Managing Sovereign External Debt to Serve Development: The Case of CABO VERDE

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Overview

1. From Poverty to MIC: The implementation of a vision
2. How Cabo Verde reached the MIC Status?
3. The Role of Sovereign Debt in reaching MIC Status/the vision

From Poverty to a MIC …. Four decades of change…

Cabo Verde, at independence in 1975

- No Nation, No State, & no Human Capital
- Memories of frequent famines (1947, 30% of the pop. died);
- Only 10% of the land is suitable for agriculture ..out of 4.033 km2
  - No resources, even water ….. due to low rainfall
  - Limited internal market
  - Zero Infrastructure
  - Educational opportunities were scarce → only 2 high schools
  - Per capital income was about US$190
  - National treasury was zero → Had to appeal to Portugal for US$300,000
- Many (including Cabo Verdeans) did not foresee a future

In 2008 …. Cabo Verde a MIC

- Per capita income increased from US$190 (1975) to US$ 3,800 (2012);
- Poverty reduced from 49% do 24%;
- Literacy among youth – 95%;
- Infrastructure development - 5th in Africa
- Cabo Verde was considered among the "Top 10" FDI destinations in the world;
- Cabo Verde was considered among the "Top 10" country reformers in the world;
- ICT Development index – 4th in Africa
- E-governance index – 6th in Africa

- **HOWEVER …Cabo Verde STILL FACE A HIGH LEVEL OF VULNERABILITY**!

There is a consistent vision: Build Cabo Verde as an International Business Platform

- To leverage our geo strategic position in the Atlantic Ocean ….
- The imperative was to mobilize financing for the ambitious infrastructure program from a physical and institutional standpoint.
- Limited domestic financing:
  - No capital markets ..
  - Narrow banking system …
  - Narrow and incipient domestic private sector …
  - Peg to the EURO
- The "only" alternative: the mobilization of external financing … external public debt …
- "**External debt is not a problem itself … debt instruments are an important element of any financing strategy … it can easily become a problem when foreign borrowing is unrelated to productive investments**"
- So a long term perspective is the key! We can not decide to issue a bond for current expenditures … does not work …
- **Pre-conditions**: Reforms … to well prepare the ground …

Mobilization of External Financing Requires a Long Term View: Reforms!

- **Political Reforms** - shift from a one-party system to a multi-party democracy, separation of powers, strengthen of external control, … Democratic nation with free press, regular elections, and peaceful transfers of power
- **Economic/Market Reforms** - market reforms were embarked **to allow private sector-led economy**
  - Privatization of almost all state enterprises: telecom, banking, maritime transportation, etc..
  - Regulatory system: aviation, telecommunications, utilities, transportation, food and pharmaceutical, oil products, …
  - In 1998, we adopted a FX regime → peg to the Euro → which has been our "anchor" → nominal rate has been the same in the past 16 years ….
- **Institutional Reforms (strengthen of the country systems)→**

  i) Public Financial Management/e-governing: **accountability**,(2014 national account has been submitted to the parliament), **transparency**;

  ii) fiscal reforms: tax department should be ready → to generate domestic resources … KEY to debt sustainability …

  iii) business environment (one day to create a company);

  v) Consistent investment in human capital … to increase the productivity of the labour factor
- **These reforms have been a source of international credibility → essential to the mobilization of external financing by Treasury**

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The Role of Sovereign Debt in reaching MIC Status: A Clear & Sustainable Debt Strategy

1st: Replace bad debt for good debt:

↓ public debt/PIB: 2005: 75,5%; 2006:70,3%; 2007:62,5%; 2008: 57.2% → mainly current expenditures

↑public debt: 2009:62,8%; 2010: 72,1%; 2011:78,5%; 2012: 85,9%; 2013: 99,2% → mainly capital expenditures (infrastructure)

2nd: Replace domestic debt for external debt → peg with the Euro. Domestic debt decrease from 33% to 19%.

