

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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Cristina Duarte

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 (Mauricias, Seychelles, South Africa)
 - Top 10 African countries - E-governance index – 7th in Africa

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

Mo Ibrahim Governance Index

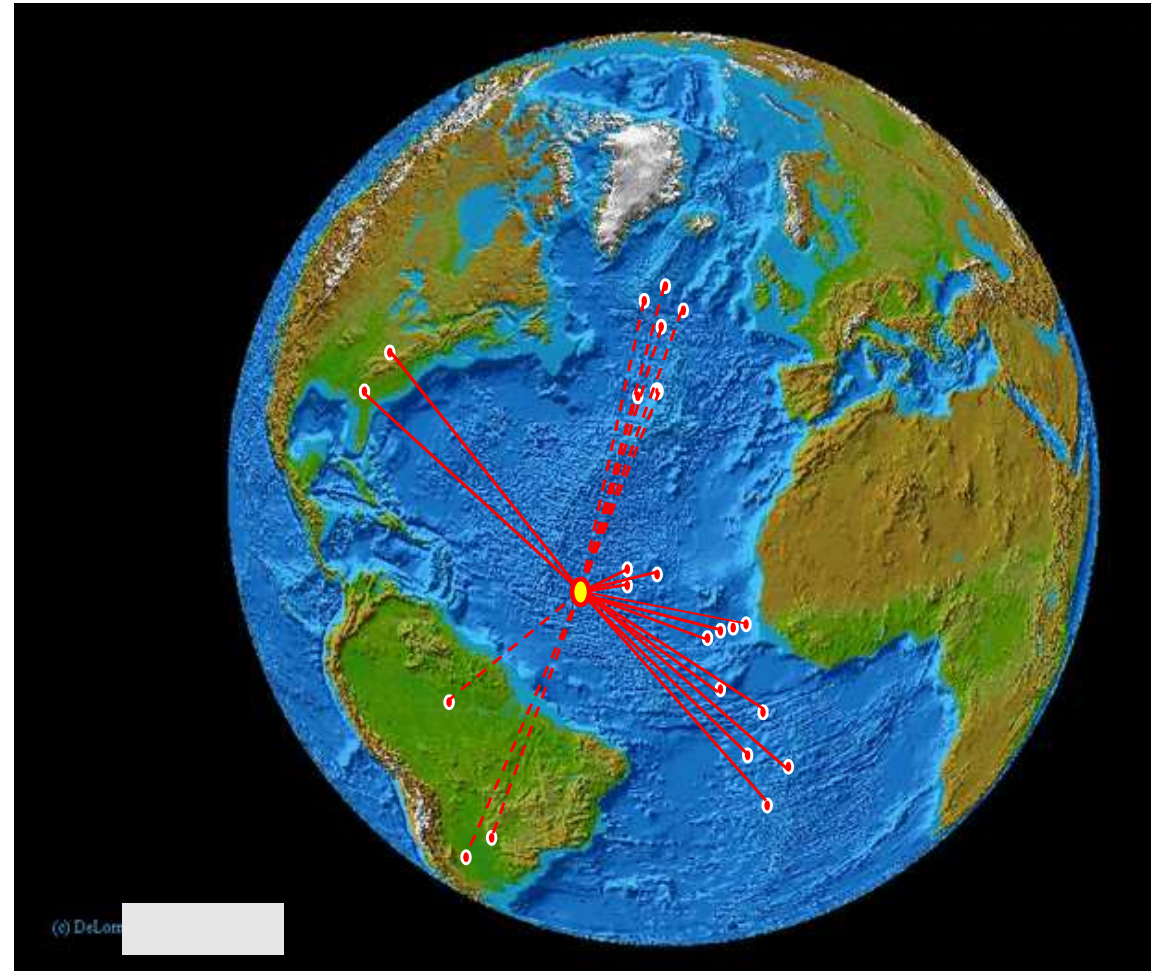
RANK/54		2017 SCORE /100.0	CHANGE 2008-2017	
1 st	Mauritius	79.5	-0.7	
2 nd	Seychelles	73.2	+4.0	
3 rd	Cabo Verde	71.1	-0.8	
4 th	Namibia	68.6	+3.3	
5 th	Botswana	68.5	-3.7	
6 th	Ghana	68.1	+0.9	
7 th	South Africa	68.0	-0.6	
8 th	Rwanda	64.3	+5.9	
9 th	Tunisia	63.5	+6.9	
10 th	Senegal	63.3	+5.9	

