The Middle Income Trap, Environmental Vulnerability and Sovereign Debt Sustainability
The Case of a SIDS (Cape Verde Islands)

Intergovernmental Group of Experts on Financing for Development
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Overview

1. From Poverty to MIC ...
2. How Cape Verde reached the MIC Status?
3. A clear “Debt Strategy” linked to a strong “Development Vision” ... To Generate “Debt Sustainability”
4. Transformation Requires: “Growth Engines” ... linked to a Debt Strategy ... To avoid the MIC Trap.
5. A Clear & Sustainable Debt Strategy
6. The Final Test ...
1. From Poverty to a MIC .... Four decades of change...

**Cape 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 Cape Verdeans) did not foresee a future

**In 2008 .... Cape 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%;
- In 2010:
  - Infrastructured development - 5th in Africa Cape Verde was considered among the “Top 10” FDI destinations in the world;
  - Cape Verde was considered among the “Top 10” country reformers in the world;
- In 2017:
  - ICT Development index – 4th in Africa (Mauritius, Seychelles, South Africa)
  - Top 10 African countries - E-governance index – 7th in Africa
From Poverty to a MIC: Four decades of change...

Mo Ibrahim Governance Index

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<tr>
<th>RANK/54</th>
<th>2017 SCORE/100.0</th>
<th>CHANGE 2008-2017</th>
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<td>68.0</td>
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<td>Rwanda</td>
<td>64.3</td>
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<tr>
<td>9th</td>
<td>Tunisia</td>
<td>63.5</td>
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<tr>
<td>10th</td>
<td>Senegal</td>
<td>63.3</td>
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2. How Cape Verde reached the MIC Status?

- **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 upon to end government’s participation in productive activities and 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 that past 14 years ....

- **Institutional Reforms (strengthen of the country systems)→
  - i) Public Financial Management - get control of the national financial flows ... accountability ... transparency;
  - ii) e-governing;
  - iii) business environment (one day to create a company);
  - iv) fiscal reforms (VAT, tax base, cut exemptions, ICT, ...);
  - v) Consistent investment in human capital development

• HOWEVER ...CAPE VERDE STILL FACE A HIGH LEVEL OF VULNERABILITY!
3. A Clear “Debt Strategy” Linked to a Strong “Development Vision” ... To Generate Debt Sustainability

- Why?
- Good Debt Management starts with Good Long Term Debt Strategy ... Linked to a Development Vision
- It is easy to get the money .... But more important than get the money is to spend well the money ... how you spend the money ...
- Test: if > 70% of a public investment program is physical infrastructure ... the Government has been captured by construction companies and commercial banks lobbies
- The Debt strategy should feature in the financing of the intangible assets of development ... institutions.
- At the end of the day institutions do matter!!
- This has been one of the missing pieces that explains ... MIC trap.

- The Vision: Cape Verde is a major crossroad .... Our starting point ... Cape Verde is more sea than land! 4.000 km² of land against 800.000 km² of sea (EEZ)
- As SIDS ... no domestic market ... international vocation ...
Cape Verde is the access point to the continents

An excellent center for commerce and merchandise transshipment

A place to finish, assemble, transship and re-export products

Ideal base for companies in textiles, electronic appliances, renewable energies, fishing and shipping
4. Transformation Requires: “Growth Engines” ... linked to debt strategy
Impressive development

- Why?
- Reforms
- Good Governance
- Political Stability
- Global growth
- FDI in tourism
- Public investment

Poverty fell from 37% in 2002 to 27% in 2010
From 2009 to 2015 Slowdown

- BUT
- Global recession
- Falling FDI & ODA
- Exhausted growth model
- Weak productivity
- Constraints of a small economy

The MIC Trap! Productivity despite huge investments ... 37% of GDP
Four international airports

9 ports, including 2 deep water ports (Santiago and Sao Vicente)

Modern Telecom infrastructure, including public digital squares with free WIFI

Energy (Power): 95% coverage rate

Strong & Clear regulatory framework

MDGs
5. A Clear & Sustainable Debt Strategy

- From 2002 to 2008 create fiscal space and debt space
- Because debt was linked to current expenditures
- From 2008 positive primary balances or around “0”
- Due to peg – external financing to infrastructure the country
5. A Clear & Sustainable Debt Strategy

- In short ... we grabbed an opportunity .... The concessional finance window
- We infrastructure the country “hard” and “soft” ... trough strong mobilization of concessional financing ...
- The debt is sustainable .....  
  - All are concessional loans  
  - Average maturity is over 25 years, with significant grace period  
  - 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  
- But to serve it we do need to complete the circle! “MARKET SIZE” .... And close the transformation agenda ... Strong fiscal competitiveness ... IBC – Trade, IBC – Services, IBC – Services ...
5. A Clear & Sustainable Debt Strategy .... BUT

• During the 2000s large FDI and ODA inflows allowed investment to reach an average of over 37 percent of GDP:

• Cape Verde’s transformation towards a service-based economy services now account for 75 percent of GDP. Tourism and related activities account for around 40 percent of GDP and have enabled Cape Verde to transition from a primary-sector-based economy to one dominated by services.

