Cabo Verde
Economic Update

Rebounding from the Crisis

Restoring Fiscal Sustainability and Leveraging the Private Sector for a more Resilient and Sustainable Recovery

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Preface

The objective of this report is to provide an update to the Government of Cabo Verde, think-tanks and researchers, and the public on the state of the Cabo Verde economy and its outlook, together with the structural reforms required to strengthen the foundations for private sector-led recovery from the COVID-19 crisis. The report begins with a chapter on recent economic developments, the medium-term outlook, and risks. It includes sections on growth, fiscal policy, public debt, the external sector, monetary developments, and inflation. The second chapter stresses the importance of improving the investment climate to leverage the role of the private sector for an inclusive economic recovery. It provides an overview of key challenges and actionable policy priorities around foreign direct investment, the business environment, and competition.

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Contents

List of Tables, Figures, and Boxes

Acronyms and Abbreviations

AdS	Aguas de Santiago SA	IPA	Investment Promotion Agency
ARAP	Autoridade Reguladora das Aquisições Públicas	KPI	Key Performance Indicator
ASA	Aeroportos e Segurança Aérea	M&E	Monitoring and Evaluation
BCV	Banco de Cabo Verde	MoJ	Ministry of Justice
CAD	Current Account Deficit	MSME	Micro, Small, and Medium Sized Enterprises
CCM	Competition Commission of Mauritius	NOSi	Public Agency for Information Technology
CPI	Consumer Price Index	NPL	Non-performing Loans
CVA	Cabo Verde Airlines	OECD	Organization for Economic Co-operation and Development
CVE	Cabo Verdean Escudos	OSS	One-Stop-Service for businesses
DSSI	Debt Service Suspension Initiative	PEDS	Strategic Plan for Sustainable Development
ECOWAS	Economic Community of West African States	PPG	Public and Publicly-Guarantee
ELECTRA	Empresa de Electricidade e Água	PPP	Purchasing Power Parity
ENAPOR	Empresa Nacional de Portos	PPPs	Public-Private Partnerships
EPA	Export Promotion Agency	SDTIMB	Sociedade de Desenvolvimento Turístico das Ilhas da Boa Vista e do Maio
ESA	External Stability Assessment	SIDS	Small Islands Developing States
EU	European Union	SIPP	Sistema de Informação Processual e Penal
FDI	Foreign Direct Investment	SIRC	Integrated Commercial Registry System Software
GCI	Global Competitiveness Index	SME	Small and Mid-size Enterprises
GDP	Gross Domestic Product	SOE	State-Owned Enterprise
GNI	Gross National Income	SSA	Sub-Saharan Africa
GPRSP	Growth and Poverty Reduction Strategy Paper	UN	United Nations
GVCs	Global Value Chains	UNCTAD	United Nations Conference on Trade and Development
ICT	Information and Communications Technology	USD	United States Dollar
IFH	Imobiliária, Fundiária e Habital SA	VAT	Value-Added Tax
INE	National Institute of Statistics	WBG	World Bank Group
IEE-ACP	Investment-Enabling Environment in African, Caribbean and Pacific countries	KPI	Key Performance Indicator

Executive Summary

The first Economic Update for Cabo Verde focuses on the importance to return to fiscal sustainability in the aftermath of the COVID-19 pandemic and on the potential of the private sector to foster a more sustainable and resilient recovery, maximizing its contribution to medium-term economic growth. The first chapter discusses the current macroeconomic situation, outlook, and risks the country faces a year after the COVID-19 pandemic started. The second chapter reviews the enabling environment to promote private investment by focusing on Foreign Direct Investment (FDI), the domestic business environment, and the level of competition. The report offers a set of policy priorities for a swift return to fiscal and debt sustainability in the aftermath of the pandemic and to lay the foundations for leveraging the role of the private sector for a more sustainable and resilient economy.

Chapter 1: The State of the Economy

Recent Economic Developments

The impact and persistence of the COVID-19 pandemic caused the largest economic contraction on record in 2020 and exposed the vulnerabilities of Cabo Verde's growth model. The development model is characterized by an overreliance in tourism, large presence of the government in the economy, and big FDI flows directed to all-inclusive hotels with little connection to other sectors of the economy. Prior to the crisis, Cabo Verde experienced robust and accelerating economic growth on the back of a thriving tourism sector and strong structural reforms. These included State-Owned Enterprise (SOE) reforms, and fiscal restraint to reduce the high levels of public sector debt. The crisis reversed progress on fiscal consolidation and debt reduction made over the last five years. Gross Domestic Product (GDP) contracted by 14.8 percent in 2020 (15.7 percent in per-capita terms), one of the largest reductions in Sub-Saharan Africa (SSA). On the demand side, net exports were a drag on growth, with a reduction of 75 percent in tourism arrivals. The tourism sector, which contracted by 71 percent, represents 25 percent of GDP, generates 23 percent of formal jobs, and accounts for 55 percent of overall exports of goods and services. All sectors of the economy contracted, except for the financial sector, construction, and public administration.

The crisis reversed the progress in poverty reduction achieved since 2015, putting around 100,000 people into temporary poverty. Cabo Verde witnessed significant poverty reduction over the last decade. Using the national poverty line equivalent to US$5.4 in purchasing power parity (PPP) terms per person per day in 2015 prices, the incidence of poverty was projected to reach 26 percent in 2020. Extreme poverty, defined as those below the national food poverty line (PPP US$2.9 per person in 2015), was expected to be 6 percent. The crisis increased the national (extreme) poverty rate to 45 (20) percent in the short-term. With the progressive resumption of economic growth, the national (extreme) poverty rate is projected to fall to 34 (10) percent in 2022. Because women are the majority of informal workers, domestic employees, and labor in the tourism sector they are more likely to fall into poverty as a result of the crisis.

Despite very limited policy buffers, the authorities rapidly implemented measures to contain and mitigate the health and economic impact of the pandemic. These measures included declaring a state of emergency for the first time in Cabo Verde's history, boosting cash transfers to vulnerable households, granting temporary tax exemptions, and deferring tax payments, and providing credits and guarantees to small businesses (Annex 1). On top of these temporary support and containment measures, the Government developed a comprehensive recovery plan entitled *Cabo Verde Ambition 2030* that seeks to achieve sustainable development and increase resilience to shocks. The strategy delineates programs to (i)

reestablish confidence in the health and safety conditions, (ii) recover and expand the tourism sector, and (iii) operationalize the concept of a 'Hub in the mid-Atlantic', which aims at transforming the country in a logistic and transport hub connecting Europe, North and South America, and Africa.

The crisis led to a significant increase in the fiscal deficit. Driven mainly by the impact of the crisis on tax collection, fiscal revenue declined by 23.8 percent in nominal terms, reaching 25.8 percent of GDP in 2020. To respond to urgent needs brought on by the pandemic, the government increased current expenditure and reduced capital investment, keeping total public expenditure broadly stable in nominal terms. As a result, the overall deficit (including grants) increased from 1.8 percent in 2019, to 8.9 percent in 2020. Consequently, fiscal financing needs for 2020 increased from an expected US$87.6 million (4 percent of GDP) before the crisis to US$176.8 million (10 percent of GDP) after the crisis. They were fully covered by concessional credits, grants, domestic borrowing, and resources freed up by the Debt Service Suspension Initiative (DSSI).[1]

Consequently, hard won gains in reducing the public debt burden over the last 4 years were erased, raising the urgency of measures to increase debt transparency. Public debt had been on a declining path since 2017, falling from 128.4 percent of the GDP in 2016 to 124.9 percent in 2019. Debt reached 151.3 percent of GDP in 2020. Public and Publicly-Guarantee (PPG) debt is assessed as sustainable, but the risk of external and total debt distress is high, according to the latest joint World Bank/IMF Debt Sustainability Assessment, conducted in September 2020. Increasing debt transparency by broadening the coverage of public debt to include guaranteed domestic debt and non-guaranteed debt held by SOEs is crucial to depict a more comprehensive situation of public and publicly guarantee debt in the country, which is essential to improve the management of fiscal risks.

The crisis negatively impacted the financial performance of an already weak SOE sector, which required emergency fiscal support, exacerbating fiscal risks. The authorities extended loan guarantees amounting to US$54.1 million to support financially distressed SOEs. Cabo Verde Airlines (CVA), partially privatized in 2019 and grounded since March 2020, received loan guarantees of US$25.6 million in 2020 (and US$20.2 million so far in 2021). Capitalizations of SOEs accounted for US$7.8 million, with NEWCO (the Special Purpose Vehicle created to absorb CVA's debt before privatization) the largest recipient with US$5.6 million. The poor financial performance of the SOE sector in 2020 will negatively impact future fiscal balances through two channels: (i) through additional financial support in the form of transfers or capitalizations that may be required to return SOEs to financial sustainability and (ii) through the realization of contingent liabilities, primarily loan and minimum revenue guarantees in the aviation and maritime sectors. These fiscal vulnerabilities may undermine Cabo Verde's efforts to restore fiscal sustainability and return debt (as a share of GDP) to a declining trajectory.

Outlook and risks

The economy is likely to recover slowly from the pandemic, but the outlook is highly uncertain with substantial downside risks. Real GDP growth is projected at 3.9 percent in 2021, gradually accelerating to 6.1 percent by 2023, with GDP per capita only expected to return to its 2019 level by 2024. In the short-term, the recovery will be driven by a gradual reactivation of the tourism sector, which is highly dependent on the success of the vaccine programs in both the major tourist markets and in Cabo Verde. Over the

[1] The DSSI is an initiative of the G20 group to help countries cope with the fallout of the COVID-19 crisis. It offered a temporary suspension of official sector debt payments, with repayment period of five years and a one-year grace period. The DSSI was approved in April 2020 for eight months, it was subsequently extended until June 2021.

medium-term, structural reforms will need to promote private consumption and investment in tourism and the blue economy, energy and ICT to help to close the output gap, with the resumption of FDI to unlock productivity. Uncertainties regarding the duration of the pandemic (including the rise of new COVID-19 variants), implementation of the vaccination campaign (including people refusing to be vaccinated), and the speed of the global recovery (particularly in Europe) cloud medium-term prospects. The country also remains significantly exposed to climate-related shocks.

The key policy priorities to restore fiscal and debt sustainability in the aftermath of the crisis are:

Policy Priorities	Timeline
Return to a prudent fiscal policy stance	
Advance revenue-enhancing reforms such as recovering outstanding tax arrears through stricter enforcement mechanisms and strengthening tax monitoring to enhance compliance through tax audits, inspections, and improved tax administration and controls mechanisms at customs.	ST
Prioritize health expenditures and capital expenditures, while containing current expenditures and enhancing the management of the public investment program to ensure fiscal sustainability.	ST
Revamp the management of fiscal risks by improving the reporting of SOE finances, quantify fiscal risks, particularly those arising from contingent liabilities, and institutionalize oversight for fiscal risk management at the Ministry of Finance.	ST+MT
Improve debt management and transparency	
Continue to implement a zero limit on non-concessional borrowing.	ST
Publish and improve the content of the quarterly SOE bulletins, by including an assessment of fiscal risks.	ST
Increase debt transparency by broadening the coverage of public debt to include guaranteed domestic debt and non-guaranteed debt held by SOEs.	MT
Reinvigorate structural policy reforms	
Reinvigorate structural reforms of SOEs by bringing private sector into the airport management company and the electricity utility company to improve efficiency and service delivery.	MT

Chapter 2: The Enabling Environment for Private Investment

The impact and persistence of the pandemic has had a large negative effect on firm performance. Given the concentration of firms and jobs in the services sector, particularly in tourism and accessory activities, the demand shock created by the abrupt and persistent global shut down of tourism negatively impacted firms and workers in Cabo Verde. Recognizing these challenges, the *Cabo Verde Ambition 2030* plan assigns a foundational role to the private sector to promote a sustainable and resilient economic recovery. To contribute to identification of key policy priorities to achieve this goal, this chapter focuses on FDI, business regulations, and competition policy.

Foreign Direct Investment

The institutional framework for FDI policy in Cabo Verde is broadly aligned with good global practices, but policy implementation is fragmented. The absence of an FDI strategy that builds on the *Cabo Verde Ambition 2030* strategy to recovery from the COVID-19 crisis will prevent an efficient and coordinate implementation of policies during the recovery phase. A strategy that identifies priority sectors

and tasks within efficient Global Value Chains (GVCs) is needed, without trying to determine particular investments. Clarification of the roles and responsibilities in policy implementation across different agencies as well as the promotion of mechanisms to allow communication between stakeholders (government agencies, the private sector, and civil society) is crucial to increase the effectiveness of investment policy.

Strengthening the Investment Promotion Agency (*Cabo Verde Trade Invest*) to effectively implement the FDI policy is critical. The agency's mandate to attract FDI needs to be updated in four areas. First, a revamped corporate strategy in support of national investment objectives. Second, enough budget and human resources should be dedicated to implement the strategy. Third, a direct and clear reporting line to the Ministry of Finance should be established, to ensure adequate oversight over their activities and ensure value for money and risk management. Finally, expanding and improving the quality of services that the agency offers to investors, particularly after-care services, is critical.

The creation of linkages between domestic suppliers and hotel chains, particularly in the agricultural and fishery sectors, is important to maximize the development impact of FDI. Connecting local suppliers, particularly in the agriculture and fishing sectors, with hotels would promote knowledge transfers and, as a result, improve the productivity of local firms. A task force could be created to delineate and implement a comprehensive set of interventions to increase FDI spillovers to domestic firms.

Business Regulatory Environment

The simplification of rules and regulations for licenses and permits would facilitate firms' entry into markets and level the playing field by ensuring a stable business environment. A stocktaking of required licenses in the strategic sectors of tourism and logistics is needed to identify unnecessary licenses or procedures that do not meet the criteria of necessity, legality, and business friendliness. Additionally, allowing for greater flexibility in the definition or change of business activities would allow businesses to adapt more easily to changing market needs, especially during the COVID-19 crisis and the recovery period, making it easier to adapt without resorting to burdensome licensing requirements.

To help businesses significantly hit by the crisis, the authorities can accelerate reforms aimed at improving access to finance. Efforts should be made to modernize and operationalize the collateral registry and support the development of insolvency procedures, through training and communications campaigns. Functioning insolvency procedures would help struggling entrepreneurs and companies liquidate their holdings and get back into the economy with new ventures.

Further efforts are also needed to support on digitalization, feedback mechanisms, and professionalization of the public procurement. Enhancing the capabilities of the e-procurement system is a priority, including bid evaluation, communication with suppliers, award, signature, and payment. This reform is particularly relevant in a fragment market structure as is the case in Cabo Verde.

Competition

Cabo Verde should continue with the process of reforming its competition law, paying special attention to prevent abuse of dominant positions. Merger notification thresholds should be revised to rely on criteria that are quantitative and objective at the individual and aggregate levels to provide clarity to firms participating in a merger or acquisition. Policymakers are encouraged to reconsider existing exemptions in the competition law, such as for credit and insurance companies. The development of

guidance for the implementation of the law is also important to clarify how certain rules will be applied in practice. Finally, the system of fines should be updated to ensure it operates as a meaningful deterrent against anti-competitive conduct.

The creation of an independent competition authority that is separate from the executive branch of government is a priority. The authority should have an exclusive enforcement mandate over competition issues in all sectors and a clear competition advocacy mandate. Advocacy is an important complement to enforcement as it facilitates the incorporation of competition principles into key sectors of the economy. Given the reduced number of firms and the large presence of SOEs in the economy, the role of a competition authority is important to level the playing field across firms in small economies.

Competitive neutrality should be strengthened particularly in markets that register both private and public sector participation. This would help to prevent the crowding out of private investment and, where possible, to remove barriers to private sector entry. In addition, Public Sector Law 104/2016 should be revised to require SOEs to separate commercial from non-commercial activities in their accounts. Oversight of SOEs and enforcement of competition principles should be bolstered, especially to ensure that SOEs deliver on the performance targets agreed upon in the annual management contracts and to ensure that they earn a commercial rate of return.

The following priority reform areas are suggested as priority to foster the role of the private sector for a more sustainable and resilient recovery from the COVID-19 crisis:

Reform Area	Lead Agency	Timeline
Theme 1: Leveraging FDI for an Inclusive Economic growth		
Develop a national investment strategy aligned with the Cabo Verde Ambition 2030 Strategy	Ministry of Finance	ST
Modernize the investment promotion agency, including the development of aftercare services.	Investment Promotion Agency	ST
Promote linkages between domestic suppliers and hotel chains, particularly in the agricultural and fishery sectors.	Ministry of Industry	MT
Theme 2: Improve the Business Environment for Domestic Firms, notably SMEs.		
Simplify licenses and permits in the tourism and logistics sectors, while strengthening social and environmental protections.	Competitiveness Unit	ST
Implement reforms identified in Doing Business action plans, particularly in the areas of collateral registry and insolvency procedures.	Competitiveness Unit	ST
Strengthen Public Procurement by improving digitalization, establishing feedback mechanisms, and professionalizing the public procurement function.	Public Procurement Regulatory Authority	MT
Theme 3: Introduce Conditions for Greater Competition		
Update the competition legal framework and foster effective implementation	Council of Ministries	MT
Establish an independent competition authority and increase enforcement capacity	Council of Ministries	MT
Level the playing field for public and private actors by applying the competitive neutrality principle	Ministry of Finances	LT

Part I –The State of the Economy

A. Recent Developments

1. Real Sector

Prior to the COVID-19 pandemic, Cabo Verde experienced robust economic growth driven by a thriving tourism sector and strong structural reforms. Between 2016 and 2019, growth averaged 4.7 percent (3.4 in per capita terms). Favorable global conditions coupled with strong structural reforms, mainly around the SOE sector, supported growth. On the demand side growth was driven by net exports and private investment and consumption, although investment contracted in 2019. On the supply side growth was driven by tourism activities supported by robust economic conditions in Europe and growth in domestic non-tradable services.[2] The privatization efforts of the government helped support investor and consumer confidence. The sustained and robust economic growth led to a decline in poverty from 24.5 percent in 2015 to 11.5 percent in 2019.[3]

Recent social and economic progress was reversed in 2020, despite the quick reaction of authorities to mitigate the economic and health impact of the pandemic. The health impact of the pandemic has been broadly similar to comparable countries, but the level of stringency of the containment measures is comparatively higher in Cabo Verde (Box 1). With a diaspora outnumbering the resident population, remittances have provided a cushion to the crisis.[4] The exogenous 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 FDI, a critical source of external finances and a key driver of growth. Recognizing the large economic threat posed by the crisis, and despite very limited policy buffers available, the authorities quickly implemented decisive measures to contain and mitigate the health and economic impact of the pandemic, including declaring a state of emergency for the first time in Cabo Verde's history (see Annex 1).

Box 1: The COVID-19 Pandemic in Cabo Verde

The first COVID-19 case was detected in Cabo Verde on March 19, 2020. Until December 31, 2020, the country recorded an incidence of 1,973 cases per 100 thousand inhabitants, the highest among the 55 member states of the African Union and among the Portuguese-speaking African countries. At the global stage, daily cases in Cabo Verde were above the global average until October 2020. (figure B1). As of April, 6 2021, the total number of positive cases reached almost 18,000.

The most affected islands are Santiago, Sao Vicente and Fogo with 59.1 percent, 14.7 percent, and 12.6 percent cumulative cases, respectively. The number of cases and deaths (per million individuals) were above the world average during most part of 2020 (Figure B1.1 and Figure B1.2). However, up to end March 2021, about 96 percent of the total positive cases had recovered, one of the highest recovery rates among African countries. The mortality rate is relatively low with 159 deaths attributed to the virus.

[2] Tourism arrivals to Cabo Verde increased from 381,000 in 2011 to 819,000 in 2019.
[3] Employing a national poverty line of US$3.2 PPP per day in 2011
[4] The increase in remittances might be reflecting a switch from informal to formal channels following travel bans.

