detail the institutional and operational arrangements for responding early to prevent and mitigate future food security crises.

We look forward to your continuous support to Cabo Verde's development and the wellbeing of its population.

Please accept, Excellency, the assurance of my highest consideration.

Vice Prime Minister, Minister of Finance
and Business Development

Olavo Correia

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Cc:

Mr. Alcindo Mota – Secretary of State of Finance – Ministry of Finance of Cabo Verde;

Ms. Adalgisa Vaz - Secretary of State of Business Development – Ministry of Finance of Cabo Verde;

Mr. Gilson Pina, National Director for Planning – Ministry of Finance;

Mr. José Luis Semedo – Chief of Staff to the Vice Prime Minister, Minister of Finance and Business Development;

Mr. Nathan Belete, Country Director, World Bank;

Ms. Eneida Fernandes, World Bank representative in Cabo Verde;

Mr. Daniel Reyes, Senior Economist, World Bank.

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar A: Reduce Fiscal Risks, Improve Debt Transparency, and Tackle Climate-related Shocks.		
Prior action #1: To further increase debt transparency, the Recipient has issued a regulatory decree broadening the coverage of public debt in the annual debt bulletins to cover the nonfinancial public sector (central Government, SOEs, and municipalities).	No	No
Prior action #2: To further strengthen FRM, the Recipient has issued a statement of the ministerial order setting out relevant criteria to assess the credit risk of guarantees' beneficiaries and the basis for charging fees, requiring collateral, and instituting a reserve fund.	No	No
Prior Action #3: To further strengthen the management of fiscal risks associated to disaster and climate-related shocks, the Recipient has issued a resolution mandating (i) the assessment of contingent liabilities associated to disaster and climate risks and (ii) its inclusion in the annual FRS.	No	No
Pillar B: Strengthen the Resilience of Poor and Vulnerable Households to Shocks, particularly Droughts.		
Prior action #4: To increase the resilience of the most vulnerable population to external shocks, including droughts, the Recipient has enacted a decree establishing a shock-responsive safety net framework, indicating its features, implementation processes, roles, and responsibilities.	Yes, positive. The establishment of a shock-response safety net framework would raise the resilience of vulnerable households to climate-related shocks (adaptation)	Yes, positive. The reform supports the temporal expansion of the emergency cash transfer to protect the most vulnerable in the case of occurrence of a climate-related shock among other covariate shocks.
Prior Action #5: To increase the resilience of vulnerable households to droughts, the Recipient has amended the decree-law establishing the FNE to expand the eligible expenditures financed by the FNE, enabling drought-related emergency response and recovery activities.	Yes, positive. Targeted drought response projects would provide water management infrastructure such as irrigation canals and water tanks and ultimately improve water management capacities (adaptation).	Yes, positive. The reform supports the financing of activities under the National Drought Response Plan supporting poor rural households and in the case of public health-related events.
Prior Action #6: To improve the coordination of social programs and the efficiency of targeting the poor and most vulnerable, the Recipient has (i) issued a regulatory decree, which amends the regulatory decree No. 7/2018 to mandate social programs using the social registry to provide	No.	Yes, positive. The reform strengthens the Social Registry to improve targeting to vulnerable and

feedback data; and (ii) issued a ministerial order, which instructs the PRH to focus support to households in group I and II in the CSU.		low-income households while expanding its coverage
Pillar C: Enable a Sustainable Private Sector-Led Recovery		
Prior Action #7: To implement the power sector restructuring, the Recipient has enacted a decree-law to (i) mandate ELECTRA's disinvestment from power sector activities; and (ii) vertically unbundle the power sector by creating a thermal electricity generation company, an electricity distribution company, and an electricity system operator company.	Yes, positive. The reform addresses commercial losses in electricity generation, which contribute to controlling electricity demand and reducing GHG emissions, given the carbon intensity of the generation system (mitigation).	No.
Prior Action #8. To modernize the tourism regulatory framework and in line with the ENRRD strategy, the Recipient has adopted three decree laws stipulating (i) updated licensing requirements for tourism accommodation operators, including disaster and climate risk considerations; (ii) a legal regime for tourism and hospitality establishments in rural areas; and (iii) updated rules and norms for tourism service providers.	Yes, positive. The reform supports the effective implementation of an overarching regulatory framework that seeks, among others, to promote environmental protection and climate adaptation in the tourism sector (adaptation).	Yes, positive, through job creation in the islands more affected by the COVID-19 crisis.
Prior Action #9: To promote the development of the fisheries sector and sustainable use of marine and coastal resources, the Recipient has issued a ministerial order approving the list of eligible species for aquaculture activities.	Yes, positive. Investment in aquaculture will provide a buffer to mitigate the volatility that climate change could impose on marine fisheries (adaptation).	Yes, positive. Private investment in the aquaculture sector will promote job creation.