• BUT ....

• Economic growth has been driven by capital accumulation and the expansion of the tourism industry ... not translated yet into productivity gains.

• Climate change is draining financial resources away from the implementation of the vision

• The overall strategy is based on a new repositioning of Cape Verde in the regional/international arena .... Which still be an uncertainty ...

• The higher infrastructure level calls for new models of management ... which means structural reforms .... Otherwise the debt service will become a stress factor ...
6. The Final Test: Structural Transformation

Figure 3.1  Composition of External Financing for Cape Verde, 1995 and 2007

1995
- tourism, 4%
- remittances, 46%
- ODA, 38%
- FDI, 12%

2007
- tourism, 49%
- remittances, 19%
- ODA, 14%
- FDI, 18%

6. The Final Test: Stage of Development

![Diagram illustrating the stages of development and countries/economies at each stage of development.](image)

Table 2: Countries/economies at each stage of development

<table>
<thead>
<tr>
<th>Stage 1</th>
<th>Stage 2</th>
<th>Stage 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factor-driven</td>
<td>Efficiency-driven</td>
<td>Innovation-driven</td>
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<tr>
<td>1</td>
<td>2</td>
<td>3</td>
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<tr>
<td>Cape Verde</td>
<td>Efficiency-driven economies</td>
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Legend: Cape Verde, Efficiency-driven economies.
Thank You
Subsidiary Slides
ENERGY CLUSTER

- National targets for renewable energy development:
  - 2012 – 25%
  - 2020 – 50% (Island of Brava - 100%)

- Strategic partnership for the National power and water supply company (Electra)

- PPP for Renewable Energy Parks development and management

- Equipment manufacturing (solar panels and wind mills) for export to the Regional markets

- Mettering/Smartgrid (Electra)
Aero Business CLUSTER: 
Regional hub for air transportation

Connecting four continents...

- Direct and existing access to:
  - ✔ Europe, USA, Brasil, and Africa
- Legal framework as per international standard
- Autonomous CAA (independent administrative regulatory entity):
  - ✔ Civil aviation safety oversight;
  - ✔ Civil aviation security;
  - ✔ Air transport regulation.
- Modern and comprehensive technical regulation of aviation safety and security;
- FAA Category 1 (since 2003);
- ICAO compliance – well above world average
- Certification of service providers:
  - ✔ Air operators (ETOPS, NA MNPS, IOSA);
  - ✔ Airports (2 LPD);
  - ✔ Air navigation services
- ✔ 20 international operators
The main challenge remains!
How have we been managing the transition from ODA to FDI/Trade?

A shared national vision and development agenda

- An inclusive just and prosperous nation, with opportunities for all
- Build a dynamic, competitive, and innovative economy anchored on Cape Verde’s geostrategic location
- Transform Cape Verde into an international platform for high value-added services based on 7 clusters!

We started the process of building Key clusters ....

- **Sea Cluster** - Maritime economy based on transshipment, fishing, commercial ports, and shipping services
- **Sky Cluster** - Air transportation and related services “Regional HUB”
- **Agro-Business Cluster**
- **Tourism Cluster** - High value-added tourism
- **ITC Cluster**
- **Financial Services Cluster** and investment
- **Renewable Energy Cluster**
- **Cultural/Creative Industry**
...and we have some unique challenges

- We are an archipelago that is
  - Small (a micro state with limited population)
  - Insular
  - Fragmented
  - Resource poor, with no resources except the sea
  - Highly vulnerable

<table>
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### IV.1.1.1 - Composição e Indicadores da Dívida Pública 4º Trimestre 2017

(em milhões CVE)

<table>
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<tr>
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<th>4º Trimestre 2015</th>
<th>4º Trimestre 2016</th>
<th>4º Trimestre 2017</th>
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<tr>
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<td>197.372,6</td>
<td>210.726,0</td>
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<td>% do PIB</td>
<td>124,4%</td>
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<td>126,4%</td>
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<td><strong>Divida Externa</strong></td>
<td>151.374,5</td>
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<td><strong>Total Desembolsos</strong></td>
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<td>% do PIB</td>
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<td>13,3%</td>
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<td>% das Exportações</td>
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<td>16,3%</td>
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<td>% das Receitas do Estado</td>
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<td>% das Reservas Internacionais</td>
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