Figure B1.1: Number of COVID-19 Cases

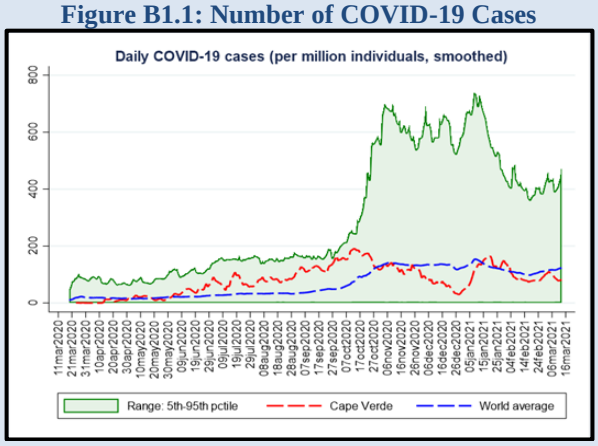
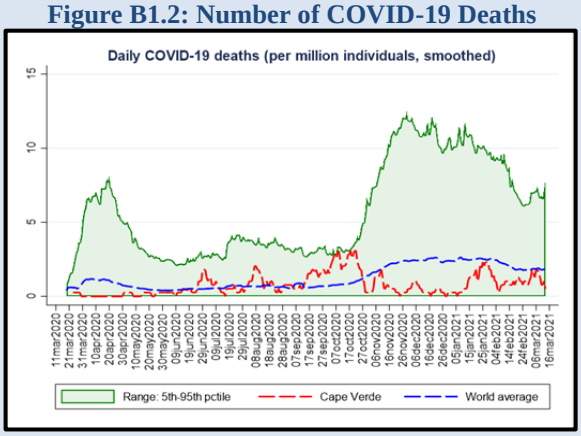
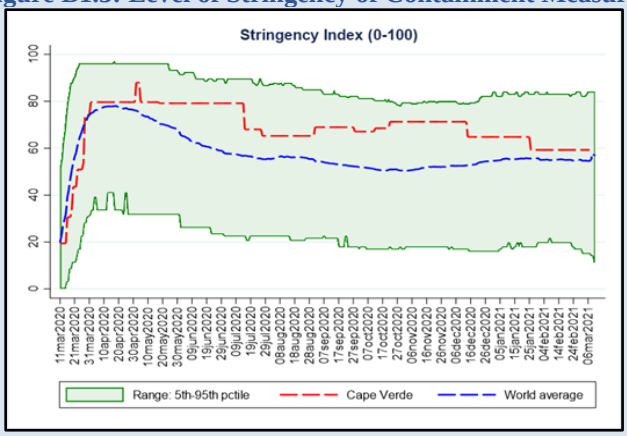


Figure B1.2: Number of COVID-19 Deaths



Given the vulnerability of the economy to the shock, authorities took swift containment measures that were more restrictive than in other countries. After the first case of COVID-19 was reported, stricter containment measures were adopted, including the complete closure of international air and sea transport borders. A state of emergency was declared to reinforce the containment measures, with restrictions on inter-island transport. Key features of the state of emergency include the following: self-quarantine for people returning from abroad; mandatory quarantine for suspects of COVID-19; closing of schools and universities; restrictions on large events and gatherings; closure of non-essential services and activities; countrywide lockdown; public services encouraged to resort to remote working; mandatory use of masks. The containment and mitigation measures adopted were tighter than the world average (figure B1.3), weighing on economic growth.

Figure B1.3: Level of Stringency of Containment Measures

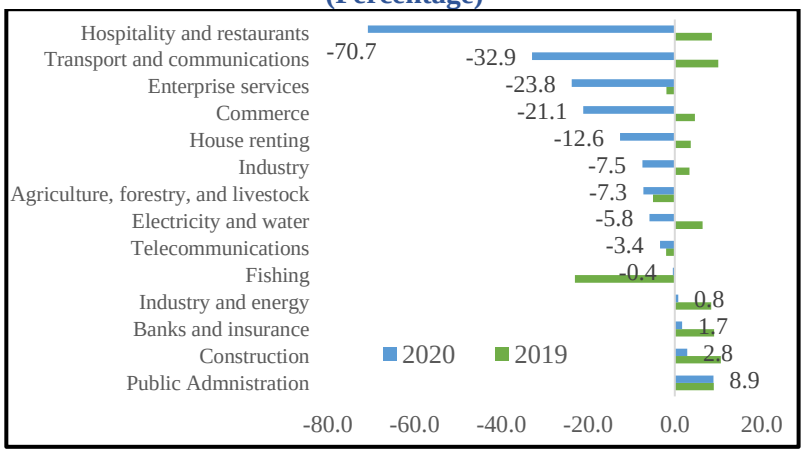


Vaccination started on March 12, 2021, but progress is slow. Cabo Verde received its first batch of 24,000 AstraZeneca's COVID-19 vaccines through the COVAX Facility and two days later 5,850 doses of Pfizer. The vaccination campaign started on March 19 and is planned to cover 70 percent of the population until end-2021. The COVID-19 National Vaccination Plan, approved on February 18, prioritizes health care workers, people with underlying medical conditions, the elderly, tourism sector and entry points professionals, teachers and support staff in schools, national police, armed forces, national service of civil protection and firefighters. As of April 7, 2021, about 4,000 people had been vaccinated with the first dose of the vaccine against COVID-19, of which 82 percent are healthcare workers. The World Bank provided US$5 million support to procure and deploy more than 400,000 doses of COVID-19 vaccine, as well as personal protective equipment.

Driven by the shutdown in the tourism sector, GDP contracted by 14.8 percent in 2020 (15.7 percent in per-capita terms) –the largest reduction on record and one of the largest in Africa. The tourism

sector was closed for nine months, which had negative spillovers in upstream sectors. Overall, the services sector contracted by 19 percent while industrial output declined by 2 percent. Hospitality and restaurants contracted by 71 percent whereas transport and communication fell by 33 percent. The agriculture and fishing sector also registered a poor performance, contracting by 7 percent and 0.4 percent, respectively. The only sectors that grew are public administration (9 percent), construction (3 percent), financial services (2 percent), and extractive industries (1 percent).

Figure 1: Annual Growth rates 2019-2020 (Percentage)



Source: The World Bank Group.

On the demand side, net exports were a drag on growth, with exports of goods and services falling by 59 percent. Imports declined by 23 percent. Private consumption fell sharply mostly as a result of strict domestic containment measures to prevent the spread of the COVID-19 virus, contributing 7.3 percentage points to GDP contraction (Table 1). However, FDI flows, accounting for 4.4 percent of GDP, and higher domestic investment, triggered by measures put in place by the Government to support businesses and hard-hit sectors, led to an increase in domestic private investment, which contributed 7.5 percentual points to GDP growth. Credit to the private sector increased by 5.3 percent at end-December 2020, boosted by the COVID-19 related credit line, government-guaranteed loans and temporary moratoria on loan payments, granted only to debtors with their loans and taxes in good standing.

Table 1: Contribution to GDP Growth (percentage points)

	2016	2017	2018	2019	2020e
GDP Growth	**4.7**	**3.7**	**4.5**	**5.7**	**-14.8**
		Demand Side			
Consumption					
Public	-1.1	1.3	0.4	0.8	0.0
Private	1.6	4.6	1.0	3.8	-7.3
Investment					
Public	-1.8	1.1	-0.5	0.2	-1.2
Private	8.4	3.4	2.2	-2.7	7.5
Exports	1.9	3.2	5.2	4.2	-28.6
Imports	4.3	9.9	3.9	0.5	-14.7
		Supply Side			
Agriculture	-0.4	-1.1	-1.6	-0.5	-0.4
Industry	0.5	0.5	1.1	1.1	-0.4
Services	4.5	4.3	5.0	5.1	-14.0

Source: Cabo Verdean authorities, IMF and WBG estimations (March 2021).

The mitigation measures played an important role in supporting businesses, families and vulnerable groups affected by the pandemic. The credit lines with state guarantees provided to companies, amounting to around US$41 million, including for micro, small and medium enterprises, are estimated to have protected 12,300 jobs. The suspension of labor contracts, which cost the Government around US$15 million, is estimated to have avoided layoffs of additional 32,000 workers. Measures aimed at preserving livelihood of the most vulnerable were successfully implemented. The Government quickly scaled up the existing safety net, using the social protection delivery systems already in place and provided emergency cash transfers to additional households, reaching approximately 24,000 people. The authorities also implemented a health security program to prepare operators for the reopening of the country to tourism. The program included qualifying hotels, restaurants, and travel agencies with a "Clean and Safe" certification, training operators in the hotel sector, and opening health centers in the two main tourist islands.

2. Fiscal and Debt Dynamics

The revenue-driven fiscal consolidation program, in implementation since 2016 and which included an ambition SOE reform agenda, was halted in 2020 due to falling fiscal revenue and increasing COVID-19 related expenditure. Driven by a substantial increase in revenues and containment of expenditures, the primary balance had improved steadily turning from a deficit of 0.5 percent of GDP in 2016 to a surplus of 0.7 percent in 2019.[5] Consequently, the overall fiscal deficit declined from 3 percent of GDP in 2016 to 1.8 percent of GDP in 2019. Total fiscal financing needs, including on-lending and recapitalization to SOEs, declined from 5.6 percent of GDP in 2016 to 3.7 percent of GDP in 2018. The fiscal consolidation plan included an ambitious plan to gradually disengage the state from SOEs, which resulted in the partial privatization of CVA and the concession for the provision of inter-island maritime services in 2019. Further progress on the SOE reform agenda, including the complete disinvestment from CVA and the privatization of the power utility company, was halted in 2020 due to large uncertainty in global financial markets triggered by the crisis.

Driven by the contraction of the economy, fiscal revenue declined by 23.8 percent in nominal terms, reaching 25.8 percent of GDP. Tax revenue decreased from $42,013 million CVE in 2019 to $32,237 million CVE in 2020. All sources of taxes contracted but the largest decrease was with taxes on goods and services, which declined from 10.6 percent of GDP in 2019 to 9 percent in 2020. The moratorium on tax payments granted to people and firms contributed to the poor performance of tax revenues. Non-tax revenue contracted by 31.1 percent, reaching 3.7 percent of GDP. This was driven mostly by a loss of income in the SOE sector, particularly from the SOE in charge of the management of airports. Grants accounted for 3.1 percent of GDP in 2020.

[5] Expansionary fiscal policy in the aftermath of the 2009 financial global crisis led to growing fiscal financing needs and a ballooning in public debt. With a small fiscal multiplier, a largely ineffective counter-cyclical public investment program led to an increase in the overall fiscal deficit from 1.6 percent of GDP in 2008 to 12.4 percent in 2012, returning to a 3 percent by 2016. Weak central government fiscal performance, including current transfers to SOEs, was compounded by increasing below-the-line financial support to loss-making SOEs, notably to the Cabo Verde Airlines (CVA) and the social housing program. Growing fiscal financing needs and the provision of guarantees to SOEs fueled a rapid accumulation of public and publicly guaranteed debt, which climbed from 57 percent of GDP in 2008 to peak at 128.4 percent of GDP in 2016.

Table 2: Key Fiscal Indicators
(Percentage of GDP) .

	Actual					Before C-19		Baseline		
	2016	2017	2018	2019	2020e	2020p	2021p	2021p	2022p	2023p
Total Revenues	26.6	28.6	28.2	29.4	25.8	32.5	31.2	29.3	30.5	30.8
Tax revenues	19.5	20.7	22.1	21.5	19.0	22.9	22.6	20.5	22.4	23.7
Tax on income and profit	6.1	6.5	6.7	6.5	5.8	11.3	11.1	6.1	6.5	6.9
Tax on Goods and Services	9.0	9.7	10.8	10.6	9.0	6.9	6.7	10.0	10.5	11.5
Tax on trade	4.1	4.2	4.2	4.1	3.9	4.3	4.4	4.0	4.9	5.3
Other tax	0.3	0.3	0.4	0.3	0.3	0.4	0.4	0.4	0.4	0.0
Non-Tax revenues	4.4	4.2	4.7	4.7	3.7	6.8	6.4	5.8	6.0	6.0
Grants	2.7	3.7	1.4	3.2	3.1	2.8	2.2	2.9	2.0	1.0
Total Expenditure	29.6	31.6	30.9	31.2	34.7	34.2	32.4	37.8	35.6	32.5
Current expenditure	26.3	25.9	26.4	27.3	32.0	29.7	28.7	32.5	31.6	28.5
Compensation to employees	11.1	10.9	10.6	10.6	12.7	11.4	11.1	13.5	13.0	13.0
Goods and services	4.6	4.0	3.9	4.1	6.0	6.4	5.7	6.5	5.4	5.4
Interest payments	2.5	2.6	2.6	2.6	2.8	2.7	2.3	2.8	2.8	2.8
Subsidies	0.1	0.1	0.1	0.1	0.4	0.3	0.3	0.3	0.3	0.3
Current transfers	3.0	3.5	3.4	3.1	3.8	3.1	3.3	3.0	3.1	3.0
Social benefits	3.1	3.2	3.4	3.7	4.9	3.6	3.4	4.9	4.5	3.0
Other expenses	1.9	1.6	2.5	3.2	1.4	2.2	2.5	1.4	2.5	1.0
Net acquisition of nonfinancial assets	3.4	5.7	4.4	3.9	2.7	4.6	3.6	5.0	4.0	4.0
Primary fiscal balance	-0.5	-0.4	-0.1	0.7	-6.0	1.0	1.2	-5.6	-2.4	1.0
Overall fiscal balance	-3.0	-3.0	-2.7	-1.8	-8.9	-1.7	-1.1	-8.5	-5.1	-1.7
Net other liabilities	-2.5	-0.4	-1.0	-3.3	-1.1	-2.2	-0.9	0.3	-0.2	-0.2
Onlending	-2.5	0.2	1.2	-1.1	-0.6	-1.6	-0.4	0.9	-0.2	-0.2
Capitalization	-0.9	-0.7	-2.2	-2.3	-0.5	-0.7	-0.5	-0.6	0.0	0.0
Financing Needs	5.6	3.3	3.7	5.1	10.0	3.9	2.1	8.2	5.3	1.9
Total financing	5.6	4.2	2.9	4.3	10.0	3.9	2.1	8.2	5.3	1.9
Net domestic financing	2.9	0.2	1.4	0.7	3.0	0.4	0.1	1.5	1.4	1.3
Net external financing	2.7	4.0	1.5	3.6	7.0	3.6	2.0	6.7	3.9	0.6
Exceptional financing (DSSI)					0.9			1.2		
Net errors and omissions	0.0	0.8	-0.8	0.0	-0.8	0.0	0.0	0.0	0.0	0.0
Public Debt	128.4	125.9	124.7	124.9	151.3	118.1	111.1	139.9	134.9	128.1
External debt	93.5	93.7	91.4	91.4	109.1	87.2	82.8	98.1	94.3	88.2
Domestic debt	32.2	32.2	33.3	33.5	42.2	30.9	28.3	41.8	40.5	39.9

Source: Cabo Verdean authorities, IMF and WBG estimates and projections (March 2021).

To respond to the urgent needs brought on by the pandemic, and in-line with a responsible fiscal stance, the Government increased current expenditure and reduced capital investment, keeping total public expenditure broadly stable in nominal terms. As a share of GDP, public expenditure increased from 31 percent of GDP in 2019 to 35 percent in 2020. Current spending increased by 4.8 percentage points (PPs), reaching 32 percent of GDP. This reflect additional spending for public health services, disease prevention and control, and support for hard-hit sectors. In addition, the increase in current spending partly reflects the phased implementation of the Career and Salary Plan for several streams of the Public Administration, the increase in the number of pensioners, and payment of arrears. Capital expenditure

declined by 41.1 percent, reaching 2.7 percent of GDP. As a result, total expenditures in nominal terms declined by 3.6 percent in 2020.

As a result of the dramatic reduction in fiscal revenue, both the fiscal deficit and financing needs increased substantially in 2020. The overall deficit (including grants) widened from 2 percent of GDP in 2019 to 9 percent in 2020. Consequently, fiscal financing needs for 2020 increased from a predicted amount of US$88 million (4 percent of GDP) before the crisis to US$177 million (10 percent of GDP) after the crisis (Table 3). Extra financing needs were covered by concessional credits in the amount of US$100 million provided by the International Monetary Fund, the World Bank, and the African Development Bank. Grants amounting to US$36 million were provided by the EU, Luxemburg, and Portugal. The remaining financing gap was covered by government securities market (US$51 million) and resources freed by the DSSI (US$16.1 million).

Table 3: COVID-19 Additional Fiscal Financing Needs and Sources

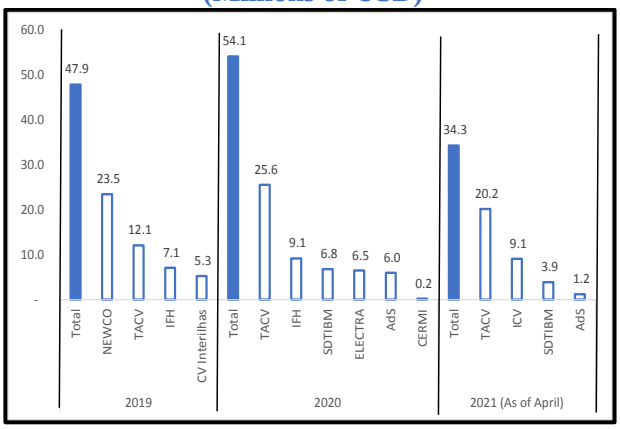
	Pre-COVID-19 '2020 (as of April)		2020 (as of December)		2020 COVID-19 Gap		2021	
	US$ millions	Percent of GDP	US$ millions	Percent of GDP	US$ millions	Percent of GDP	US$ millions	Percent of GDP
Total Revenue & Grants	730.0	32.5	457.0	25.8	-272.9	-6.7	536.2	29.3
Tax Revenue	514.4	22.9	335.8	19.0	-178.6	-3.9	375.1	20.5
Nontax revenue	152.7	6.8	65.4	3.7	-87.3	-3.1	106.1	5.8
Grants	62.9	2.8	54.8	3.1	-8.1	0.3	53.1	2.9
Total Expenditure	768.2	34.2	613.9	34.7	-154.3	0.5	691.7	37.8
Overall balance (incl. grants)	-38.2	-1.7	-157.4	-8.9	-119.2	-7.2	-155.5	-8.5
Net other Liabilities	-49.4	-2.2	-19.5	-1.1	30.0	1.1	5.5	0.3
onlending to SOEs for investment purposes	-22.5	-1.0	-14.1	-0.8	8.3	0.2	-5.5	-0.3
Financing needs	**87.6**	**3.9**	**176.8**	**10.0**	**89.2**	**6.1**	**150.1**	**8.2**
Financing sources	**87.6**	**3.9**	**176.8**	**10.0**	**89.2**	**6.1**	**150.1**	**8.2**
Domestic Financing (net)	9.0	0.4	53.0	3.0	44.1	2.6	27.4	1.5
External Concessional Financing (net)	80.9	3.6	123.8	7.0	42.9	3.4	122.6	6.7
Budget support (disbursement)	33.7	1.5	100.8	5.7	67.1	4.2	42.0	2.3
IMF RCF			32.3	1.8	32.3	1.8		
WB DPF*	15.0	0.7	25.0	1.4	10.0	0.7	20.0	1.1
WB CAT-DDO			10.0	0.6	10.0	0.6		
African Development Bank	18.7	0.8	33.5	1.9	14.8	1.1	22.0	1.2
Project and Program loans (disbursement)	47.2	2.1	51.1	2.9	3.9	0.8	115.6	6.3
of which WB COVID-19 Emergency Response Project			5.0	0.3	5.0	0.3		
Loans to on lend to SOEs (disbursement)			14.1	*0.8*			5.5	*0.3*
Amortization			58.4	*3.3*			64.2	*3.5*
Debt Service Suspension Initiative			16.1	0.9	16.1	0.9	23.8	1.3

Source: Cabo Verdean authorities, IMF and WBG estimations (March 2021).

The crisis negatively impacted the financial performance of an already weak SOE sector, which required emergency fiscal support in 2020, exacerbating fiscal risks over the medium term. The authorities extended loan guarantees amounting to US$54.1 million to support financially distressed SOEs. CVA accounted for almost half of the amount of loan guarantees, followed by the social housing SOE (*Imobiliária, Fundiária e Habital SA*– IFH), the Society for the tourism development of Boa Vista and Maio (*Sociedade de Desenvolvimento Turístico das Ilhas da Boa Vista e do Maio* – SDTIMB), the power company (*Empresa de Electricidade e Água, SA* – ELECTRA), and the Water company in Santiago island (*Aguas de Santioago SA* - AdS) (Figure 2). Capitalization to SOEs accounted for US$7.8 million, being NEWCO (the Special Purpose Vehicle created to absorb CVA debt before privatization) the largest recipient with US$5.6 million (Figure 3). The poor financial performance of SOEs in 2020 have two

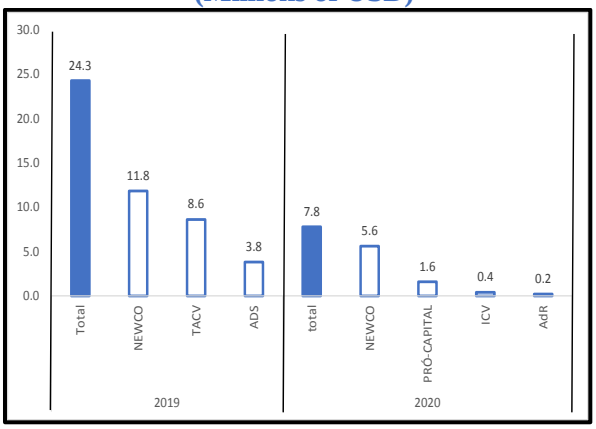
implications for future fiscal balances.[6] First, through additional financial support in the form of transfers or capitalizations that may be required to return SOEs to financial equilibrium. Second, through the realization of contingent liabilities, primarily loan and minimum revenue guarantees in the aviation and maritime sectors, which would demand additional fiscal resources. These fiscal vulnerabilities may undermine Cabo Verde's efforts to restore fiscal sustainability and return debt (as a share of GDP) to a declining trajectory in the aftermath of the pandemic. Improving the monitoring of fiscal risks is paramount (Box 2).

Figure 2: Loan Guarantees to SOEs (Millions of USD)



Source: Cabo Verde's Ministry of Finance.

Figure 3: Capitalization to SOEs (Millions of USD)



Source: Cabo Verde's Ministry of Finance

Box 2: Fiscal Risks in Cabo Verde: A Call for Action

Fiscal risks are especially important in Cabo Verde because of its high risk of debt distress and vulnerability to external shocks, such as created the COVID-19 pandemic. Risks created by contingent liabilities associated with SOEs are particularly important. At end 2019, SOEs' liabilities to entities outside the public sector amounted to 22.2 percent of GDP, of which 3.9 percent of GDP was explicitly government guaranteed, creating a significant exposure to contingent liabilities in addition to the already very high central government debt stock of 137.6 percent. Even before the pandemic, the finances of many of the SOEs were poor. Notably, the electricity utility Electra had negative equity, had made a loss in each of the past four years, and could continue in business only with government support. The pandemic has caused a deterioration in the finances of most SOEs, including the formerly profitable airport company. Public-private partnerships (PPPs) and local governments also create fiscal risks related to contingent liabilities, but on a smaller scale.