ANNEX 5: DPF PRIOR ACTIONS AND ANALYTICAL UNDERPINNINGS

Prior Actions	Analytical Underpinnings
Pillar A: Reduce Fiscal Risks, Improve Debt Transparency, and Tackle Climate-related Shocks.	
1-3	• Cabo Verde 2016 Debt Management Performance Assessment (DeMPA). • Tailored TA to improve the assessment of credit risk from SOEs, and production of risk indicators for the debt management bulleting. • Cabo Verde Fiscal Risk Assessment (2021). **Key findings:** The DeMPA highlighted that the draft of a new consolidated debt management law is an opportunity for improving effective debt management in Cabo Verde.
Pillar B: Strengthen the Resilience of Poor and Vulnerable Households to Shocks, particularly Droughts.	
4-5	• Protecting People and Economies: Integrated Policy Responses to COVID-19 (World Bank 2020). • Social Protection and Jobs Responses to COVID-19: A Real-Time Review of Country Measures (World Bank 2020). **Key findings**: Use of existing structures especially where there are social safety nets in place is the preferred social policy response. RSIs are the most widely used interventions by Governments for social assistance.
6	• Bowen, T. et al, 2020. "Adaptive Social Protection: Building Resilience to Shocks." World Bank. • Felipe et. al. 2017, *Social Registries for Social Assistance and Beyond: A Guidance Note & Assessment Tool*, Discussion Paper No. 1704. • Monsalve, 2019, "Social Protection System in Cape Verde". **Key findings:** Social registries can enhance their relevance for adaptive social protection by expanding into certain areas prone to shocks, but also by ensuring data on those vulnerable to shocks and their capacity to cope
Pillar C: Enable a Sustainable Private Sector-Led Recovery	
7	• Report on ELECTRA restructuring financed by Project CV-Recovery &Reform of Electricity Sector - (P115464). • Implementation report for the Action Plan for Sustainable Reduction of Commercial Losses of ELECTRA, supported under the Cabo Verde Recovery and Reform of the Electricity Sector project (P115464). • Cabo Verde master plan for the electricity sector (2018-2040). **Key findings**: The PwC report provides a roadmap for the restructuration and privatization of the utility company. The implementation report provides the status of the activities and challenges in the implementation of the program.
8	• World Bank (2014). Establishing a Tourism Ministry, Board or Institute? Selecting and Institutional Arrangement to Promote Tourism Growth in Cabo Verde. • World Economic Forum (2019). The Travel and Tourism Competitiveness Report 2019 Travel and Tourism at a Tipping Point. **Key findings:** The needs and gaps assessment in the tourism sector remains substantial, particularly with regards to the policy and regulation vacuum. Bottom-up planning, particularly zoning, has been a challenge as most of the existing tourism land bank plots do not have the proper zoning plans nor have any link with the island tourism masterplans.
9	• Government of Cabo Verde (GoCV) (2020). National Investment Plan for the Blue Economy. • GoCV (2020). Blue Economy Promotion Program. • GoCV (2019). Unified Strategic Framework for the Blue Economy. • FAO (2010). National Aquaculture Strategic Framework for Cabo Verde. **Key findings:** Government's commitment to provide increased support to the aquaculture sector is a prerequisite for the sector's sustainable development. Therefore, the need for a suitable framework for the development of the sector