3rd: Freedom budget resources to investment → Revenues – Current Expenditures → current primary balance positive → freedom resources to pubic investment → crucial for the mobilization of external financing

Investment → Public **Deficit**: 2005: -3,0%; 2006:-3,2%; 2007:1,2%; **2008: -1,6%; 2009:-5,8%; 2010:-10,5%; 2011:-7,7%; 2012: - 9,8%; 2013:7,3%**

"Between 2005 and 2009 → very large capital inflows entered Cabo Verde causing domestic credit boom, strong asset appreciation (touristic real state) and currency appreciation …, increase in imports of goods …"

- **Window of opportunity → MIC transition period!**

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- We infrastructure the country "hard" and "soft" … trough strong mobilization of concessional financing …
- **Only Concessional financing: Why? We have not yet a BoP structure to tap international capital markets …. Maybe in 8 years time.**
- Cabo Verde is not yet ready for the shift from loans or syndicated loans from official lenders to external bond financing from private lenders … narrow productive and export base … a crucial element for debt sustainability
  - Average maturity is over 25 years, grace period 7 years ..
  - Average interest rate is 1.41%
  - About 95.6% of the debt is on fixed interest rate, 3.9% floating interest rate and 0.5% no interest
  - 53% of our debt is in the Euro Zone, while 17% is in SDR
  - 52% of the debt is with Multilaterals, 23% with Bilaterals and 24% with Commercial entities
- The Structure of external debt is important: 98% to official creditors … and due to the peg with euro is mainly denominated in Euros…
  - despite pressure from private creditors … we have been refusing commercial debt … "**it is important to avoid high capital inflows much above the amounts that developing countries could use productively"**
- **"The sustainability of an external debt depends on the relationship between the growth of domestic income and exports earnings AND the average interest rate and maturity profile of the debt stock → foreign capital inflows should be used to expand production capacities"**

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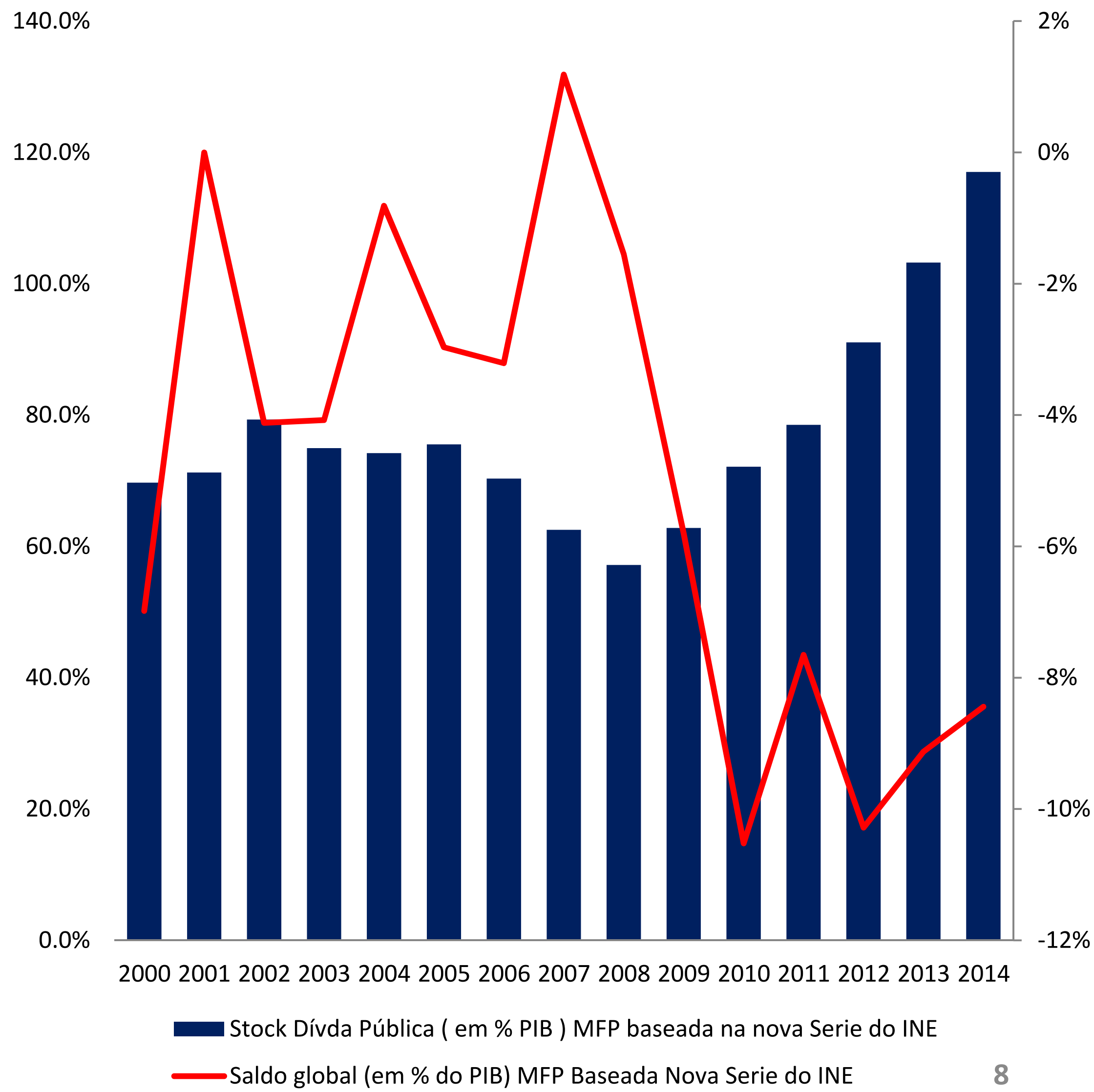
Increase in the public deficit and related public debt → strong infrustructure program → it was needed a fiscal consolidation program … strong disagreement with the IMF that advocate a contractionary approach … they proposed very strong fiscal and monetary austerity measures namely the cut of the public investment program **PIP** … we did not renew the PSI … and decided to implement a consolidation program based on the 3 pillars:

1) Rationalization and qualification of public expenditures;
2) Consolidation of budget revenues through the implementation of strong reforms: fiscal policy & tax administration
3) Economic reforms & institutional reforms

Deficit has decreased from 10% to 7%... and will be around 5% by 2018.

- The keeping of the PIP was important … as a countercyclical measure and to implement "**reproductive investments in order to generate output and export growth …** rather than import contraction …. "
- And in the case of Cabo Verde the decrease in PIP would not be automatically replaced by private investment … Cabo Verde's private sector is incipient …
- Government debt should be reduced through increasing public revenue rather than reduce capital expenditure …

Public Deficit vs Public Debt



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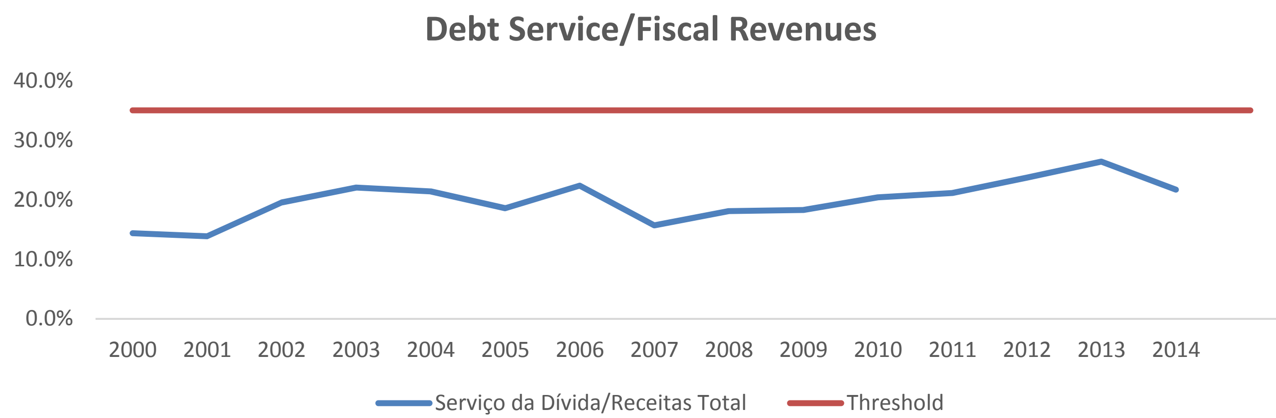
1. Debt Service/Fiscal Revenues

- 2004 2005 - very large capital inflows entered Cabo Verde causing domestic credit boom & strong asset appreciation
- 2007-2013 – comfort zone decrease due to international crises
- 2014 – comfort zone start increase … fiscal reforms

2. Debt Service/ Export Revenues

- Reforms + infrastructure = increase exports/comfort zone
- **“Avoid fiscal austerity during recession → fiscal multipliers were crucial to help Cabo Verde to cope with the international crisis”**



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	Debt Service/Exp Revenues	Public debt stock
2004	21.2%	74.2%
2005	16.3%	75.5%
2012	12.4%	91.1%
2014	14.7%	117%

THANK YOU