The government has taken steps to manage fiscal risks, but due to increasing debt vulnerabilities, it is important to accelerate the pace of the reforms, particularly on the SOE front. Among other things, it is important to reform SOEs to improve their profitability, including, in the case of Electra, by reducing the high rate of electricity losses. The Ministry of Finance has established a unit to monitor SOEs and PPPs. The government also discloses fiscal risks in various ways, including in the annual budget report, quarterly reports on debt, and an annual report on contingent liabilities from the SOE sector.

However, a more updated and complete picture of overall fiscal risks is needed. The section on fiscal risks in the budget report mentions many risks but does not offer any information on their size, nor any emergency measures planned by the Government to address them, such as through privatization operations or by the design of new

[6] The timely reporting of SOEs' financial statements risks remains a critical challenge. As of April 2021, financial statements for 2020 of SOEs are unavailable. The audited financial statement for CVA for 2019 is also unavailable.

strategies for individual SOEs. Likewise, reporting of SOEs risks is not as timely and informative as it should be, and credit risk assessments are qualitative, not relying on financial ratio analyses. Published information on the finances of local governments is almost nonexistent. Additionally, there is not an institutional setup for fiscal risk management, such as a Fiscal Risk Committee.

Hard won gains in reducing the public debt burden over the last 4 years were erased in 2020. Debt reached 151.3 percent of GDP in 2020 but remained sustainable with a high risk of total and external debt distress. Public debt (as a share of GDP) had been on a declining path since 2017, falling from 128.4 percent of the GDP in 2016 to 124.9 percent in 2019. However, Cabo Verde remained one of the most heavily indebted countries in Africa.[7] The decreased in the debt burden was driven primarily by the acceleration in growth, favorable exchange rate movements, and fiscal restraint. The increase in concessional external borrowing and domestic lending to cover fiscal financial needs in 2020 (and the contraction of GDP) increased public debt to 151.3 percent of GDP (Figure 4). The country has the second largest debt-to-GDP ratio within SIDS (Box 3). Public and Publicly-Guarantee (PPG) debt is assessed sustainable, but the risk of external and total debt distress is high, according to the latest joint World Bank/IMF Debt Sustainability Assessment, conducted in September 2020. Approximately 73 percent of central government debt is denominated in foreign currency, of which two-thirds is in Euros, limiting exchange rate risks as the Escudo is pegged to the Euro (Figure 5). Debt service indicators are forecasted to remain below their respective thresholds because of the concessional nature of the debt portfolio, which is characterized by long maturity profiles and low interest rates. The average interest rates on domestic and foreign debt are 1.5 percent and 1 percent, respectively, while average maturities are 17.4 years and 25.7 years.[8]

[7] Total public debt includes central government external and domestic debt and external debt contracted by the central government on behalf of SOEs (referred to as "on-lending"). It also includes external debt contracted directly by SOEs that carry a central government guarantee. Domestic debt contracted directly by SOEs and by local governments that carry a central-government guarantee are not included. [8] Debt risks steam from the existence of non-guaranteed domestic debt contracted by SOEs, which is not included in the DSA baseline. Downside risks to the assessment also include a more severe or prolonged impact of the COVID-19 shock, realization of contingent liabilities from SOEs, and external shocks. To support the return to a declining path in the ratio of public debt-to-GDP in the aftermath of the pandemic requires a refocus on sustained fiscal consolidation, growth-enhancing structural reforms, notably in the SOE sector, and continuous prudent borrowing policies.

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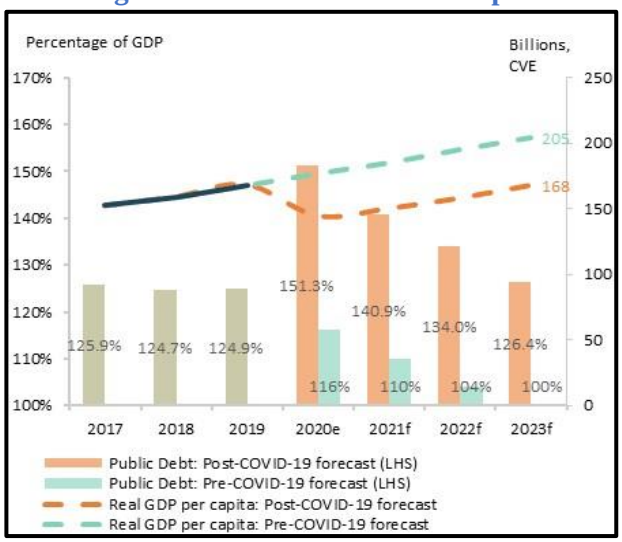
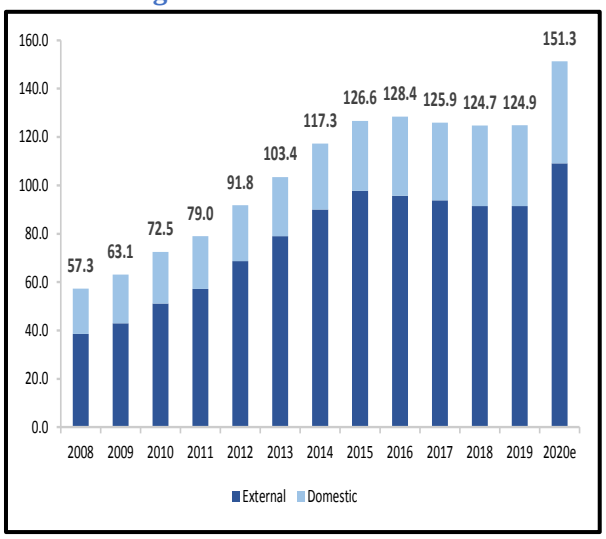
Figure 4: Debt and GDP Per-Capita



Source: World Bank (2019).

Figure 5: Debt-to-GDP Ratio

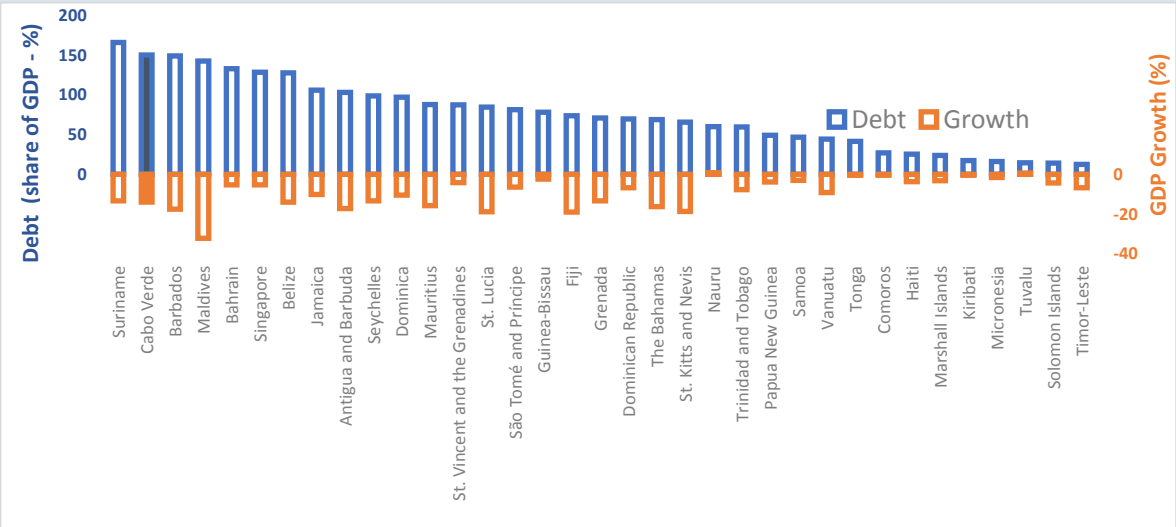


Source: World Bank (2019).

Box 3: Debt Pressures in SIDS and Potential Patways for Development Financing

The COVID-19 pandemic exacerbated debt pressures in SIDS. On average, public debt accounted for 60.6 percent of GDP in SIDS prior to the crisis. In 2019 Cabo Verde displayed the third largest debt-to-GDP ratio with 125 percent, after Singapore (129 percent) and Barbados (126.8 percent). In 2020, because of increasing financing needs brought about by the crisis, public debt increased on average by 13.2 percentual points in SIDS. Public debt in Cabo Verde increased by 25 percentage points, reaching 150 percentage of GDP –the second largest debt burden after Suriname (166 percent) (Figure B3.1).

Figure B3.1: Public Debt as share of GDP and GDP growth in 2020



Source: World Bank Estimates.

The fiscal consolidation program envisioned by the Government over the medium term should help to return public debt to a sustainable path, but it may not be enough. Given the fiscal needs to support social programs and the recovery of key sectors over the medium term, innovative options for debt financing may need to be considered. While the G-20 Debt Service Suspension Initiative (DSSI) freed up fiscal resources to respond to the crisis in 2020

and 2021, it does not include any write-off of debt. Should debt vulnerabilities continue increasing in 2021, the country can consider options for debt restructuring. Some options include:

1. **G-20 common framework for debt treatments beyond the DSSI:** To address unsustainable public debts in DSSI-eligible countries, the G-20 put forward a framework for debt restructuring. Eligible countries would be those for which public debt is assessed as unsustainable by the joint WBG-IMF Debt Sustainability assessment. The countries benefitting from the debt-relief initiative would be subjected to an IMF program involving additional IMF financing and policy-conditionality.

2. **Debt-for-nature swaps:** It is an agreement that reduces a developing country's debt stock in exchange for a commitment to protect nature from the debtor-government. It is a voluntary transaction whereby the creditor cancels the debt owned by a developing country's government. The savings from the reduced debt service are invested in conservation projects. The 2017 Seychelles debt for adaptation swap was the first global experience in which the country agreed to swap parts of its debt in return for designating nearly a third of its waters as protected areas.

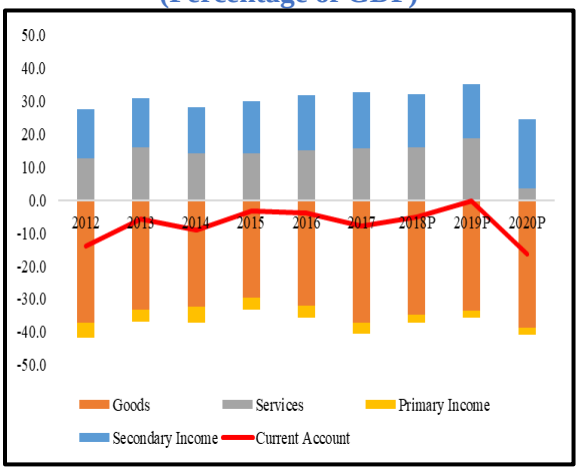
3. **Debt-for-climate swaps:** They are a variation of debt for nature swaps in which bilateral and multilateral debt relief enable vulnerable developing countries, including SIDS, to reduce their external debt while investing the liberated funds in national climate adaptation and mitigation programs. The Caribbean region (Jamaica, Haiti, Grenada, and Antigua and Bermuda) have negotiated swaps, with various levels of success.

4. **Debt-for-development swap:** A similar swap in which creditors entered in an agreement with the Government to write-off debt with the agreement that those resources are channeled to agreed investment projects with high social and economic impact.

3. Balance of Payments

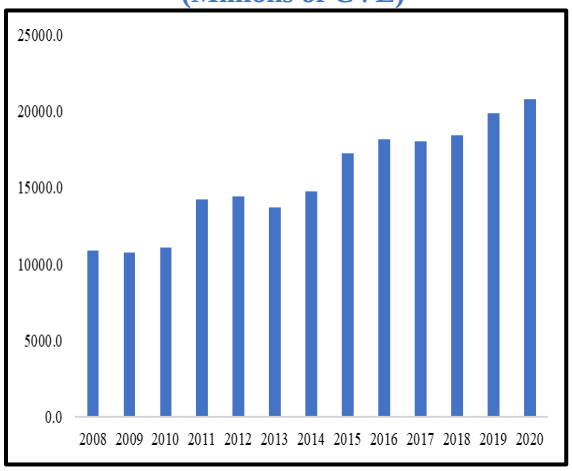
The COVID-19 shock curtailed export growth and increased external pressures. The Current Account Deficit (CAD) increased from 0.4 percent of GDP in 2019 to 16.5 percent in 2020. The sharp increase reflects lower net services exports, which decreased by 83.6 percent. Tourism receipts, which represents around 40 percent of services exports, declined by 70 percent in 2020 owing to the adverse impact of travel restrictions and other social distancing measures in the tourism industry (Box 4). Official remittances increased by 4.5 percent in 2020, easing the impact of COVID-19 on households by supporting private consumption and investment. This reflects strong social safety nets, such as job support programs, in Europe, which contribute around 70 percent of Cabo Verde's inward remittances (Figures 7 and 8). However, given global travel restrictions, it is possible that the increase in official remittances reflect a switch from informal channels to formal channels.

Figure 6: Current Account Balance (Percentage of GDP)



Source: IMF and World Bank staff estimates.

Figure 7: Annual Remittances Inflows (Millions of CVE)



Source: IMF and World Bank staff estimates

Box 4: Impact of the COVID-19 Crisis in the Tourism Sector

The COVID-19 pandemic has created an unprecedented shock for tourism in Cabo Verde. Following the closure of international borders in March 2020 and the partial reopening in October 2020, the authorities estimated a reduction of around 75 percent in tourism arrivals in 2020 and 78 percent in overnight stays. In absolute terms, this represented 612,183 fewer guests and 3,966,752 fewer overnight stays than in 2019. Most hotels, including major all-inclusive resorts, announced temporary closings and transient layoffs under a special regime enacted by the Government. According to the National Institute of Statistics, hotel establishments in operation at the end of December 2020 were 56.3 percent less than in the same period of 2019 and staff employed had declined by 82.6 percent compared to December 2019. Service sectors directly linked to tourism like restaurants, transport, and entertainment, were impacted by the combined effect of missing tourists and mandatory curfew restrictions that were imposed across islands according to the evolution of the pandemic.

Figure B2.1: Tourism Receipts

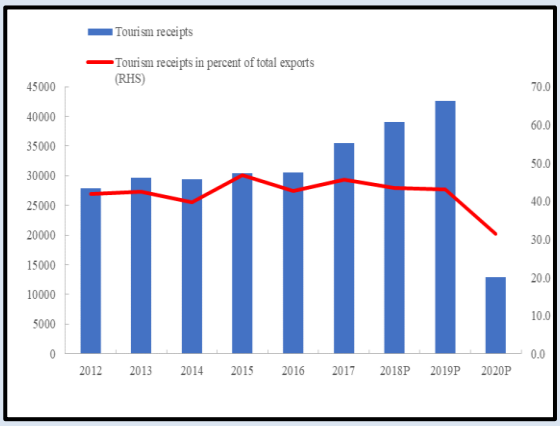
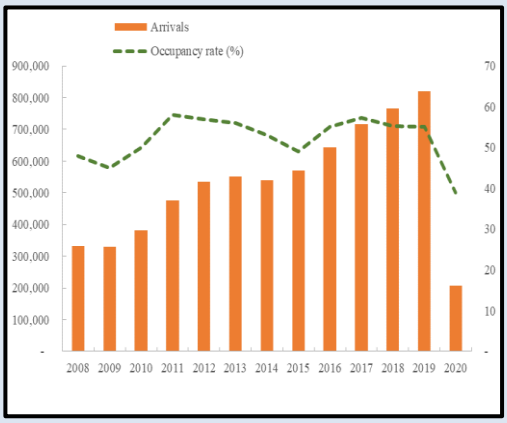


Figure B2.1: Tourism Arrivlas and Occupancy Rate



Authorities are looking to pursue needed reforms to relaunch the tourism sector as soon as possible. The authorities have enacted immediate response measures to support MSMEs across the economy and announced a tourism recovery plan to support the revitalization of the economy in the short term. The plan is based on four pillars. First, health safety, which aims at restoring tourist confidence and stimulating demand by implementing training and sanitary certification programs for tourism operators. Second, tourism diversification, which intends to position other tourist attractions nationwide while still promoting the well-established sun and beach

destinations of Sal and Boa Vista islands. Third, culture, which focuses on the rehabilitation of cultural heritage. Finally, the fourth pillar is strengthening support mechanisms to businesses and workers in tourism to build crisis resilience. In addition, Cabo Verde Ambition 2030 Plan opens a new opportunity for pursuing medium-term reform to promote sustainable tourism, diversified across more niches and islands, and better linked to the natural and cultural assets of the country.

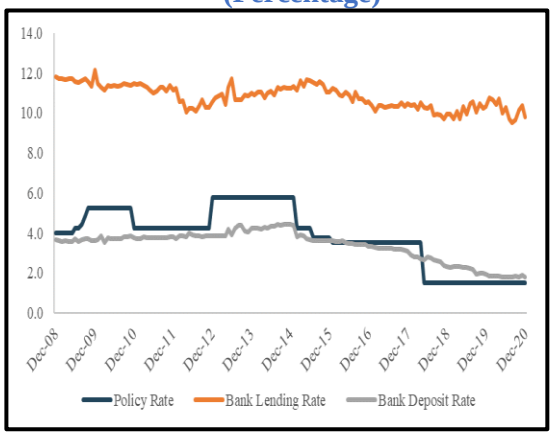
The CAD was financed through international capital inflows, grants, and external debt in 2020. The financial account contracted by 12.7 percent, mainly reflecting a decline of 32 percent in FDI due to the delay or cancelation of planned investment projects. FDI accounted for 4 percent of GDP in 2020. Grants increased from US$6 million in 2019 to US$28.5 million in 2020. External debt and international financial assistance contributed US$150 million. Gross international reserves decreased by US$94 million, reaching approximately US$687 million and covering about 7.2 months of imports, well above the level of 3.6 months recommended by the IMF 2019 External Stability Assessment (ESA).

4. Monetary Policy and Inflation

Low inflation and improved monetary conditions in the Euro Area facilitated an accommodative monetary policy stance in 2020. 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 in Cabo Verde is to ensure price stability while supporting the peg. In response to the COVID-19 crisis, the Government announced a monetary stimulus package to increase bank liquidity and allow debt repayment holidays. The measures included a reduction of the reference rate from 1.5 to 0.25 percent, a reduction in the lending facility rate from 3 to 0.5 percent, and the standing deposit facility rate from 0.1 to 0.05 percent (Figure 8). Additionally, reserve requirements were reduced to 10 percent from 13 percent, and the rediscount rate from 5.5 to 1 percent. A US$450 million credit line to banks was also created, with a 0.75 percent interest rate.

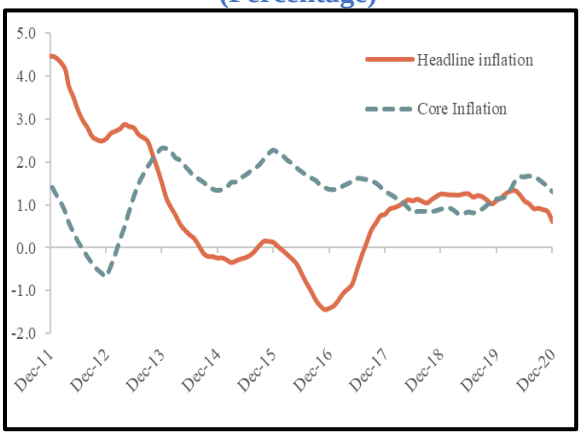
Inflation stood at -0.9 percent in December 2020 (year-on-year), reflecting weak demand and lower fuel prices. The decline in inflation was driven mainly by lower year-on-year prices for food and alcoholic beverages (-2.6 percent), transport (-1.4 percent) and clothing and footwear (-0.9 percent), reflecting continued weak domestic demand and lower international oil prices. Annual inflation for 2020 (CPI average) stood at 0.6 percent, below the 1.1 percent registered in 2019. Core inflation (overall index excluding unprocessed food and energy products) reached 0.2 percent (year-on-year), which compares to 1.7 percent in December 2019 (Figure 9).

Figure 8: Interest Rates (Percentage)



Source: Source: Cabo Verde's National Institute of Statistics.

Figure 9: Inflation (Percentage)



Source: Source: Cabo Verde's National Institute of Statistics

Despite the COVID-19 crisis, the financial system remained resilient in 2020, supported by the monetary policy measures adopted by the Central Bank to maintain market liquidity. The financial soundness indicators of the banking sector evolved positively in 2020. The regulatory capital-to-risk weighted assets increased from 17.7 percent in 2019 to 18.6 percent at end-September 2020. Return on assets stood at 1 percent, while return on equity at 12.7 percent. Commercial banks added record profits of more than 30 million euros in 2019, but risks associated with the COVID-19 pandemic prevented the distribution of dividends to shareholders, which led to a built-up in reserves. The banking sector remained liquid and credit to the economy increased by 4.8 percent (y-o-y) at end-December 2020, supported by credit lines and moratoria on loan payments provided in response to the COVID-10 crisis. The facility for long-term financing provided to banks, and reduction of the central bank's reference rates and reserve requirements supported the liquidity in the economy.

The financial sector continues to display structural weaknesses and risk aversion due to chronic high levels of Non-performing Loans (NPLs). High liquidity levels reflect risk aversion in an environment of persistently high NPLs (an elevated ratio of 10.1 percent at end-March 2020 despite recent declines), 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, respectively.

5. Poverty

The COVID-19 crisis erased the progress in poverty reduction achieved since 2015, pushing around 100,000 people into temporary poverty mainly in urban areas. The national moderate poverty rate (based on the national poverty line equivalent to PPP US$5.4 per person per day) was estimated at 35 percent in 2015, mainly due to high rates of poverty in rural areas (49 percent). Over the past five years, Cabo Verde registered significant gains in poverty reduction. Whereas the poverty rate was expected to decline to 26 percent in 2020 before the pandemic, World Bank simulations indicate that moderate poverty increased to 45 percent in 2020 (Figure 10 and Figure 11). Although poverty is largely a rural phenomenon,

the crisis disproportionally affected people living in cities, with a projected increase in urban poverty to 41 percent (from 28 percent in 2015) and in rural poverty to 52 percent (from 49 percent in 2015).

Figure 10: Moderate Poverty Rates

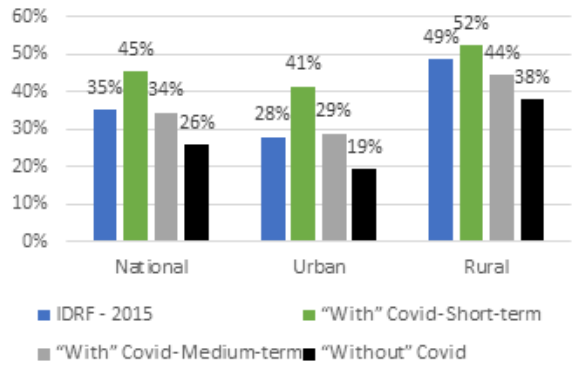
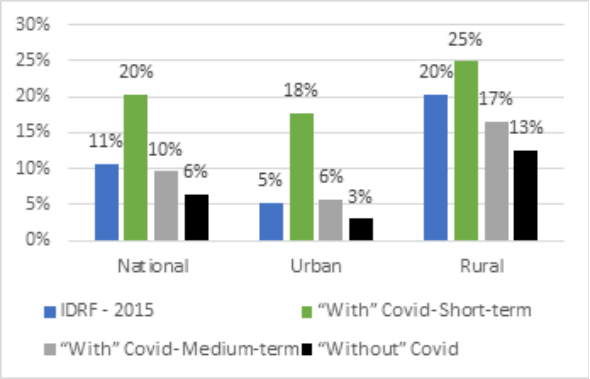


Figure 11: Extreme Poverty Rates



Source: Own calculations using 2015 IDRF and National Accounts data.

The crisis exacerbated income inequality, particularly in urban areas. Overall income is estimated to have fallen by an average of 21 percent. Growth incidence analysis shows that the income level of the lowest decile fell by at least half, while the income level of the highest decile dropped by 10 to 15 percent. Moreover, income for the bottom forty percent of the population is estimated to have decreased by 31 percent, compared to 14 percent for the rest of population. Consequently, the Gini coefficient is estimated to have risen to 0.479 in 2020. The increase is more pronounced in urban than in rural areas. In urban areas, the Gini index is estimated to have increased from 0.411 to 0.489 whereas it increased from 0.367 to 0.394 in rural areas. The larger increase in income inequality in urban areas is the result of the impact of the crisis in services and industrial activities.

Poverty will increase disproportionally for households connected to the tourism, hospitality, and transportation sectors as well as in the more touristic islands of Sal and Boa Vista. The sudden stop in international travel in 2020 led to income losses for households employed in the tourism and transport value chains and is likely to result in a contraction in consumption levels, driving some of them into poverty. The islands of Boa Vista and Sal had the lowest poverty rates in Cabo Verde at 7 percent and 19 percent, respectively. In the counterfactual scenario without COVID-19, poverty was expected to decline to 4 percent and 13 percent, respectively. However, with the crisis the poverty is projected to increase to 20 percent and 30 percent, respectively, in 2020.

The crisis disproportionally affected women. Women lost their livelihoods faster because they are overrepresented in the tourism sector. As quarantine measure keep people at home, women's unpaid care and domestic workloads may have also intensified. Women also make up a large proportion of those working in the informal sector, characterized by low pay and poor working conditions, including a lack of basic worker protections like paid sick and family leave. Domestic workers are also at risk. While the need for caregiving and cleaning services has increased, lockdowns and quarantine measures have made it difficult to maintain pre-pandemic working arrangements, resulting in a loss of income and employment among this largely female workforce.

B. Outlook and Risks

Real GDP is projected to recover gradually in 2021 and average a growth rate of 5.1 percent between 2021 and 2023. GNI per capita is projected to return to the 2019 pre-crisis level by 2024. Growth is projected to be 3.9 percent in 2021 supported by the gradual resumption of tourism flows in the last quarter of the year. The baseline assumes that the program to vaccinate the tourism sector and entry points professionals by December 2021 will be implemented. Over the medium term, the return of tourism and capital flows, and the restarting of structural reforms will drive growth. Private consumption and investment in tourism, energy and ICT linked to planned SOE reforms will sustain growth. As the Government refocuses its role in the economy towards regulation and policy aspects, private investment will be mobilized to expand and modernize the operation of several important SOEs through public-private partnerships (PPPs), direct sale and concession arrangements. Export of services will continue to be the leading contributor to growth.

Inflation is expected to remain subdued at 1.2 percent in 2021 and move closer to the EU average over the medium term. The negative output gap will keep inflation under control in 2021. In the medium term, the strong nominal anchor provided by the peg with the Euro and the return to fiscal consolidation will keep inflation contained. Monetary policy will continue to focus on improving transmission channels, including the low turnover in the interbank market, excess liquidity in the banking system, and limited development of the government securities market. The authorities plan to resume the recapitalization plan of the Central Bank, which started in 2019 but was halted in 2020 because of the crisis.

As the tourism sector is expected to start reactivating by the end of the year, the current account deficit is expected to reach 12.5 percent of GDP in 2021 and continue improving over the medium term. The CAD is projected to start declining in 2021 underpinned by the increase in tourism receipts towards the latter part of the year. Higher public debt amortization outflows are expected to increase external financing needs, which are projected to be met primarily by official borrowing and FDI. Despite the COVID-19 crisis in 2020, the Government has signed several investment establishment agreements for projects in the tourism sector, amounting to EUR $1,070 million as of April 2020, which will contribute to finance the CAD over the medium term. International reserves are expected to remain robust at an average of 6.2 months of prospective imports over the medium term.

The authorities are committed to a return to expenditure-driven fiscal consolidation over the medium term and to placing the debt-to-GDP ratio decisively on a downward trend. The Government intends to support enhanced macroeconomic stability as an important condition for boosting private investment in the aftermath of the crisis. The overall fiscal deficit is projected to decrease slightly from 8.9 percent of GDP in 2020 to 8.5 percent in 2021 as the impact of crisis on fiscal accounts will continue to be felt in 2021, and gradually decline to 1.7 percent in 2023. The Government is targeting a primary surplus of 1.0 percent of GDP by 2023. Public debt is expected to decline from 151.3 percent of GDP in 2020 to 139.9 percent in 2021 and to reach 128.1 percent by 2023. The authorities are also developing a debt relief proposal to discuss with their main creditors, aimed at opening fiscal space to invest in a green and inclusive recovery from the COVID-19 crisis.

The Government aims at maintaining the strong level of total revenue of around 30 percent of GDP over the medium term, with a progressive increase in tax revenue in lieu of grants. The Government remains committed to continue to enhance domestic revenues, including through measures to: (i) restrict some fiscal and customs benefits as part of efforts to reduce tax expenditures; (ii) revamp the micro and small enterprises framework to reduce evasion; and (iii) increase the excise tax rates for tobacco and alcohol. The Government is also 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 2022 due to the COVID-19 crisis, is projected to increase trade tax revenue over the medium term. Tax revenue is forecasted to increase from 19.0 percent of GDP in 2020 to 20.5 percent in 2021 and 23.7 percent in 2023. In parallel, grants should decline from 3.1 percent of GDP in 2020 to 1.0 percent in 2023.

Total expenditures are projected to gradually decline back to their pre-crisis levels by 2023. Current expenditures are expected to fall from 32 percent of GDP in 2020 to 28.5 percent in 2023, reflecting lower payments for goods and services, and the progressive reduction of emergency subsidies and transfers that were enacted in 2020. Capital expenditure is projected to increase from 2.7 percent of GDP in 2020 to 5.0 percent in 2021 to accelerate projects delayed in 2020 in the areas of transportation, water and sanitation, and ICT. Over the medium term, capital expenditure is projected to remain at 4 percent of GDP as new investment projects are subject to stricter selection criteria consistent with the use of the new public investment management system. Overall, total expenditure will account for 37.8 percent of GDP in 2021 and decline to 32.5 percent in 2023.

Despite the fiscal setbacks in 2020, decisive measures undertaken before the crisis to reduce net financing needs stemming from loss-making SOEs will contribute to a return to fiscal consolidation over the medium term. The partial privatization of CVA in 2019 was a step forward and will be instrumental in reducing financing needs over time. The reform will be followed by a proactive restructuring and privatization of other SOEs in 2021 and 2022, including the airport management company and the electricity utility company. Financial support to the SOE sector will be reduced over the medium term. On-lending to SOEs for investment purposes is expected to reach only 0.2 percent of GDP by 2023.

The outlook is highly uncertain with substantial COVID19-related downside risks. Uncertainties regarding the duration of the pandemic (including the rise of new variants of the virus), implementation of the vaccination campaign (including hesitancy by some people to take the vaccines offered to them), and the speed of the global recovery (particularly in Europe) cloud medium-term prospects. These factors could slow further the resumption of tourism, thereby impacting economic growth and deteriorating the fiscal and external position. To quantify these risks, a downside scenario was calibrated (
Table *4*). It assumes a sharper upsurge in new cases that lasts into the second half of 2021, delays in the immunization process, leading to lower tourism arrivals in 2021. Under such a scenario, growth would reach only 2.5 percent in 2021. Exports of service would remain depressed, worsening the external current account balance, to 13.1 percent of GDP. The fiscal deficit would reach 8.8 percent of GDP, as revenues drop further and spending to support households and firms increases. And the decline in public debt would be less, to 140.6 percent of GDP.

Table 4: Selected Economic Indicators under Baseline and Downside Scenarios

	2019	2020e	2021p	2022p	2023p	2021p	2022p	2023p
			Current Baseline			Downside		
Real GDP	5.7	-14.8	3.9	5.2	6.1	2.5	5.0	6.0
Real GDP per capita (annual % change)	4.5	-15.7	2.7	4.1	5.2	2.5	3.2	4.6
Consumer prices (annual average)	1.1	1.0	1.2	1.4	1.5	1.1	1.3	1.4
Total Revenue and Grants	29.4	25.8	29.3	30.5	30.8	29.1	30.1	30.7
Tax Revenue	21.5	19.0	20.5	22.4	23.7	20.3	22.0	23.6
Total Expenditure	31.2	34.7	37.8	35.6	32.5	37.9	36.1	32.6
Budget balance (including grants)	-1.8	-8.9	-8.5	-5.1	-1.7	-8.8	-6.0	-1.9
Current account balance	-0.4	-16.5	-12.5	-9.3	-4.7	-13.1	-9.6	-4.9
Overall BOP balance	7.4	-5.0	-0.5	0.0	1.0	-2.1	0.3	0.7
Public debt (external and domestic)	124.9	151.3	139.9	134.9	128.1	140.6	135.2	128.5
External Debt	91.4	97.5	98.1	94.3	88.2	97.4	94.7	88.5

Source: Bank of Cabo Verde, IMF and WBG estimates and projections (March 2021).

The outlook is also subject to risks beyond the COVID-19 pandemic. Domestic, political, and social pressures against continue fiscal consolidation in the aftermath of the crisis could also derail SOE reform efforts. Delays in advancing the structural reform agenda could hamper GDP growth, competitiveness, and employment. 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. Additionally, the country remains significantly exposed to climate-related shocks.

The key policy priorities to restore fiscal and debt sustainability in the aftermath of the crisis are:

Policy Priorities	Timeline
Return to a prudent fiscal policy stance	
Advance revenue-enhancing reforms such as recovering outstanding tax arrears through stricter enforcement mechanisms and strengthening tax monitoring to enhance compliance through tax audits, inspections, and improved tax administration and controls mechanisms at customs.	ST
Prioritize health expenditures and capital expenditures, while containing current expenditures and enhancing the management of the public investment program to ensure fiscal sustainability.	ST
Revamp the management of fiscal risks by improving the reporting of SOE finances, quantify fiscal risks, particularly those arising from contingent liabilities, and institutionalize oversight for fiscal risk management at the Ministry of Finance.	ST+MT
Improve debt management and transparency	
Continue to implement a zero limit on non-concessional borrowing.	ST
Publish and improve the content of the quarterly SOE bulletins, by including an assessment of fiscal risks.	ST
Increase debt transparency by broadening the coverage of public debt to include guaranteed domestic debt and non-guaranteed debt held by SOEs.	MT
Reinvigorate structural policy reforms	

Policy Priorities	Timeline
Reinvigorate structural reforms of SOEs by bringing private sector into the airport management company and the electricity utility company to improve efficiency and service delivery.	MT

Part II –Special Focus: The Enabling Environment for Private Investment*

1. A Portrait of the Private Sector in Cabo Verde

Firms in Cabo Verde are highly concentrated in the islands of Santiago, São Vicente, and Sal. According to the latest census of firms conducted in September of 2019 by the National Institute for Statistics, there are 8,118 active companies in Cabo Verde. Around 75 percent of them operate in the main islands of Santiago, São Vicente, and Sal. Overall, these firms accounted for 95 percent of national output and generated around 85 percent of formal jobs in 2018. On average, across islands, 41.5 percent of formal employees are women. However, female jobs are more prominent in the most touristic island of Sal and Boa Vista, where they represent 44 percent of the workforce. In the less vibrant islands of São Nicolao and Maio, the female share in formal employees reaches 52.5 percent and 51.1 percent, respectively (Table 5).

The services sector, particularly tourism and accessory activities, account for the lion share of jobs. Retail trade and tourism accommodations represent 67 percent of all formal jobs in the country. The hotel sector is the most important in Sal and Boa vista, where it accounts for 44.3 percent and 24.4 percent of all formal jobs in each island. Retail trade activities is the most common activity in the rest of islands. The role of agriculture and fisheries in terms of employment and output is minor in all islands. Some dynamism is observed in food manufacturing, mainly processing and preserving of fish, in São Nicolao and São Vicente. These sectors are the second largest in these islands, accounting for 14.7 percent and 8.8 percent of total employment, respectively (Table 5).

Table 5. Firms, Output, and Employment in Cabo Verde

Island	Firms		Sales		Employment			Two largest sectors	
	Number	Share (%)	Million Escudos	Share (%)	People	Share (%)	Of which women (%)	(Within island employment share)	
Santiago	3,128	38.5	116,511	44.3	26,826	41.2	39.7	Retail trade (17.5)	Security Activities (7.4)
São Vicente	1,801	22.2	73,804	28.0	15,448	23.7	40.4	Retail trade (20.6)	Food manufacturing (8.8)
Sal	1,107	13.6	58,784	22.3	13,117	20.1	44.0	Accommodation (44.3)	Repair of household goods (8.0)
Santo Antão	681	8.4	3,517	1.3	2,708	4.2	44.5	Retail trade (36.0)	Construction (14.4)
Boa Vista	555	6.8	7,913	3.0	3,988	6.1	44.0	Accommodation (24.4)	Retail trade (13.5)
Fogo	419	5.2	1,526	0.6	1,575	2.4	42.2	Retail trade (44.1)	Food and Beverages (12.5)
São Nicolao	248	3.1	568	0.2	787	1.2	52.5	Retail trade (46.5)	Food manufacturing (14.7)
Maio	106	1.3	352	0.1	399	0.6	51.1	Retail trade (30.1)	Other activities (15.0)
Brava	73	0.9	290	0.1	267	0.4	42.7	Retail trade (50.9)	Food and Beverages (22.5)
Total	8,118	100	263,263	100	65,115	100	41.46	Retail trade (42.0)	Accommodation (25.4)

Source: Authors computation using the 2018 Census of firms from the National Institute for Statistics

Micro, Small, and Medium Size Enterprises (MSMEs) are the backbone of the economy. They constitute around 98 percent of formal companies and account for 40 percent of formal jobs. As in many

* This chapter relies on the Investment Climate Reform Action Plan prepared by the World Bank Group as part of the Investment-Enabling Environment in ACP (IEE-ACP) program. The program is part of a broader program implemented in partnership with UNIDO and ITC, entitled Support to Business Friendly and Inclusive National and Regional Policies, and Strengthening Productive Capabilities and Value Chains.

developing countries, the informal sector is considered large, possibly as high as 59 percent of the number of formal establishments and provide job opportunities mainly to women (2018 UN Country Gender Profile). Large companies operate only in Santiago, São Vicente, Sal, and Boa Vista and account for 60 percent of formal jobs (Figure 12)

Given Cabo Verde's small scale and insular geography, firms are highly dependent on international investment and trade flows. Around 20 percent of formal companies have at least 50 percent of foreign ownership. Multinational corporations are in operation in all islands, but they are disproportionally represented in Boa Vista and Sal where they account for 52.1 percent and 37.9 of formal firms, respectively (Figure 13). Foreign firms dominate the accommodation sector. About 13.5 percent of firms are directly connected to international trade of goods, as exporters, importers, or both. Traders are more commonly found in Santiago and São Vicente, the production islands of the country (Figure 14). While comparable information for peer countries is unavailable, the share of multinationals and international traders is larger in Cabo Verde than in the United States, where they represent 1.3 percent and 6.4 percent of the universe of firms, respectively (Bernard et al 2005). The high dependence on international markets make the private sector very vulnerable to external shocks, such as the COVID-19 pandemic (Box 5).

The state plays an active role in the delivery of goods and services through an array of State-Owned Enterprises (SOEs), including in sectors usually served by the private sector. Notwithstanding recent privatization efforts, 32 SOEs continue to play an active role in the economy in 2020, particularly in utilities, energy, and transportation. Output from SOEs account for 26 percent of GDP whereas the average in Africa is 15percent. SOEs hold assets worth over 60 percent of GDP and debt of over 50 percent of GDP. Across 30 sectors and subsectors surveyed for this diagnostic, 14 sectors have at least one SOE in operation. Although at the sectoral level this number is relatively low, there are several SOEs in sectors typically served by the private sector such as ship building and repair, house construction, agriculture, and soup production.

Firms that are connected to international markets are larger, employ more people, pay higher wages, and are more productive than domestic private companies. A firm involved in international trade employs on average 16 employees, whereas a firm that serve exclusively the domestic market employs on average 5 people. A foreign firm pays, on average, a monthly wage of $9,583.4 CVE (US$103) while a trader pays $14,142.1 CVE (US$151) and domestic private companies $9091.5 CVE (US$103). There is a pecking order across types of firms in terms of labor productivity. Multinational companies and international traders display higher level of productivity than domestic firms. State owned enterprises are characterized by disproportionally high levels of employment (150 people, in average), high capital, low wages, and low productivity levels (Table *6*).

Table 6. Firm Characteristics, by type (Averages)

	Sales (in logs)	Employment (number)	Capital (logs)	Wages (logs)	Labor productivity (logs)
Foreign Firms	14.5	9.0	13.7	11.7	13.5
Traders	14.3	16.4	14.5	12.0	13.4
SOEs	14.4	148.9	18.1	11.1	13.2
Rest	14.0	4.8	13.3	11.6	13.1

Source: Authors computation using the 2018 Census of firms from the National Institute for Statistics

Figure 12: Firms Distribution by Size (percentage)

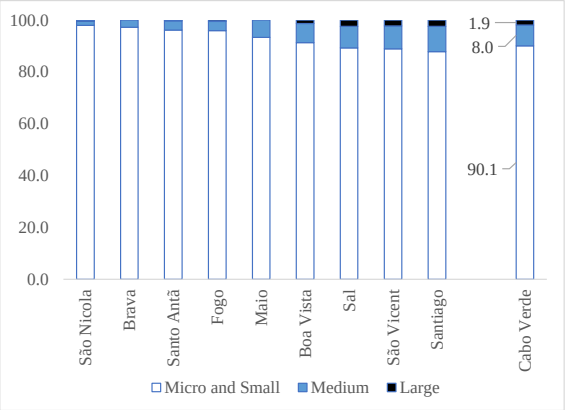


Figure 13: Firms Distribution by Ownership (percentage)

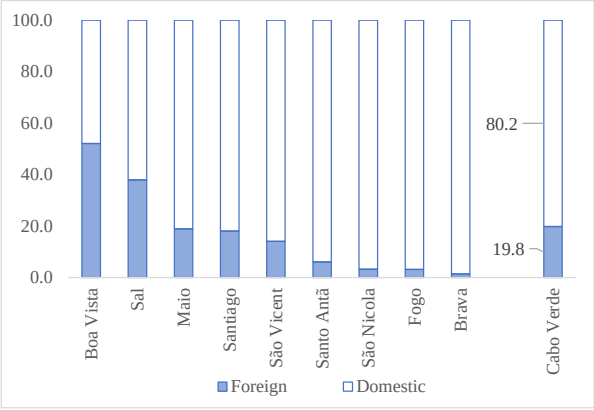


Figure 14: Firms' Distribution by Export/Import Status (percentage)

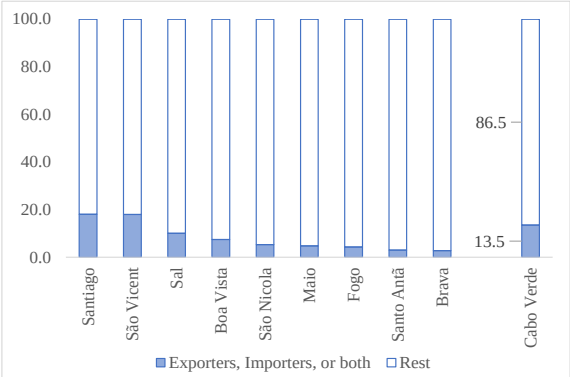


Figure 15: Number of Firms with Public Capital

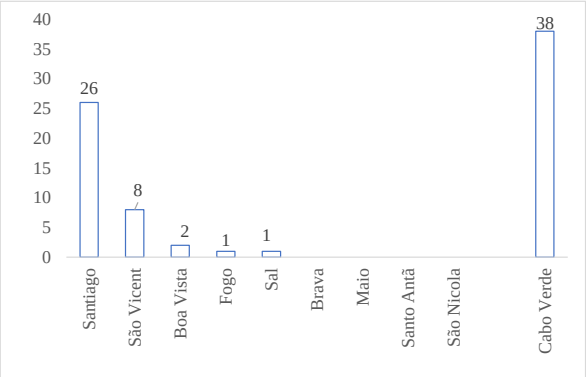
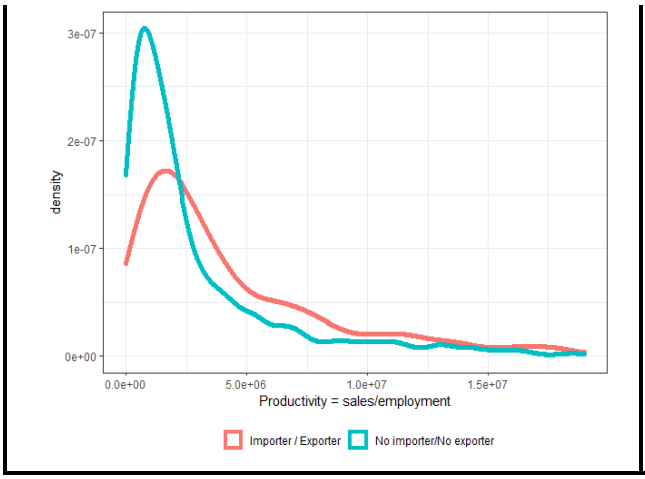


Figure 16: Labor Productivity by Export/Import Status

Figure 17: Labor Productivity by Ownership


3e-07
2e-07
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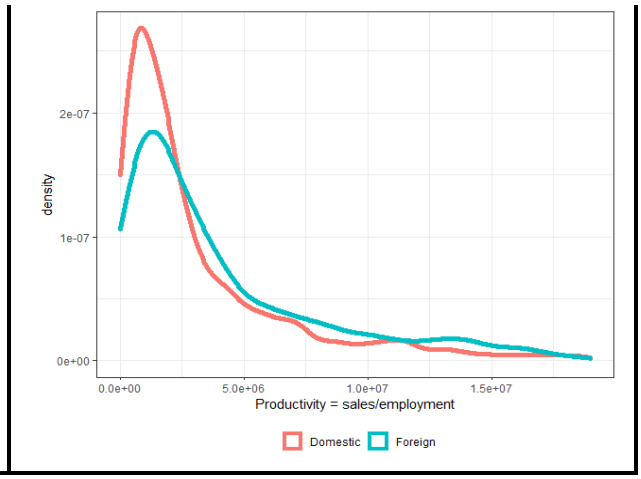
1.0e+07
1.5e+07
Productivity = sales/employment
Importer / Exporter
No importer/No exporter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1.0e+07
1.5e+07
Productivity = sales/employment
Domestic
Foreign

Box 5: The Impact of the COVID-19 crisis on Businesses in Cabo Verde

The impact and persistence of the COVID-19 pandemic has had a large negative effect on firm performance. Given the concentration of firms and jobs in the services sector, particularly in tourism and associated activities, the demand shock created by the abrupt and persistent global stoppage of tourism negatively impacted firms and workers in 2020. To assess the impact of the pandemic, the National Institute of Statistics (INE) conducted two surveys of businesses in March and June 2020 on the islands of Santiago, São Vicente, Sal, and Boa Vista. The key findings of the surveys are:

1. About 90 percent of establishments in the tourism sector and 15 percent in the commerce sector temporary ceased operations.

2. Around 83 percent of the companies reduced their turnover. Mobility restrictions brought on by the State of Emergency (75 percent) and difficulties in delivery orders (72 percent) were the main causes of the reduction in output.

3. About 43 percent of firms had a reduction in employees. Within this group, 36 percent of companies had a reduction of less than 10 percent in the workforce, while 11 percent declared a reduction larger than 75 percent.

4. Most firms (81 percent) did not need credit to pay salaries. Out of the companies that required credits, 31 percent indicated that the credit was on more favorable terms compared to the past.

5. About 25 percent of surveyed companies had an investment in progress before the pandemic. About 30 percent of them reduced the pace of investments due to the crisis.

6. Teleworking was seldom used. Around 54 percent of companies stated that they had no people in the teleworking. Within those companies implementing teleworking, 36 percent consider that it had no impact on productivity, whereas 28 percent attested that it decreased productivity. Only 6 percent stated that it had increased productivity.

7. When asked about their expectations regarding the end of the COVID-19 crisis, almost 34 percent of the companies expect it to end by 2022. Around 60 percent indicated 2021.

8. Three out of four companies surveyed indicated that the temporary lay-off granted by the Government was the most relevant measures taken by the Government to ameliorate the impact of the crisis.

2. Foreign Direct Investment: In Pursuit of Economic Diversification

Foreign Direct Investment (FDI) plays a central role in economic growth and development. Investment from multinational corporations is a source of external financing and an important contributor of jobs. Additionally, foreign capital flows embody advance technology, superior knowhow, and frontier managerial expertise that have the potential to increase the productivity of the host economy. Foreign firms can also increase competition in input and output markets, thereby supporting the efficient reallocation of factors, which in turn can boost the competitiveness of the economy. Finally, FDI may also enhance product

differentiation in sectors in which a country has a comparative advantage, therefore contributing to economic diversification.[9] However, these benefits are not automatic, particularly in SIDS.

Low economies of scale hinder the ability of SIDS to increase the development impact of FDI. Low economies of scale usually result in high levels of export specialization (in products and markets), low backward linkages between foreign firms and domestic suppliers, and large costs of running the government that often creates high levels of public debt. A key implication of these economic outcomes is the high level of economic vulnerability to external shocks. As a result, SIDS tend to face external economic volatility in the form of terms of trade volatility and GDP growth rate volatility.[10] Given these characteristics, how can Cabo Verde leverage FDI for a more inclusive and resilient economic growth?

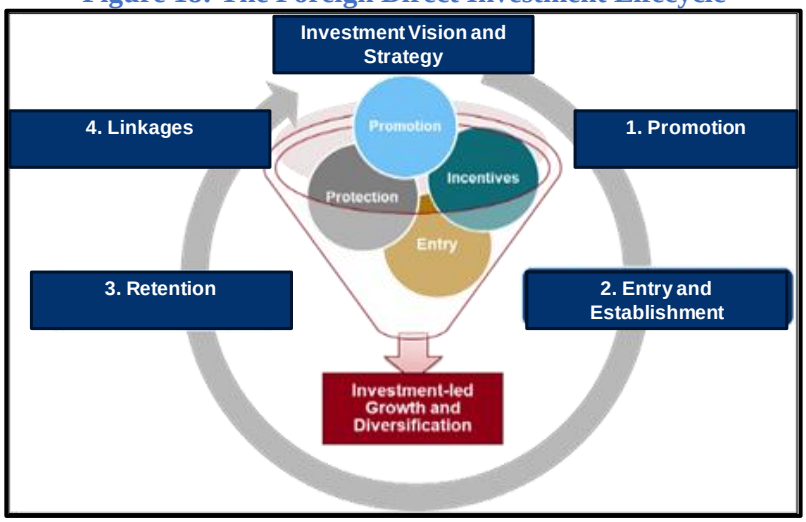
This section examines the dynamics of FDI in Cabo Verde and identifies main constraints to leverage FDI to build back better from the COVID-19 crisis. The Cabo Verde Ambition 2030 strategy seeks to ensure sustainable and more resilient economic growth over the long run. This objective is intrinsically linked with the development of the tourism sector, which is the main engine of the economy and can be the catalyst for development in other sectors. Because investment in the tourism sector is overwhelmingly dominated by multinational corporations, the progress towards achieving this objective depends inexorably on the ability of the Government to maximize the development impact of FDI and promote local MSMEs.

The analysis is based on the fundamental premise that FDI is not a one-off transaction but rather a continuous relationship between the government and the foreign investor. Public policies should go beyond promotion efforts and include a comprehensive set of policies and instruments along the investment life cycle (Figure 18). Globally, roughly 25 percent of annual FDI are reinvestments from existing investors.[11] An emphasis on investment retention is thus key to maximize the development impact of FDI. This has become even more important as the COVID-19 pandemic has made attracting new investment more uncertain. This approach provides a policy framework to identify the challenges that foreign firms face at different stages of their engagement with the country. The investment life cycle begins with the host country's investment strategy and policy priorities. This strategy articulates the different instruments (promotion campaigns, investment incentives, international investment agreements) available to support the policy goals. Policy implementation occur in four stages:

1 I**nvestment promotion** targets foreign investors through a proactive, sector specific, outreach program and influences them to establish their operations in the host economy.
2 The entry stage supports the **establishment** process of the project.
3 At the operation phase of the project, the **expansion and retention** support investors to promote reinvestment and expansion, and avoid grievances, conflicts, and investment withdrawal.
4 The **linkages** stage supports the connection of domestic suppliers with foreign investors.

[9] The positive relationship between FDI and aggregate productivity gains and economic growth has been shown by Dollar (1992), Harrison (1996), and Frankel and Romer (1999).
[10] Lederman and Lesniak (2018) analyze the characteristics of small open economies and discuss possible policy solutions to address some of these challenges.
[11] World Bank Group (2018) Global Investment Competitiveness Report.

Figure 18: The Foreign Direct Investment Lifecycle



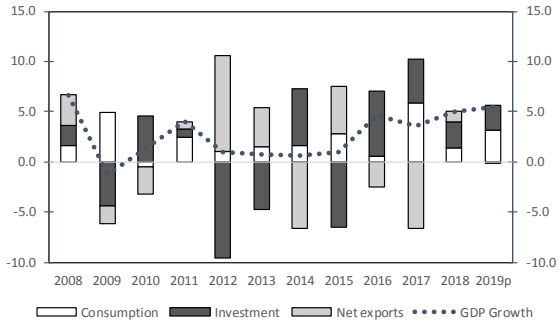
Source: The World Bank Group.

a) Benchmarking FDI in Cabo Verde

Investment is a key driver of economic growth in Cabo Verde. Gross fixed capital formation is the largest contributor to growth and a good predictor of the economic cycle. The resumption of growth in 2016 was driven mostly by high investment rates. Between 2018-2019 investment contributed 2.5 percentual points to economic growth –around half of the observed growth (Figure 19). FDI is also the largest component in gross fixed capital formation. Multinational corporations dominate the tourism sector.

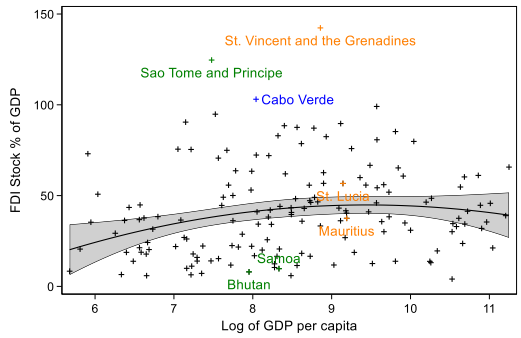
In line with its SIDS status, exceptionally high levels of FDI (as a share of GDP) situate Cabo Verde as an outlier on the global stage. The stock of FDI-to-GDP ratio, which evaluates the role of external capital in the economy, accounted for 100 percent of GDP in the period 2016-2019. This value is significantly higher than what would be expected in countries with the same level of development. Compared with peer countries, the role of FDI in the economy is more important in Cabo Verde than in Bhutan, Samoa, Mauritius, and St. Lucia (Figure 20). Only São Tome and Principe and St. Vincent and the Grenadines have a larger FDI stock as a share of GDP. The large accumulation of FDI is the result of large annual flows that represented, on average, 7 percent of GDP during the last decade. However, FDI flows have continuously decreased from 8.8 percent of the GDP at the beginning of the decade to 6.3 percent of the GDP between 2016 and 2019 (Figure 21).

Figure 19: Real GDP Growth Decomposition
(Percentage)



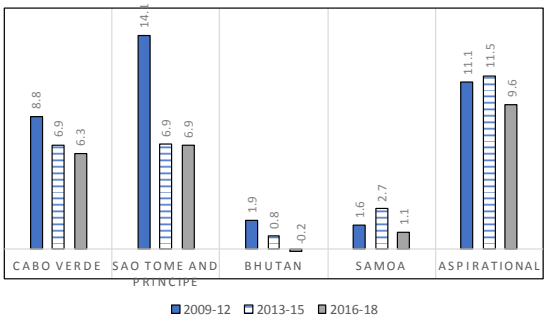
Note: This figure shows the contribution of the largest components of the demand side to real GDP growth.
Source: Authors' calculations using data from the Cabo Verde Institute of National Statistics.

Figure 20: Stock of FDI as a Share of GDP
(Average 2016-2019)



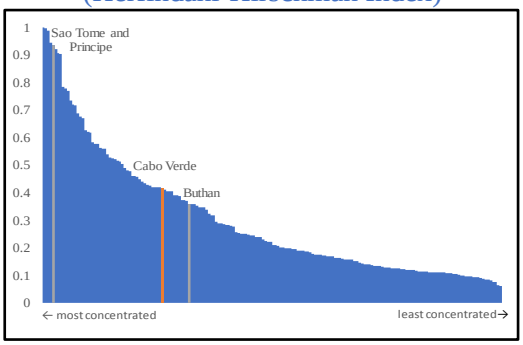
Note: This figure benchmarks Cabo Verde's stock of FDI with respect to all countries in the world. Each cross in the figure indicates a country. The curve represents the expected stock of FDI as a share of GDP for a given per capita income, controlling for GDP per capita and GDP per capita squared.
Source: Authors' calculation using data from the World Development Indicators and UNCTAD.

Figure 21: FDI Inflows as a share of GDP
(2009-2019)



Source: World Development Indicators

Figure 22: Market Concentration of FDI
(Herfindahl-Hirschman Index)



Note: The Herfindahl-Hirschman Index (HHI) of geographic concentration is defined as the sum of the squares of FDI inward stock from a given country. It would take the value of 1 in a case where all FDI originates from one country and approach zero the more dispersed FDI projects are across source countries.
Source: The World Bank

As the tourism sector has been the main driver of FDI over the past two decades, diversification and inclusiveness remain key challenges. The rapid development of the sector has brought several challenges, namely poor diversification in terms of products, operators, and geography with a high concentration of tourist (78 percent of international tourist) in the islands of Sal and Boa Vista. Additionally, the "all-inclusive" resort segment, dominated by large vertically integrated international tour operators with limited linkages to local suppliers, dominates the sector. The average tourist discretionary spending outside the resorts has been trending downwards from US$1,500 in 2007 to US$800 in 2015 and has remained broadly stable since then. Beyond tourism, there are latent opportunities for economic diversification in the agriculture and fisheries sectors (Box 6)

Box 6: Potential Opportunities for Economic Diversification

The economic diversification aspiration has been continuously articulated, in different iterations and frameworks, in the recent national development strategies of Cabo Verde. The first Growth and Poverty Reduction Strategy Paper (GPRSP), approved in 2004, started to underscore the importance of private sector led growth as well as the accompanying business environment conducive to it. The next two editions of the GPRSP, covering the period from 2008 to 2016, further deepened the due diligence and prioritization of areas of perceived economic comparative advantage around a vision of business clusters: i) tourism; ii) maritime economy (including fisheries and transshipment); iii) air transport hub and related services; iv) ITC service-hub in the subregion; v) financial services hub in the subregion; vi) creative economy products and services; and vii) agrobusiness.

The subsequent Strategic Plan for Sustainable Development (2017-2021), reiterated the vocation to develop service and products areas around similar anchors and platforms. The diversification agenda is again reflected in the new "Ambição 2030" vision, which underscores the need to diversify the economic poles of the country in the wake of the shock induced by the COVID-19 global pandemic.

The success of the diversification agenda has been to date nonetheless modest – tourism has remained the sole driving sector, commanding the overwhelming share of FDI in the last decade concentrated just on the all-inclusive resort segment in Boavista and Sal islands. Whilst the light industry canning of fisheries (commanded by a single Spanish group) and promising bunkering trends, both in São Vicente island, have been exceptions in terms of export dynamics and employment creation, other sectors have struggled with binding constraints associated with lack of scale, high relative cost of factors, non-conducive business environment, and difficulty and costs in transportation and access to credit.

Recent pre-pandemic trends have laid the ground for optimism, notably in the tourism and fisheries, both of which present the greatest diversification potential in the short and medium run. Some specific examples of economic diversification potential include:

- **Investments in new aquaculture niche**: the government recently approved the first regulatory framework for aquaculture. The attraction of private investment in the sector seems promising, including a Norwegian-led group called Nortuna which will be commanding a phased potentially transformational EUR 200 million investment in aquaculture production of Atlantic Bluefin Tuna.

- **Diversification inside tourism sector:** growing tourism flows to islands like Santo Antão have opened up new segments with higher spending and spillover effects, notably trekking, culture and hiking tourism. The upcoming visit of The Ocean Race (largest yachting event in the world) to Mindelo in late 2022, inducing additional recreational nautical and cruise-ship tourism flows to the country, will also be an opportunity to steer a broader Blue Economy agenda.

- **Backward linkages in the endogenous agriculture and fisheries value chains:** servicing both tourism and import substitution for the domestic market, remain signaled with high potential to induce poverty reduction nationwide, but will require additional investments in scaling, certification and logistics.

The COVID-19 crisis highlighted the need to pursue economic diversification and enter into new GVCs to reduce the vulnerability of the economy to external shocks The pandemic negatively affected FDI and value chains in tourism and travel, given the vulnerability of the sectors to containment measures.

FDI decreased from 5.4 percent of GDP in 2019 to 4.4 percent in 2020.[12] The reduction of tourism arrivals in Cabo Verde was 70 percent in 2020. Most hotels, including major all-inclusive resorts, announced temporary closings and temporally layoffs under a special regime enacted by the Government. The open investment regime and privatization processes have enabled FDI in market-seeking sectors such as financial services, infrastructure, and tourism. To increase the resilience of the economy for future shocks, it is then important to attract FDI in export-oriented services beyond tourism, which requires the attraction of efficiency-seeking investors. [13]

b) Institutional Framework for Investment Policy and Promotion

The quality of the institutional framework has a direct effect on the coherence of policy direction, formulation and implementation, and an indirect effect on policy outcomes. A focus on establishing an aligned, well-coordinated and effective institutional arrangement is key to a country´s aspirations to successfully integrate into global markets by means of attracting more investment flows and trading more goods and services. Such endeavor entails a clear vision, commitment, and action-oriented leadership to convert a series of government agencies into an articulate, high-performing institutional cluster, capable of designing and implementing an agenda to properly leverage FDI and international trade to foster economic growth and more and better jobs.

Efficient institutional arrangements to foster a proper economic transformation are highly idiosyncratic and must respond to the specific political economy of a country. However, a review and comparison of the experiences of many countries which have succeeded in this endeavor, confirms four fundamental functions that are common practices on the organization and structure of their institutional framework: (i) policy direction, prioritization and coordination oversight; (ii) foreign trade and investment policy formulation, execution and coordination, including negotiation of trade and investment agreements and involvement of private sector stakeholders through appropriate information and consultation mechanisms; (iii) export promotion and the support of internationalization of domestic firms; and (iv) attraction of inward foreign direct investment and support to foreign investors (see Box 7).

Box 7: Best Practices in Institutional Arrangements for Investment Policy and Promotion
In many countries, four organizations comprise the institutional cluster in charge of undertaking the fundamental functions to leverage FDI and international trade to foster job generation, economic diversification, product upgrading and, ultimately, development. These organization must work closely aligned and coordinated, each with its own roles and responsibilities:

[12] However, since April 2020, the Government has signed several establishment agreements with private investment for investments in the tourism sector, totaling more than 1 billion euros. These investment announcements, if they materialize, have the potential to generate nearly 8,500 direct jobs.

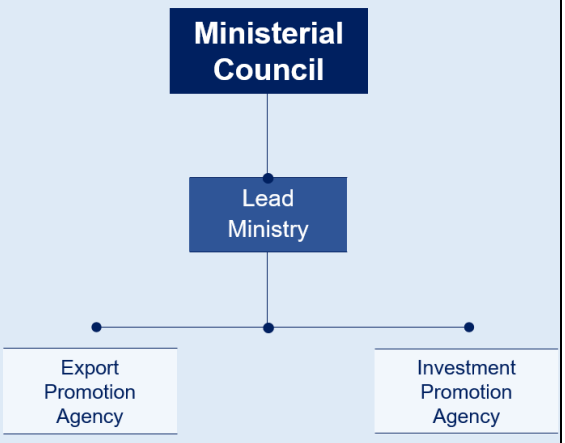
[13] The motivation of foreign companies to invest can broadly be categorized as (i) natural resource-seeking investment, which describes a situation where a foreign investor establishes an enterprise in the host country to access natural resources; (ii) market-seeking investment, which is driven by the foreign investor's intention to primarily serve the host country's market; and (iii) efficiency-seeking investment, in which the investor chooses a host country in order to take advantage of some competitive factor, such as a labor force, utilities, services, or geographic location. See Dunning (1993).

1. A Ministerial Council: in charge of policy direction, prioritization, and coordination oversight.

2. A Lead Ministry for foreign investment and trade policy undertakes the executive leadership role, including policy formulation, execution and coordination, and manages the involvement of private sector stakeholders through appropriate information and consultation mechanisms.

3. An Export Promotion Agency (EPA): supports domestic companies in their efforts to internationalize, either by exporting directly, becoming suppliers to export-oriented FDI firms established in the host country, or by promoting the establishment of domestic companies in international locations by promoting outward FDI;

Institutional Framework for FDI Policy



4. An Investment Promotion Agency (IPA): attracts foreign direct investment and provides specialized support services to foreign investors in their establishment and rooting in the country.

A shared strategic vision is needed to unite the agencies in this institutional cluster, each of which would have its roles and responsibilities well defined, with functioning collaboration and coordination mechanisms, and high technical, operational and political capabilities. Success will depend on the commitment of the government to provide the agencies in the cluster with the necessary means to properly execute their respective missions and mandates. This entails not only human and financial resources (including specific budget allocations) but also, in many cases, flexible administrative arrangements to attract the best human talent available in the country.

In Cabo Verde, the Council of Ministers is responsible for high-level policy coordination of the country's economic affairs, while the Ministry of Finance is the lead ministry for FDI. The Strategic Plan for Sustainable Development 2017-2021 (PEDS), developed in 2016, and the Cabo Verde Ambition 2030 plan, establishing the recovery strategy from the COVID-19 crisis, are the two high level strategic documents informing policy implementation.[14] The Minister of Finance, who is also the Vice Prime Minister, presides over the Council of Ministers for economic issues and leads inter-ministerial coordination on economic affairs.

Policy implementation is the responsibility of the Investment Promotion Agency, the Tourism Institute, and line ministries. Cabo Verde's *TradeInvest* delivers a range of investor services, including the organization of several investor fora to attract investment. The agency also has the role of export promotion agency. A range of line ministries, including (i) the Ministry of Industry, Trade, and Energy, (ii) the Ministry of Tourism and Transports; and (iii) the Ministry of Maritime Economy are responsible for the design and implementation of several, often uncoordinated, sectoral strategies to attract FDI. The Ministry of Foreign Affairs oversees the negotiation of international investment treaties. The Tourism Institute implements the tourism policy, including investment policy, and assists services to existing foreign

[14] Decree 28/2018 grants the Ministry of Finance a general mandate over the development, coordination and implementation of investment promotion applicable to public and private investment, including the investment promotion agency, currently Cabo Verde TradeInvest.

investors in the sector. Its role also includes the organization of events to promote the country abroad and has an active role in investment promotion in the sector.[15]

Despite the broad alignment of Cabo Verde institutional framework with best global practices, FDI policy implementation is fragmented. The absence of an FDI strategy that builds on the Cabo Verde Ambition 2030 strategy to recovery from the COVID-19 crisis will prevent an efficient and coordinated implementation of policies in the recovery phase. A strategy that identifies GVCs and reform priorities for FDI in the aftermath of the COVID-19 crisis should be developed. Additionally, investors already present in the country should receive enhanced assistance and aftercare services to mitigate the economic impact of the pandemic. Finally, the clarification or roles and responsibilities in policy implementation across different agencies as well as the promotion of mechanisms that allow the flow of communication between stakeholders (government agencies, the private sector, and civil society) is paramount to increase the effectiveness of investment policy.

c) Investment Entry and Promotion

Investment Promotion Agencies (IPAs) play a significant role through a proactive investment promotion in sectors that are key to implement the economic development agenda. In the current context, countries need to define their value proposition as an attractive investment location in line with the recovery strategy. In the aftermath of the pandemic, a proactive outreach to selected markets and investors in sectors with comparative advantages should be conducted. Global experience indicate that best performing IPAs are focused exclusively on investment promotion functions rather than on a dual role of promotion and regulation functions (Heilbron and Kronfol 2021).

Strengthening *TradeInvest* to effectively implement the FDI-led diversification agenda should be a core element in the recovery agenda. The agency's mandate to attract FDI should be updated in three areas. First, the agency needs to develop a corporate strategy in support of national investment objectives that is investor-centric and action-oriented with a clear sectoral and GVC focus.[16] Second, enough budget and human resources should be dedicated to implement the program[17]. Third, a direct and clear reporting line to the Ministry of Finance should be established, to ensure adequate oversight of their functions and ensure value for money.[18]

Expanding and improving the quality of services that *TradeInvest* offers to investors along the investment lifecycle is critical for the successful implementation of the FDI policy. *TradeInvest*'s investment promotion arm should work towards a proactive generation of investment leads, support to investor's establishment in a location, and in the short term support the retention of FDI to mitigate the impact of the COVID-19 crisis. The services that a modern IPA should offer to investors include:

[15] Decree 32/2029 bylaws Article 2.2 q

[16] An update of staff competences is needed. Most staff only speak Portuguese, which limits the effectiveness of their interaction with potential investors.

[17] *TradeInvest*'s budget was reduced from US$1.4 million in 2017 to US$1 million in 2019. The number of staff went from 36 to 30 over the same period. According to an IPA survey conducted by the WBG in 2017, only 2 staff members were dedicated to investment promotion. WBG Global IPA Survey, 2017.

[18] To ensure an adequate accountability of public funds to support the implementation of the FDI strategy, it is important to define and monitor a set of KPIs with the investment promotion agency for the different services, including the organization of international investment forums.

1. **Marketing services:** To accelerate recovery from the COVID-19 crisis, *TradeInvest* should promote new competitive segments by putting into place outreach programs to reposition the country as an investment destination. Its investment facilitation role—not only in articulating value propositions in segments offering new opportunities, but also in streamlining approval processes to establish investment—is likely to become pivotal. Marketing services include the organization of investment forum. The latest forums in Boston in 2020 and Paris in 2019 generated interests from 41 projects worth EUR1,600 million. However, only EUR150.5 million were actual investments. These forums were not led by the IPA, limiting their effectiveness.

2. **Information services:** Proving relevant and updated information to potential investors on business opportunities and the regulatory environment governing the entry, establishment, and business operations is an important component of investment promotion. The information services of *TradeInvest* are limited to a general overview of the investment climate, the services the agency offers, and broad information on investment opportunities. This information ought to be complemented with information about the requirements and processes of investing in each sector. Finally, the website should present the relevant rules and regulations that apply to investments in the country.

3. **Assistance services**: *TradeInvest* is responsible for approving FDI projects, which is not aligned with best international practices. Decree 42/2015 gives the agency the mandate to analyze and decide on the feasibility of investment projects. The risk of this practice is that often IPAs do not have the technical knowledge required to determine the ability of investors to carry out their business plan in line with the national regulatory framework. This role also deviates the attention of the agency from its core mandate of promoting FDI.

4. **Advocacy services:** The direct day-to-day contacts that IPAs have with foreign investors provides an opportunity to identify regulatory bottlenecks, policy failures, and other regulatory gaps in the investment ecosystem. This information should be used to advocate for reform within the Government and with other stakeholders to improve the investment cycle. *TradeInvest* does not have a policy advocacy role.

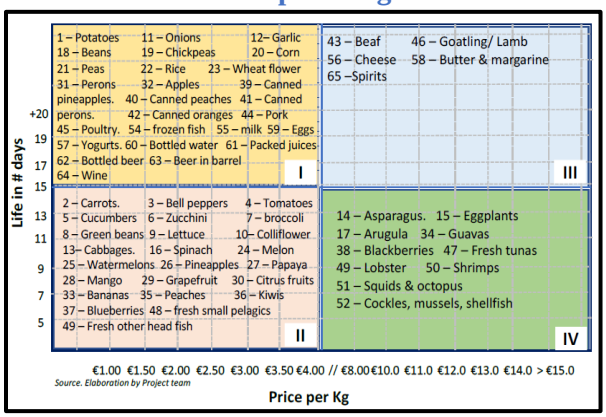
d) Developing linkages between Local Suppliers and Hotels

Foreign investors bring a wide range of knowledge and know-how that has the potential to bring positive spillovers to the host economy. These benefits, however, are not automatic. The main transmission channel to transmit these knowledge spillovers is the development of contractual linkages between foreign firms and domestic suppliers. The superior technical and quality requirements of foreign firms to source inputs is associated with an increase in the productivity of their domestic suppliers. Policies and programs that promote domestic linkages will maximize the development impact of FDI (Reyes 2017).

Linkages between domestic suppliers, particularly in the agriculture and fisheries sector, and hotels in Cabo Verde are low. Despite a large variety of fruits and vegetables produced locally, particularly on Santiago island, over 80 percent of food and beverage products consumed by the all-inclusive resorts are imported (World Bank 2019). There are three main constraints to develop domestic linkages in Cabo Verde. First, the small size of domestic producers makes it difficult for individual suppliers to respond to large orders from hotels. Second, domestic enterprises may not have the production standards required to meet minimum quality requirements of hotels. Third, the geographic dispersion of the archipelago increases the time and cost to move perishable goods from one island to the other.

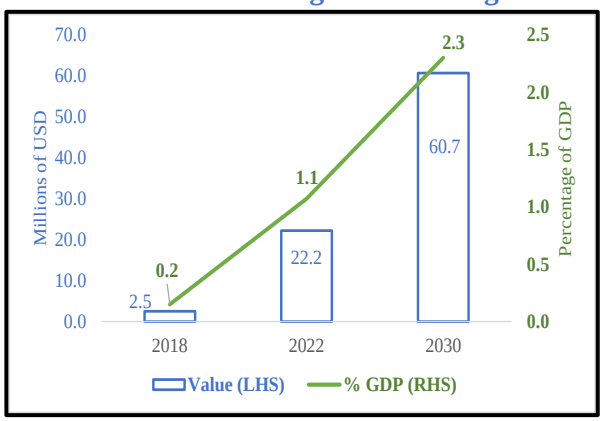
Fruits, vegetables, and seafood products are opportunities to develop domestic linkages with hotels, given the country endowments and comparative advantages. By comparing the total landed cost of imported products (which includes the price of buying the product, freight, insurance, excise duties and breakage) with the resilience of the products to overcome the logistic factor, the products that are produced in Cabo Verde and have a latent opportunity to be sold to hotels are asparagus, eggplants, arugula, guavas, fresh tuna, lobster, shrimp, octopus, and mussels (quadrant IV, Figure 23). Connecting local supplier with hotels would not only transfer technology and know-how to the domestic supply chain but will also translate in greater domestic value added embedded in export of services. It is estimated that the additional domestic value added contribution to GDP goes from US$2.5 million (0.15 percent of GDP) in 2018 to US$60 million (2.3 percent of GDP) in 2030 (Figure 24).

Figure 23: Identification of Products with Potential to Develop Linkages with Hotels



Source: World Bank (2019).

Figure 24: Estimated Contribution to Value Added of Increasing Local Linkages



Source: World Bank (2019).

The key constraint to promote linkages is the logistics of moving products across islands, which hampers the competitiveness of local producers. While the new inter-island maritime concession included the development a logistic master plan to connect the islands, the COVID-19 crisis precluded its implementation. The inability to move produce across island in a timely fashion inhibit local producers of agricultural products in the Santiago island to develop stable and predictable commercial relationships with hotels chains in the islands of Sal and Sao Vicente. A key priority ought to be the development and implementation of the inter-island logistic plan that provide a predictable and cost-effective service to transport goods across island.

Other key bottlenecks to the development of domestic linkages include:

1. **High prices of key inputs:** High transport, electricity, and water costs reduce the competitiveness of local suppliers. Inter-island shipping remains the greatest challenge for the flow of food products from the producing islands to the tourism centers. Lack of cold storage facilities in ports, and inefficient port operations further limit participation of local entrepreneurs in the value chain of hotel operators.

2. **Restricted access to land:** The existing regime guarantees the right to private property of land. However, some restrictions apply. Agricultural land near shores can only be leased, with costly permits to set up facilities and securing sectoral licenses. Most of the arable land is already taken by families, which implies direct negotiations for acquisition, subjected to market price fluctuations and speculation.

The available public land is subjected to a significant bureaucratic and lengthy process for acquisition (Monteiro and Ferro 2017).

3. **Lack of managerial and production know-how:** Despite the existence of several training centers and universities, graduates and entrepreneurs lack the managerial, technical, business development and financial skills needed to seize business opportunities in tourism.

4. **Limited access to competitively priced capital:** access to finance remains a barrier, especially for smaller firms. Despite the availability of financing instruments by *Pro-Garante*, *Pro-Capital* and *Pro-Empresa*, general interest rates vary between 12-14 percent, and microcredit interest rates are even higher, reaching on average 24-36 percent. Collateral requirements are very high, making access to finance even more difficult for smaller firms.

5. **Fragmented agriculture production:** Small farmers cannot reach the scale required by hotel operators. Traders currently collect production, as well as undertake transport, storage, marketing, sales and payment collection activities. The absence of effective cooperatives or production collection schemes presents a major barrier to greater and a more profitable participation of domestic producers in the tourism value chain.

6. **Low production quality and lack of certification:** Difficulties in obtaining certification on products and production process limit the ability of domestic supplies to meet stringent product requirements from hotels.

3. Business Regulatory Environment: Slow Progress, Better Prospects

A strong business environment is a key enabler for achieving productivity growth, attaining high levels of private investment, and unleashing economic diversification. There are a variety of aspects that, taken together, can make or break firms, especially MSMEs which constitute near 98 percent of the formal companies in Cabo Verde. Economic activity in Cabo Verde is commonly performed by informal small enterprises, scattered among the nine inhabited islands. Reforms aimed at regulatory simplification can contribute to incentivizing firms to formalize and promote entrepreneurship, as well as increase investor confidence through greater predictability. A more competitive regulatory environment for local firms will also facilitate their integration into global value chains and strengthen their ability to compete at the international level. This section identifies and assesses key business regulation topics following the business lifecycle (

Figure 25: The Lifecycle of a Firm

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Figure 25: The Lifecycle of a Firm

Source: The World Bank Group.

After being one of the top business environment reformers in 2011 and 2012, Cabo Verde's reform momentum stalled over the last decade. Although Cabo Verde is placed above the Sub-Saharan average in the Doing Business Indicators, the ascending trend seen in the overall score from 2010 to 2013 has flattened, with Cabo Verde Doing Business ranking dropping from 119th in 2012 to 137th in 2020.[19] Furthermore, regulatory progress over the past decade was mostly anchored in four topics: (i) starting a business (4 reforms); (ii) registering property (5 reforms); (iii) dealing with construction permits (2 reforms); and (iv) paying taxes (2 reforms).

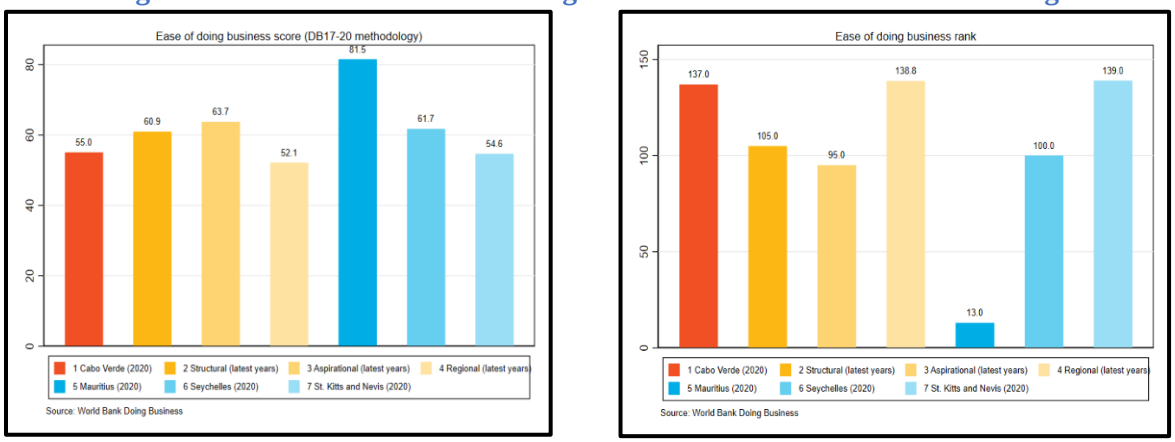
Cabo Verde's current Doing Business score and ranking show that the country lags structural and aspirational peers in getting electricity, protecting minority investors, and resolving insolvency. The ease of doing business score is below Mauritius, Seychelles, and St. Kitts and Nevis (

[19] The Doing Business project provides objective measures of business regulations and their enforcement across 190 economies and selected cities at the subnational and regional level. See https://www.doingbusiness.org/

Figure 26: Cabo Verde Ease of Doing Business: Current Score and Ranking

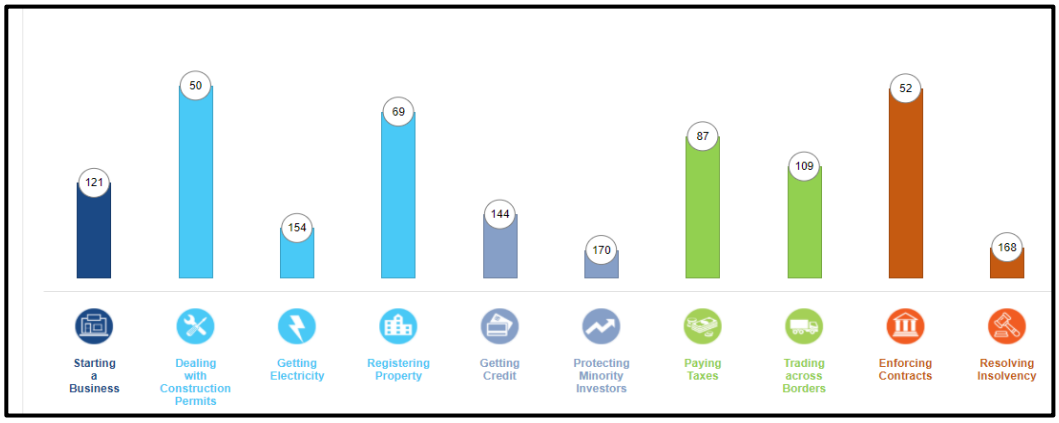
). As a result of recent reforms, Cabo Verde performs relatively well on dealing with construction permits, registering property, and enforcing contracts. However, the county is located at the bottom 20 percent worldwide on getting electricity, protecting minority investors, and resolving insolvency (Figure 27). A new reform effort has been initiated by Cabo Verde in the years 2017-2018. Initial improvements were recorded in the last two DB reports and more substantial ones are expected in the coming years.

Figure 26: Cabo Verde Ease of Doing Business: Current Score and Ranking



Note: Score is relative to the best practice frontier (i.e., 100); both the score and relative ranking relate to the methodology in use in the respective years (i.e., does not account for retrospective revisions of score and ranking based on the methodology currently in use in the 2020 DB Report).
Source: World Bank Doing Business Indicators

Figure 27: Cabo Verde Rankings on Doing Business Topics (1-190)



Source: The World Bank Group.

Following the new reform effort initiated in 2017, a Competitiveness Unit at the Prime Minister office was tasked with the elaboration of Doing Business Action Plans. The government thus adopted a comprehensive DB action plan 2020-2021 in December 2019 with a range of 5 to 10 actions or reforms for each of the 10 DB indicators. The implementation of this plan led to several reforms that would contribute to improve the business environment. In the meantime, the Unit is already developing an ambitious Doing Business Action Plan for 2022 that aims at improving the country's score by 5 to 10 points under each of the 10 indicators through an impressive number of planned reforms.

Despite significant efforts by the government to improve the business environment during the last decade, several constraints throughout the business lifecycle remain to be addressed.

a) Business entry

Commendable efforts have improved the business registration process, yet full back-office procedure integration is still lagging.

The Government undertook several efforts to simplify business registration and entry. The launch, in late 2007, of the public one-stop-shop *Casa do Cidadão* (Citizen's House) provided the basis for most of the improvements in the starting a business indicator. To empower this one-stop-service for businesses (OSS), the Government legislated in early 2008 a simplified "company-in-a-day" regime (*Empresa no Dia*) to streamline the procedures and costs for incorporating limited liability firms based on standard statutes and preapproved company names. The decree also included provisions for an online-based platform, but due to missing complementary reforms such as the electronic signature, it has not yet been implemented. Recent statistics show that the *Casa do Cidadão* is increasingly a preferred front-office channel – about 13,723 business-related services performed in 2018, up from 10,322 in 2017 alone.

However, and despite the impressive progress, full operational integration is still lacking at the back-office level, and the service-level is heterogeneous across municipalities. The online-based platform is yet to be fully operational, currently hindered primarily by a gap of complementary reforms, such as e-signature. Full-scale integration, as intended in the OSS concept, is therefore still not in effect. Some entrepreneurs continue to open firms in the Ministry of Justice (MoJ) front-offices and must use these for some of the more complex services, such as changing the bylaws or opening larger companies such as joint-stock ownerships *(Sociedades Anónimas*). Another challenge is the distinct level of cooperation between *Casa do Cidadão* and the different Municipalities, which may cause certain procedures, such as registering for municipal commercial licensing, to be more burdensome in some of the smaller islands.

The approval of a new Commercial Registry Code (*Código de Registo Comercial*) in March of 2020 should tackle some of the challenges in streamlining processes and procedures. The new Code aims to enable the use of digital mediums in all services throughout the firm life cycle, including registration. Certain legacy procedures, such as the purchase and verification of physical company books, needed for ex-ante proof of minimum capital in certain company forms have been removed. The Code consolidates all legislation concerning business registration, expands the range of services possible under the *Empresa no Dia* simplified regime, and imposes time caps on certain procedures, in addition to enabling the possibility of accepting documents in English and French. The streamlined legal framework in this new code is expected to support the desired operational integration between all levels of front-office and back-office involved in public services to businesses, notably the OSS (*Casa do Cidadão*), MoJ services, and Municipalities.

Obtaining operational licenses adds one more layer of complexity.

In certain municipalities, including Mindelo, it can take as long as 6 months to obtain an operating business license, and up to 5 months for an industrial license that is valid for only a year. Although information on licensing requirements is available online, there is no integrated platform and no integrated process management to submit and complete licensing requirements. Other licenses and permits such as environmental permits or import/export licenses are equally burdensome. Environmental permits may take up to 6 months to receive. As a result, there's generally a lack of predictability in terms of timeline.

Risk-based approach standards aimed at adapting the Government's degree of regulatory control to the actual hazards and level of severity posed by industry sectors, economic activities or business establishments are also not followed. For instance, a low-risk/low-impact activity such as tourism is subject to the same requirements as a high-risk activity. It may be appropriate to require a notification of commencement of operations for low-risk activities instead of a prior approval, which is currently taking 6 months to obtain and impeding businesses from commencing operation in many islands. The same risk-based approach could be applied for the duration of a license, which could either be longer for low-risk operation or have no fixed term until non-compliant behavior is demonstrated or found. Business process re-engineering on the back end is also needed in order to (i) simplify procedures and cutting down unnecessary steps and integrate all the business registration steps; (ii) improve the licensing framework; and (iii) enhance and optimize data sharing across all agencies involved in the process, notably the *Casa do Cidadão* and the Ministry of Finance.

b) Business Operations

MSMEs remain cash-constrained with limited access to finance

Access to finance remains a challenge. The authorities recently revamped the MSME support mechanism to tackle key constraints. Even for small projects, access to credit for investment or working capital is difficult due to high collateral requirements and steep interest rates. The Government has launched since 2017 a triad of institutions to tackle the different supply and demand side challenges – Pró-Empresa mandated with providing MSMEs with capacity building, coaching and technical assistance for business development purposes; Pró-Garante which is working to provide eligible MSMEs with partial credit guarantees to reduce collateral requirements by participating financial institutions; and Pró-Capital, the first public venture capital fund in the country, just recently launched in 2019. All three institutions are supported by World Bank projects, and Pró-Garante especially has been instrumental in the current crisis-response context - as of December 2020, it has enabled access to investment and liquidity credit facilities to 539 MSMEs, corresponding to an estimated US$35 million in new loans.

The development of the financial infrastructure to facilitate access to credit has been somewhat sluggish in the last decade, but ongoing reforms lay the ground for cautious optimism. Cabo Verde recorded two positive reforms captured in the getting credit indicator over the past ten years, both associated with the progressive development of the public credit registry based at the Bank of Cabo Verde (BCV). Looking to continuously strengthen the credit information apparatus, the BCV has invested further in a new state-of-the-art IT public credit registry center, expected to come online in 2021. Additionally, recognizing the gap in the usage of movable collateral assets by MSMEs, the Government introduced in April 2020 a new secured transactions legal framework (*Código de Penhor e Registo de Bens Móveis*), particularly aimed at streamlining and facilitating the repossession and sale of movable assets. The online platform to register and publicize pledges on these assets is now under development, expected to come online in late 2021.

Recent legal reforms are expected to increase protection of minority investors

Cabo Verde currently ranks 170 out of 190 economies on DB's Protecting Minority Investors indicator. This is the country's worse ranked indicator. This indicator essentially looks at the protection of minority investors from conflicts of interest and at shareholders' rights in corporate governance. Investor protections matter for the ability of companies to raise the capital needed to grow, innovate, diversify and

compete. Without investor protections, equity markets fail to develop, and banks remain the only source of finance. Economies that have dynamic capital markets tend to protect investors effectively. In these economies, investors receive financial information they can trust, they participate in major decisions of the company, and directors are accountable for their managerial decisions. If the laws do not provide such protections, investors may be reluctant to invest, unless they become controlling shareholders.

The recent approval of the new Commercial Code and Company Charter Code, replacing legacy decrees with more than 20 years, is expected to improve protection of minority investors. The framework of the new Code will aim to unify all the decrees governing different types of incorporation, as well as to legislate on the costs and roles of all the front-end service providers. It also aligns legislation with modern practices such as abolishing minimum capital requirements in companies, regulating modern types of contracts, and removing unused types of company incorporations (such as *sociedades em comandita*). Further, the public agency for information technology (NOSi) is continuing to develop the Integrated Commercial Registry System Software (SIRC) in tandem with the digitization of all existing registries across islands. This is a crucial necessary condition for full integration, as well as for the operational launch of the online-based platform.

Land management remains a major challenge for businesses

Despite procedural improvements in property-related processes, access to land remains a challenge in the country's business environment. Access to land and private land rights are important for business operations and access to credit. In Cabo Verde, the issue is particularly important for the development of agriculture / agribusiness and increased linkages between the tourism sector and local producers. The legacy of paper-based registries and a profusion of distinct documents governing plot ownership resulted in many litigation cases across the islands due to overlapping claims, encroachment into protected areas, and development in areas considered at risk. The Municipality of Praia has invested considerable resources in recent years to digitize and publish its land record documents online, streamline the payment of municipal property tax, and enhance the connection with the central land registry. This resulted in an improvement in the time necessary to complete a land transfer transaction (from 83 days in 2007 to 22 in 2020) at a lower cost. Nonetheless, there is still a way to go to improve Cabo Verde's quality of land administration.

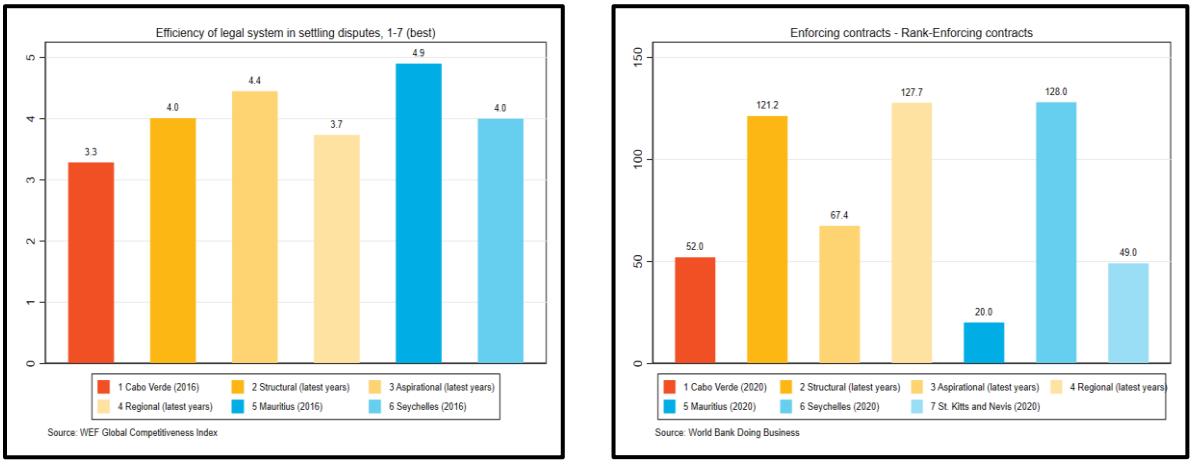
Acknowledging the land tenure challenge, the Government mobilized about US$ 17.2 million under the LAND Project in 2012. The objective of this milestone project was to establish a unified framework for land ownership across the national and local levels, enabling secure property rights and more transparent and conclusive land information for all private and public agents. If the project recorded some major achievements and deployed a fully functional Land Management, Information and Transaction System in Sal as a pilot, it is unclear whether there are enough financial resources and political will in order to keep the system operational.

Modernization of court systems is a step in the right direction but remains a fragmented effort.

The performance of the judiciary continues to face challenges due to insufficient court automation and inefficient case management. Judicial institutions are an important transmission channel for economic growth and firm productivity and could be improved in Cabo Verde. Although enforcing contracts is one of the better ranked indicators in Cabo Verde's DB spectrum (52nd out of 190), the quality of the judicial process index continues to score subpar (7,5 points in 18 possible). The country's legal system

underperforms structural and regional comparators with respect to challenging regulations and settling disputes, although it outperforms on contract enforcement (Figure 28) The IT reform of the judiciary system has progressed at a slow pace. The electronic case management system dubbed SIPP (*Sistema de Informação Processual e Penal*) was deployed in Praia and Mindelo in early 2018, but effective full-scale use has proven challenging and highlighted the need for additional training and progressive onboarding with judges and justice clerks. The digitization of existing records, only partially tackled in the largest courts of Praia, is also an impending challenge. The creation of a dedicated court for commercial cases was discussed as a possibility by the judiciary, but such a measure has been, thus far, discarded due to a lack of resources.

Figure 28: Challenging Regulations and Settling Disputes, and Contract Enforcement



Note: score is relative to the best practice frontier (i.e., 100); both the score and relative ranking relate to the methodology in use in the respective years (i.e., does not account for retrospective revisions of score and ranking based on the methodology currently in use in the 2020 DB Report).
Source: World Bank Doing Business Indicators

The alternative dispute resolution mechanisms for arbitration and mediation are not effectively used due to a lack of trust and awareness. The São Vicente mediation center (covering the Northern islands) is operational, with one dispute resolved. However, the arbitration and mediation centers of the Northern and Southern Commerce Chambers, are not used. The general population continues to prefer the traditional court process either due to lack of awareness or lack of confidence in the alternate systems.

c) Business Expansion and Growth

The public procurement system could be further optimized to support firms' growth

Access to the public procurement market for private firms in Cabo Verde could be further enhanced, especially for MSMEs. Public procurement is the largest single marketplace in developing and developed economies alike, accounting for around one fifth of global GDP. Given its magnitude, a transparent, fair, and competitive public procurement system can generate business opportunities – especially for MSMEs, foster innovation, and drive economic growth. Governments can significantly impact national employment and growth through legislation promoting the development and participation of SMEs in public procurement markets. Examples of preferential provisions include allocations of quotas, divisions of large public contracts into smaller lots, restrictions on bid securities, and provisions of targeted technical assistance and trainings to SMEs bidding for public tenders.

Cumbersome procedures, the lack of professional procurement expertise, and the distortion of opportunities between SMEs and larger suppliers, and between SMEs across islands are important limitations. The current legal framework establishes set-aside quotas for MSMEs and other preferential measures to promote a fair competition for firms with limited resources. However, these quotas are often not respected in practice, and the lack of transparency in the way the procurement process takes place and monitoring of procurement outcomes is widespread. Suppliers outside of the capital are at a disadvantage given that online submission of bids is not possible. In addition, the inadequate capacity of the procurement workforce is a recurring concern raised by the private sector.[20] There is no institutionalized professional training at a university level or certification of procurement staff available or even systematic ad-hoc training courses in public procurement. ARAP (*Autoridade Reguladora das aquisições Públicas*) is currently working on setting standards and systematic training support for the procurement workforce. The improvement in public procurement polices does not mean the expansion of the public sector to more sectors of the economy but, rather, the enhancement of the enabling environment to support firms' growth.

d) Business Exit

Developing the practice of insolvency procedures

Cabo Verde is improving its legal and regulatory insolvency framework, but the practice of these procedures remains limited. After revising its insolvency law in 2016, Cabo Verde further improved its insolvency legal framework through the adoption of the Statute of the Judicial Administrator in March 2020. This body will be responsible for managing the recovery of credits and assets in the context of insolvencies. Conferences and training sessions were recently organized to disseminate these reforms. However, despite these efforts, insolvency procedures are hardly used in the country. As a result, Doing Business considers there is "no practice" (or almost no practice), and ranks Cabo Verde equal last (with 16 other countries) on this indicator.

In the context of the current economic crisis following the COVID-19 pandemic, insolvency procedures will become particularly relevant as an increased number of companies in distress is to be expected. Redoubling efforts to disseminate the recent reforms and the benefits of insolvency procedures will be key for economic and social recovery. Insolvency procedures can help struggling entrepreneurs/companies liquidate, enabling them to get back into the economy and putting the companies' assets back to productive use. In the medium term, an established practice of insolvency procedures also improves access to finance as lenders' risks are reduced.

4. Competition: Leveling the Playing Field Between Public and Private Actors.

Competition fosters cost reductions, promotes innovation, and contributes to productivity growth. A competitive market facilitates the efficient reallocation of inputs toward more efficient producers and induces firms to become more efficient (Acemoglu et al 2017 and Aghion et al 2005). Moreover, empirical evidence confirms that the degree of competition in domestic markets is a key determinant of international competitiveness, since exporting firms typically acquire many key inputs in local markets (Goodwin and

[20] This is primarily due to the lack of recognition of the procurement profession and insufficient support provided to procurement officials.

Pierola 2015). If those inputs are not priced competitively, exporting firms are likely to be less competitive than their foreign rivals in international markets.

While recent government initiatives have made important contributions to increased competition, SOEs continue to play a prominent role across in the Cabo Verdean economy. The Government's broad SOE privatization agenda has created greater space for private sector led growth. Moreover, ongoing efforts to adopt a revised competition law and establish an independent competition authority, demonstrate the Government's commitment to improving competition. However, SOEs continue to play a prominent role across the economy and potentially benefit from weak implementation of the competitive neutrality principle, which aims to ensure public and private actors compete on the same terms. Enabling and even incentivizing the entry of private operators to markets is critical to enhance competition and promote greater efficiency amongst incumbents. Moreover, although concentrated market structures may emerge naturally and efficiently, especially in SIDS, markets with fewer participants are even more vulnerable to anti-competitive behavior such as collusion.

a) The State of Competition.

The intensity of competition is generally considered to be low in Cabo Verde

While perceptions on the level of competition in Cabo Verde's markets are mixed, the lack of effective competition enforcement and the prominent role of SOEs limit the intensity of local competition. The latest available data on Cabo Verde from the Global Competitiveness Index (GCI) 2019[21] indicates that the perceived extent of market dominance is broadly in line with comparator countries and even slightly better relative to structural and aspirational peers (

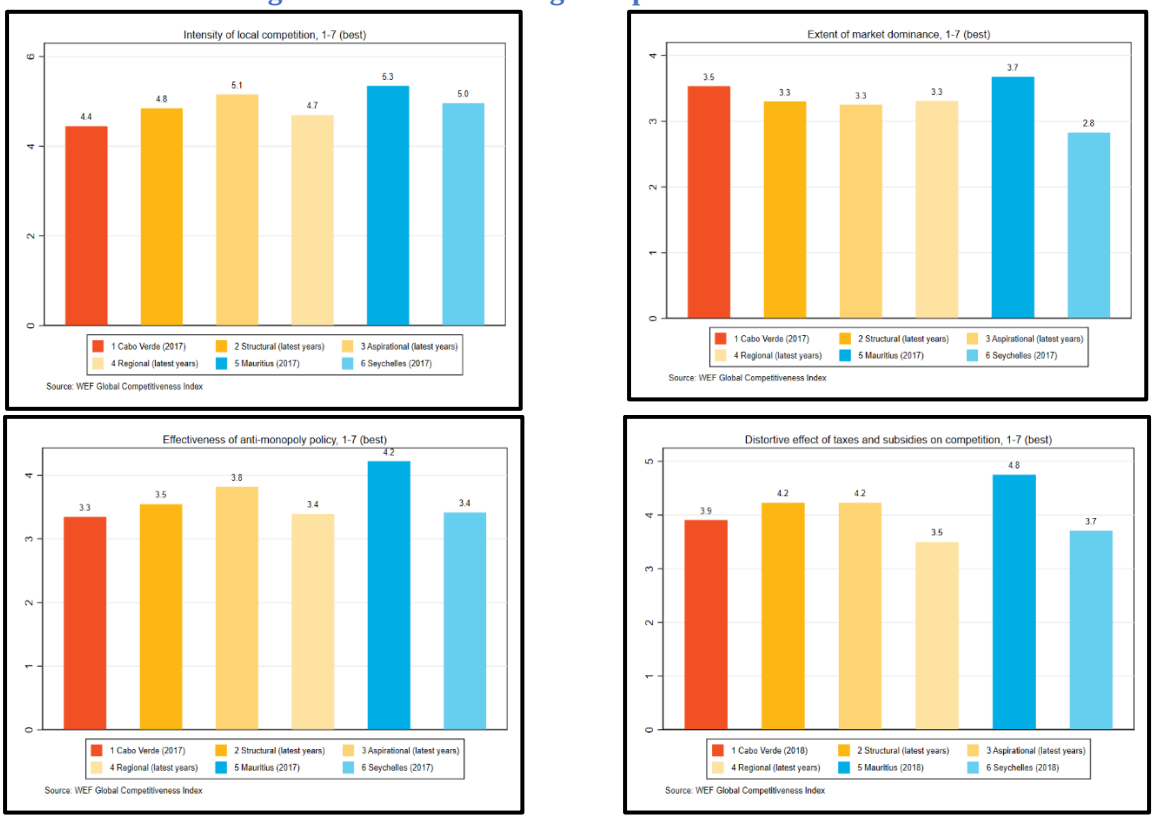
[21] World Economic Forum. Global Competitiveness Report 2019, available at: http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf

Figure 29: Benchmarking Competition in Cabo Verde

). However, this data shows the intensity of local competition is much lower in Cabo Verde. In addition, anti-monopoly policy is also deemed to be relatively weak. State interventions in the form of subsidies and tax breaks are perceived as the main source of competition-related market distortion. [22] In addition, Cabo Verde is perceived as having slightly weaker competition in services, especially professional and retail services, as compared to structural and aspirational peers. Burdensome regulation and mandatory professional fees appear to restrict entry and competition in professional services, and competition in retail may be hindered by restrictive rules on opening hours

[22] There is a complex system of tax expenditures for various sectors including finance and construction, and extensive VAT exemptions appear to apply to particular goods with administrated prices, including energy, water, fuel and communication. In addition, there is no legal framework to control the distortive market effects of subsidies, which might otherwise work to reduce the anticompetitive effects of subsidies on the market.

Figure 29: Benchmarking Competition in Cabo Verde



Vertically integrated SOEs may affect market dynamics in network sectors

Although competition in network sectors is not perceived to be a significant problem, a review of enterprises across several network sectors reveals that the state still plays a prominent role and there is a lot of vertical integration. In electricity, for example, the state-owned electricity and water company ELECTRA holds a monopoly over the production, distribution, and commercialization of energy across the country. The power sector reform plan recently adopted is an important step to bring private investment in the sector. Port infrastructure is operated by wholly state-owned *Empresa Nacional de Portos* (ENAPOR), although greater participation of the private sector in the delivery of services in maritime transport more generally has already resulted in improvements in connectivity and quality of maritime services. The Government has also launched an expression of interest to restructure port operations (such as install container handling cranes and maintain the terminal facilities).

Notable progress was achieved in air transport before the crisis, but the management of airports is operated through the wholly state-owned *Aeroportos e Segurança Aérea* (ASA). The partial privatization of the national airline in 2019 was a step in the right direction to alleviate the fiscal burden to public finances and bring private sector expertise to manage the company. However, the impact of the COVID-19 pandemic of global air traffic put this progress in peril. In March 2021 the Government retook the financial management of the company, which has been grounded for over a year, and granted loan guarantees amounting to EUR30 million to return the company to a financial equilibrium to restart operations.

b) The Prominent Role of the State in the Economy.

Weaknesses in competitive neutrality may distort markets in favor of SOEs

In the context of heavy direct participation of the state in the economy through SOEs, the lack of implementation of competitive neutrality principles may unlevel the playing field against the private sector. Notwithstanding past and ongoing privatization efforts, as of 2019, 32 SOEs continued to play an active role in the economy, particularly in utilities, energy, and transportation[23]. In total SOEs contributed 26 percent of GDP in sales (way above the average for the Africa region, which is 15 percent), hold assets worth over 60 percent of GDP, and debt of over 50 percent of GDP.[24] Across 27 sectors and subsectors surveyed for this report, 14 sectors have at least one SOE in operation. Although at the sectoral level this number is relatively low, there are several SOEs in sectors typically served by the private sector.

Where there is no reason, a priori, that a specific activity should be reserved to the State, it is important to enable and even incentivize the entry of private operators to markets as a means to enhance competition and promote greater efficiency amongst incumbents. Certainly, the heightened presence of SOEs could be related to the relatively small size of Cabo Verde markets, natural market concentration, and an absence of private investment. However, especially in times of health and economic crisis, which places a significant financial burden on the state, the rationale behind and need for public spending on SOEs should be carefully evaluated. Correspondingly, the possibility for the private sector to enter the market and compete on the same terms as public operators should be accommodated, by removing any de facto or de jure entry barriers that may exist.

The application of the competitive neutrality principle is important to ensure that SOEs do not benefit from undue privileges that make it more difficult for private operators to compete. Several gaps in Cabo Verde's competitive neutrality framework may result in undue benefits to SOEs over private actors.[25] In particular, there is no obligation for SOEs to separate commercial from non-commercial activities in their accounts, nor to achieve a commercial rate of return. Identifying the costs of commercial versus non-commercial activities is necessary to ensure public funds do not finance commercial activities in the market. In addition, SOEs are systematically granted subsidies from the State budget, primarily through capitalizations and on-lending operations on top of transfers and small subsidies, and SOE debt guarantees are extensive. Given the limited public resources, the absence of mechanisms to track the use of public funds is problematic. To ensure the best use of COVID-19 recovery funds, governments need to target measures towards the primary needs of the economy, avoid supporting companies that were in difficulty prior to the coronavirus outbreak, employ control mechanisms to avoid the misuse of public funds by recipient companies, and calibrate the amount of assistance to what is actually needed.

[23] The state is sole owner of 17 companies and is a majority shareholder in another seven, and a minority owner in a further eight companies. See World Bank. 2018.
[24] World Bank (2019), pages 8, 43.
[25] Competitive neutrality occurs where no entity operating in an economic market is subject to undue competitive advantages or disadvantages.

c) Limitations in the Competition Policy Framework.

Weaknesses in the current competition law undermine the government's ability to foster competition

The current legal and institutional framework exhibits several weaknesses that may exacerbate the lack of competition and competitive neutrality in Cabo Verde. Competition Law 53/2003 includes important provisions, such as the application of the competition law to all economic activities including in the public sector and the obligation that state aid should not distort competition in any part of the market, but several regulatory, institutional, and implementation gaps persist. There are six important shortcomings of the current competition law:

First, the 2003 Competition Law contains broad scope for exclusions and exemptions, which limits the scope of its application. The law grants the government discretion to exempt sectors or anti-competitive practices from the law and pass special legislation with anti-competitive effects where it sees fit (Articles 1.2, 1.3). Furthermore, the law itself already includes a specific carve out for credit, para banking institutions and insurance companies, which are exempt from merger notification requirements (Article 7.2). In addition, although the law provides that state aid must not significantly restrict or affect competition, this rule does not apply to benefits granted under specific programs approved by the State (Article 11).

Second, the law takes a mixed approach to practices that are very different in nature: collusion and abuse of dominance. The distinction between collusion (cartels) and abuse of dominance as separate offences in competition law is important.[26] There are different criteria to evaluate these two conducts in each case: on the one hand, the prohibition of cartels is about detecting and punishing collusion and conspiracy among competitors, and on the other hand, the prohibition of abuse of dominance is about sanctioning anticompetitive unilateral conduct. Therefore, they should be treated separately.

Third, the extension of the prohibited practices to situations of "economic dependence" without the need to establish dominance may hinder the freedom to deal and compete. The "abusive exploitation" of a firm that has "no alternative available" seeks to identify situations of relative dominance in one-to-one, often vertical relationships, and prohibits in such circumstances any of the behaviors listed in Article 2.1. But by eliminating the need to establish market dominance of the perpetrator or the existence of an agreement between multiple perpetrators in this context, this provision would capture legitimate business practices between market players and be overly inclusive (Article 4). As noted earlier, international best practice provides that such behaviors are only illegal when they constitute abuse by dominant players to the potential detriment of consumer welfare or competition in the market, or they stem from collusive practices.[27]

Fourth, limited predictability in merger control may burden the private sector. The requirement to notify a merger is based on a self-assessment of dominance using aggregate market share after the merger

[26] Since the end of the 19th century, the core of competition laws around the world has been the prohibition of two types of conducts: first, anticompetitive agreements among competitors also called "cartels" (i.e., agreements among competitors to fix prices or allocate markets); and second, unilateral abuse of market dominance (i.e., practices from a dominant company aiming at excluding other competitors from the market).

[27] See Portugal's approach to economic dependence, for example: http://www.concorrencia.pt/vEN/Praticas_Proibidas/Anti-competitive_practices/Abuse_of_economic_dependence/Pages/Abuse-of-economic-dependence.aspx.

(30%), but this is difficult for enterprises to measure with any certainty (Article 7). International best practice recommends using quantitative and objective notification thresholds that rely on information more easily obtained by merging parties at both the individual and aggregate levels, such as the one billion in business volume requirement set out in Article 7.1(a), and with a nexus to the size of Cabo Verde's economy.[28] Finally, merger reviews are vulnerable to politicization given the involvement of the Government Minister for Trade during the review process and given its final decision-making authority (Articles 32 and 34).

Fifth, the lack of independent institutions appears to hinder effective implementation. Currently, day-to-day enforcement work lies with the General Directorate of Trade, which is under the authority of the Minister of Trade. Although the Competition Council appears to be functionally independent, the Council is appointed by the Prime Minister and dependent on the General Directorate as a quasi-secretariat; and it appears to lack final decision-making authority on certain enforcement issues, as is the case with merger review.

Finally, Competition Law 53/2003 appears to lack important tools for implementation and effective enforcement. For example, the permitted fines for violations are too small to pose a reasonable threat as compared to the potential benefits that could result in companies from anti-competitive behavior (Article 37).[29] The draft reform appears to address this issue, stating that the Competition Authority will determine the level of the fine based on a series of qualitative factors, including the gravity of the infringement and the benefits secured by the perpetrator.

Draft reforms to the competition law and to establish a competition authority are currently under consideration, but the COVID-19 crisis delayed their adoption

Delaying on the reforms to the competition legal and institutional framework pose an important risk to competition and consumer welfare in the medium to long term, and to the Government's objective of improving the competitiveness of Cabo Verde businesses. Specifically, the economic crisis caused by the COVID-19 pandemic could be exacerbated by collusive behavior amongst suppliers, especially in concentrated markets, as already dominant actors amass greater market power due to shifts in consumption patterns and the exit of smaller competitors. There is also a heightened risk regarding the misuse of public funds. Strong competition laws and independent oversight mechanisms are critical to ensure that, in the aftermath of COVID-19, market distortions are minimized.

It is widely acknowledged that competition agencies should exercise a high degree of independence from the executive branch of government, to ensure that decisions are taken on a technical basis and to insulate them from political pressures, cronyism, and interference with their core mandate to protect market competitiveness. Accordingly, a draft law to establish a new, independent Competition Authority for Cabo Verde notes that the current set-up is a source of inefficiencies. Although the current law does not appear to provide either the General Directorate for Trade or the Competition Council with a

[28] Other options include value of assets or amount of the transaction. The OECD identifies as a best practice the use of "clear and objective criteria to determine whether and when a merger must be notified." OECD Recommendation of the Council on Merger Review (March 2005).

[29] Most modern competition authorities calculate fines based on the defendant's annual turnover, which better calibrates the fine to the need to deter anticompetitive conduct. For example, in Europe, violations can result in a fine of up to 10% of the worldwide turnover of the ultimate corporate parent.

competition advocacy mandate, this may be envisaged in the draft reform. The ability of independent competition authorities to raise awareness and issue opinions whenever policies, laws, or regulations have the potential to negatively affect competition, is at the core of ensuring competitive and open markets, particularly in a small economy such as Cabo Verde. The competition commission of Mauritius is a good reference for the role of competition authorities in SIDS (Box 8).

Box 8: The Competition Commission of Mauritius (CCM)

The Competition Commission is a statutory body established in 2009 to enforce the Competition Act. This Act established a competition regime in Mauritius, under which the Competition Commission can investigate possible anticompetitive behavior by businesses. In its investigations, the Competition Commission has considerable powers to compel businesses and others involved to provide information. If it decides that a business's conduct is anticompetitive, it has strong powers to intervene and correct the situation. Where businesses have been found to be deliberately agreeing to fix prices or share markets, the Commission can impose fines.

The Commission is a parastatal, under the aegis of the Ministry of Commerce and Consumer Protection. However, the Commission is independent from Government in its decision-making. The Executive Director of the Commission decides independently what to investigate and carries out the investigation. Decisions are then taken by five Commissioners, headed by a Chairman. The Executive Director is not a Commissioner.

Since inception, the Competition Commission of Mauritius (CCM) has established a solid track record in enforcing competition law in the country. It has effectively dealt with different forms of anticompetitive conduct across various sectors of the Mauritian economy and recently picked up momentum in the area of anti-cartel enforcement. CCM also scrutinizes cross-border merger transactions and investigates complex abuses of dominance cases.
Alongside enforcement, the law mandates the CCM with an advisory role to government further to any action or proposed action it makes that may adversely affect competition. The CCM recurrently advised government on various policy decisions. With the aim of boosting the awareness of its competition law and the deterrence of anticompetitive conduct, the CCM carried out several advocacy initiatives targeting businesses, associations and the public in general.

As of July 2019, after 10 years of experience, the CCM had completed 216 pre-investigations (enquiries to establish whether there are reasonable grounds to launch investigations) and 32 investigations across different sectors, including: media and information and communications technologies; food and beverages; insurance; banking and finance; and construction and property development.

Source: CCM website: https://competitioncommission.mu/

5. Policy Priorities: Reform Areas and Action Plan

Improving the enabling environment for mobilizing private investment to support the recovery of the economy from the COVID-19 crisis is critical to build a more sustainable and resilient economy. Without a systematic and comprehensive public agenda to improve the conditions to promote private investment that contributes to the diversification of the economy, Cabo Verde faces the risk to return to the previous growth model based on the tourism sector as the only engine of growth. The unfolding crisis proved the vulnerability of this growth model to external shocks. To contribute to the discussion on reform priorities to build a more resilient economy, this section recommends the following priority reform areas that are considered critical in the recovery process of economy.

a) Leverage FDI for an Inclusive Economic growth

Develop a national investment strategy aligned with the Cabo Verde Ambition 2030 Strategy

The development of an investor centric national FDI strategy that sets investments targets and is aligned with the development goals of the Government strategy for the recovery of the economy is warranted. The strategy ought to be developed collaboratively between public stakeholders and private sector representatives to maximize its operability. It should be developed following several steps. First, the undertaking of a competitive benchmarking to identify new (or confirm existing) priority sectors or production segments for a proactive FDI attraction that generate positive impacts in terms of jobs, exports, diversification, and knowledge transfers. The assessment should identify which sectors and parts of GVCs are resilient to the crisis, and whether there are new opportunities arising from COVID-19-induced changes to the value chains of multinational corporations. Second, identify policy reforms required to further improve the value propositions of the priority sector and segments. This stage entails realigning policies and strengthening inter-agency coordination. Finally, promote the new segments by putting into place an aggressive attraction and outreach investment program to be carried out by *TradeInvest*.[30]

Modernize the investment promotion agency, including the development of aftercare services.

A broader reform of *TradeInvest* in line with global practices is central for the implementation of the national investment strategy. A corporate assessment and institutional review of the Investment Promotion Agency is important to bring it to best standards.[31] There priorities in the short term are the development of a corporate strategy that focus on attracting investment into a shortlist of priority sectors and subsectors and the upgrading of key investor services around the investment life cycle that cover four core types of investment promotion services: marketing, information, investor assistance, and policy advocacy.

[30] The development of the strategy should be led the Ministry of Finance, as the lead ministry for investment policy, and approved by Council of Ministers. It should involve all public agencies involved arounds the life cycle of foreign investment, including *TradeInvest*, the Tourism Institute, the Ministry of Maritime Economy, the Ministry of Industry and Trade, the Ministry of Foreign Affairs and key regional/municipal level agencies.

[31] The experience of Mauritius and Costa Rica could provide useful benchmarks to assess the model and performance of Cabo Verde trade invest.

Promote linkages between domestic suppliers and hotel chains, particularly in the agricultural and fishery sectors.

The implementation of a taskforce to develop a linkage program in the tourism sector and lead its implementation would be important to maximize the medium-term development impact of FDI. Connecting local suppliers, particularly in the agriculture and fishing sectors, with hotels would promote knowledge transfers and, therefore, improve the productivity of local firms. Linkages programs should include a comprehensive set of interventions to tackle constraints at the market level, the supply side (domestic firms), and the demand side (foreign company). Interventions at the market include the creation of supplier databases and matchmaking services. Supply-level interventions entails the creation of supplier development programs and establishment of business. Demand-level interventions include tax and behavior incentives to foreign firms. While compulsory local content requirements are sometimes used, they can discourage the entry of foreign investors and, more important, preclude altogether the entry of foreign technology that could itself be the source of positive spillover effects.

b) Improve the Business Environment for Domestic Firms, notably SMEs.

Simplify licenses and permits in tourism and logistics.

Simplification of rules and regulations for licenses and permits would facilitate firms' entry into markets and level the playing field by ensuring a stable business environment. A stocktaking of required licenses in the strategic sectors of tourism and logistics is needed to identify unnecessary licenses that do not meet the criteria of necessity, legality, and business friendliness. In the context of the COVID-19 crisis, implementing e-licensing services is critical to allow remote requests for approvals, reduce transaction costs, and mitigate possible disruption in physical public service delivery. Finally, allowing for greater flexibility in the definition or change of business activities allows businesses to adapt more easily to changing market needs during the COVID-19 crisis, making it easier to adapt without resorting to burdensome licensing requirements. This will also facilitate the post-pandemic recovery.

Implement reforms identified in Doing Business action plans, particularly in the areas of collateral registry and insolvency procedures.

To help businesses significantly hit by the crisis, it is critical that authorities accelerate reforms aimed at improving access to finance. Efforts should be made to modernize and operationalize the collateral registry (*Registo de Garantias Mobiliárias*) and support the development of insolvency procedures, through training and communications campaigns. The latter will help struggling entrepreneurs/companies liquidate and enable them to get back into the economy. In the medium-term, the government is encouraged to develop the Integrated Commercial Registry System Software (SIRC) and digitize commercial registries across islands, support usage by businesses of the online platform for the payment of corporate income tax and VAT, improve inter-agency coordination to streamline import-export operations, and create dedicated courts (tribunals) for commercial cases.

Strengthen Public Procurement by improving digitalization, establishing feedback mechanisms, and professionalizing the public procurement function.

Efforts are needed on digitalization, feedback mechanisms, and professionalization of the public procurement function to better align public procurement to international good practices. Enhancing the capabilities of the e-procurement system is a priority to fully digitizing the procurement system, including bid evaluation, communication with suppliers, award, signature, and payment. This reform is particularly relevant in a fragment market structure as is the case in Cabo Verde. It is important to also introduce tools such as feedback loops; improving the Monitoring and Evaluation (M&E) process of the procurement and public expenditure process by collecting and publishing more comprehensive tendering and contracting outcome data. Finally, part of the reform is to professionalize the public procurement function and enhance the capacity of the procurement workforce through trainings and procurement guidelines. This will allow greater transparency and efficiency during times of pandemic and crisis when procurement officers should be prepared to engage in emergency procurement.

c) Introduce Conditions for Greater Competition for all Firms

Update the competition legal framework and foster effective implementation

Cabo Verde should continue with the process of reforming its competition law, paying special attention to delineate prohibited practices from abuse of dominance to avoid confusion in enforcement. Merger notification thresholds should also be revised to rely on criteria that are quantitative and objective at the individual and aggregate levels in order to provide clarity for combining firms. Policymakers may also wish to reconsider and/or remove existing exemptions in the competition law and develop guidance for implementation. Finally, the system of fines should be updated to ensure it operates as a meaningful deterrent against anti-competitive conduct.

Establish an independent competition authority and increase enforcement capacity

The creation of an independent competition authority that is separate from the executive branch of government is a priority. The authority should have an exclusive enforcement mandate over competition issues in all sectors and a clear competition advocacy mandate. Advocacy is an important complement to enforcement as it facilitates the incorporation of competition principles into key sectors of the economy.

Level the playing field for public and private actors by applying the competitive neutrality principle

Competitive neutrality should be strengthened particularly in markets that register both private and public sector participation, to prevent the crowding out of private investment and, where possible, to remove barriers to private sector entry. In addition, Public Sector Law 104/2016 could be revised to require SOEs to separate commercial from non-commercial activities in their accounts. Oversight of SOEs and enforcement should be bolstered, especially to ensure that SOEs deliver on the performance targets set out in annual management contracts and they earn a commercial rate of return.

To propose actionable policy priorities to implement the reforms suggested in this report, Table 7 lists an action plan the government can take in each reform area.

Table 7: Proposed Action Plan

Reform	Action	Timeline	Priority
Theme 1: Leveraging FDI for an Inclusive Economic growth			
Develop an investment strategy aligned with the Cabo Verde Ambition 2030 Strategy	Undertake a competitive benchmarking to identify sectors and GVC tasks for a proactive investment promotion strategy/	ST	H
	Identify sector-specific bottlenecks to further enhance the value propositions of those sectors	MT	H
Modernize the investment promotion agency, including the development of aftercare services.	Conduct an institutional and capacity needs assessment of *TradeInvest*.	ST	H
	Develop and publish the *TradeInvest's* corporate strategy	MT	H
	Develop a Comprehensive investor service framework, including aftercare and policy advocacy programs	MT	M
Promote linkages between domestic suppliers and hotel chains, particularly in agriculture and fishery.	Conduct a demand-supply gap analysis to identify opportunities for backward linkages	MT	M
	Develop a supplier database and organize B2B matchmaking services	MT	M
	Design and implement a supplier upgrading program	LT	L
Theme 2: Improve the Business Environment for Domestic Firms, notably SMEs.			
Simplify licenses and permits in the tourism and logistics sectors, while strengthening social and environmental protections.	Allow for greater flexibility in the definition or change of business activities	ST	H
	Conduct a stocktaking of required licenses in tourism and logistics to identify unnecessary licenses	MT	H
	Adopt e-licensing services	LT	H
Implement reforms identified in Doing Business action plans.	Conduct training and communications campaign on the benefits of insolvency procedures	ST	H
	Develop the Integrated Commercial Registry System Software and digitize commercial registries across islands	MT	H
	Modernize and operationalize the collateral registry	MT	M
Strengthen Public Procurement	Fully digitize the e-procurement system including the bid evaluation, communication with suppliers, award, signature, and payment.	MT	H
	Introduce feedback loops, collect, and publish more comprehensive tendering and contracting outcome data.	MT	M
	Professionalize the public procurement function through trainings and the issuance of new procurement guidelines.	LT	M
Theme 3: Introduce Condition for Greater Competition			
Update the competition legal framework and foster effective implementation	Prepare and implement extensive communication campaign	MT	M
	Reform Public Sector Law 104/2016 to strengthen competitive neutrality	LT	M
Establish an independent competition authority	Create an independent competition authority with an exclusive enforcement mandate over competition	MT	M
Apply the competitive neutrality principle	Revise Public Sector Law 104/2016 to require SOEs to separately highlight commercial from non-commercial activities in their published accounts	MT	M

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Annex 1: Cabo Verde Emergency Response to the COVID-19 Crisis

MITIGATION/HEALTH MEASURES	
Containment measures • Self-quarantine for people returning from abroad. • Mandatory quarantine for suspects of COVID-19. • International air and sea borders closed. • Suspension of inter-islands transportation, except for emergencies. Mitigation measures • Closing of schools and universities. • Restrictions on large events and gatherings. • Closure of non-essential services and activities. • Countrywide lockdown. • Public services encouraged to resort to remote working. • Mandatory use of masks.	• Wide-ranging awareness campaigns and surveillance (systematic screening at the airport and port borders). • Reinforcement of national laboratory capacities (six virology laboratories were opened in six months). • Mechanisms for country-level coordination, planning and monitoring. • Rehabilitation of facilities to put in place epidemic treatment centers with isolation capacity.
SOCIAL MEASURES	
• Monthly cash transfers of US$55 to the poorest families registered in the social registry - Cadastro Social Unico (CSU). • Emergency cash transfer schemes using the CSU to support additional families, formal and informal workers in micro and small firms and self-employed workers in the informal sector. • Suspension of electricity and water cut-offs due to non-payments (during the State of Emergency). • State assumption of overdue water and Energy reconnection debts of CSU enrolled households with service cuts derived from these same debts. • 100 percent professional training allowance for 3600 young people from poor families.	• Rehabilitation of homes of the poorest families. • Exemption of health fees for children, pregnant women, people with disabilities and poor people enrolled in the CSU. • Introduction of a simplified lay-off regime under which the workers retain 70 percent of the salary; 35 percent supported by the national pension fund (INPS) and 35 percent by the employer (extended until December 2020). • Exceptional unemployment benefit measures - reduction of the guarantee period, removal of some formalities in the application process. • Introduction of a 14-day prophylactic isolation allowance, paid at 70 percent of remuneration.
ECONOMIC AND FISCAL MEASURES	
• Immediate settlement of invoices by the Government. • Acceleration of the reimbursement of VAT credits. • Moratorium and negotiation of tax payments and fees. • Exemption from custom taxes of emergency-related items (health). • Credit moratoriums. • COVID 19 credit line for cash flow reinforcement, with state guarantee up to 80 percent. • Credit line for new investments, with interest bonus up to 100 percent and state guarantees up to 80 percent. • Refinancing line for microfinance institutions, with interest bonus up to 100 percent and state guarantees up to 80 percent. • Micro financing line, with interest bonus up to 100 percent and state guarantees up to 80 percent.	• Guarantee lines for construction contracts, with state guarantees up to 80 percent. • Central Bank stimulus package to the financial sector: - Reduction of the reference rate from the current 1.5 to 0.25 percent. - Reduction of standing lending facility rate from 3 to 0.5 percent. - Reduction of standing deposit facility rate from 0.1 to 0.05 percent. - Reduction of the reserve requirement from 13 to 10 percent. - Reduction of the rediscount rate from the 5.5 to 1 percent. - Creation of a new credit line to banks, with 0.75 percent interest rate and amount up to US$450 million.