2. How Cape Verde reached the MIC Status?

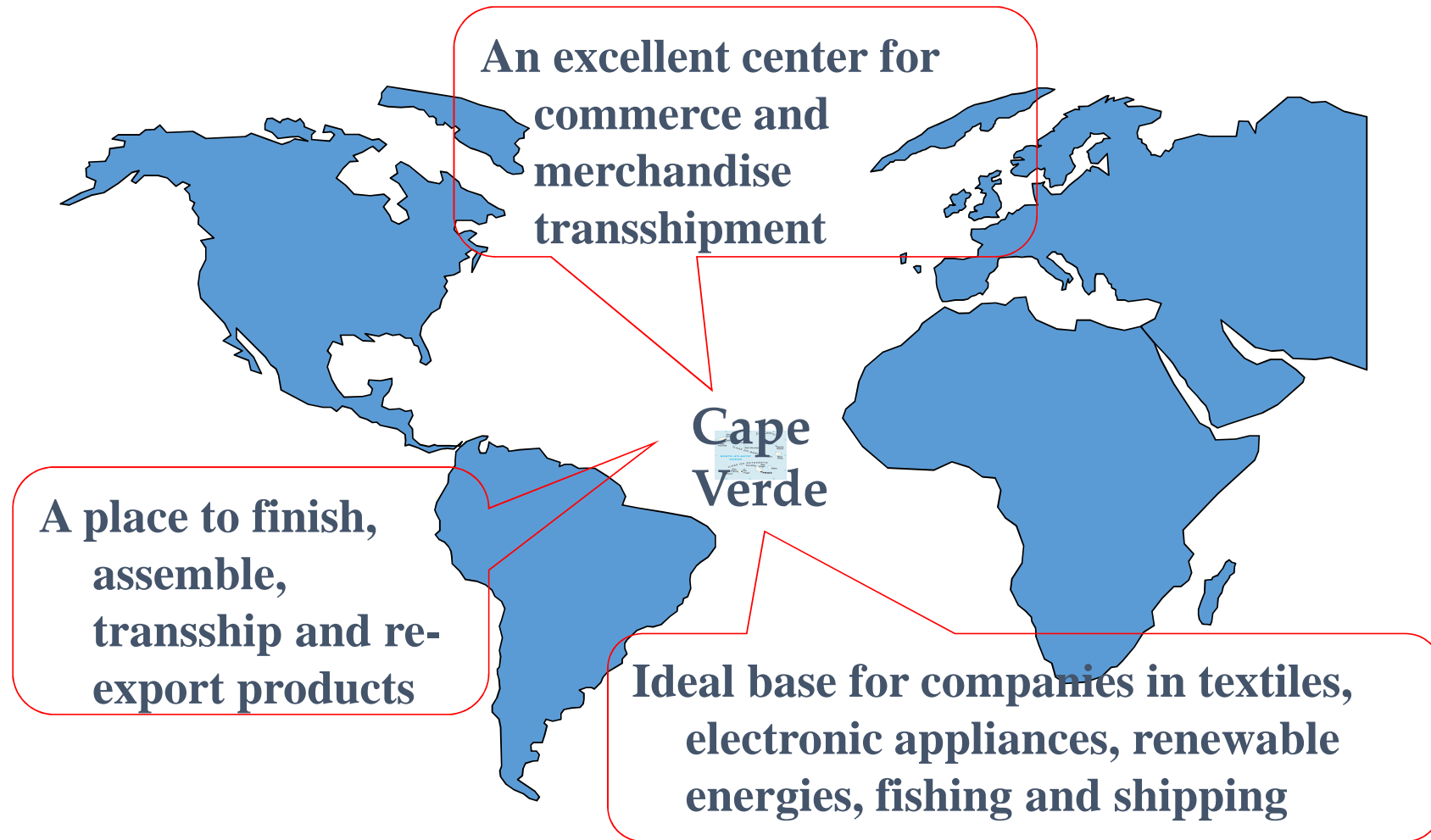
- **Political Reforms** - shift from a one-party system to a multi-party democracy, separation of powers, strengthen of external control, ... Democratic nation with free press, regular elections, and peaceful transfers of power
- **Economic/Market Reforms** - market reforms were embarked upon to end 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

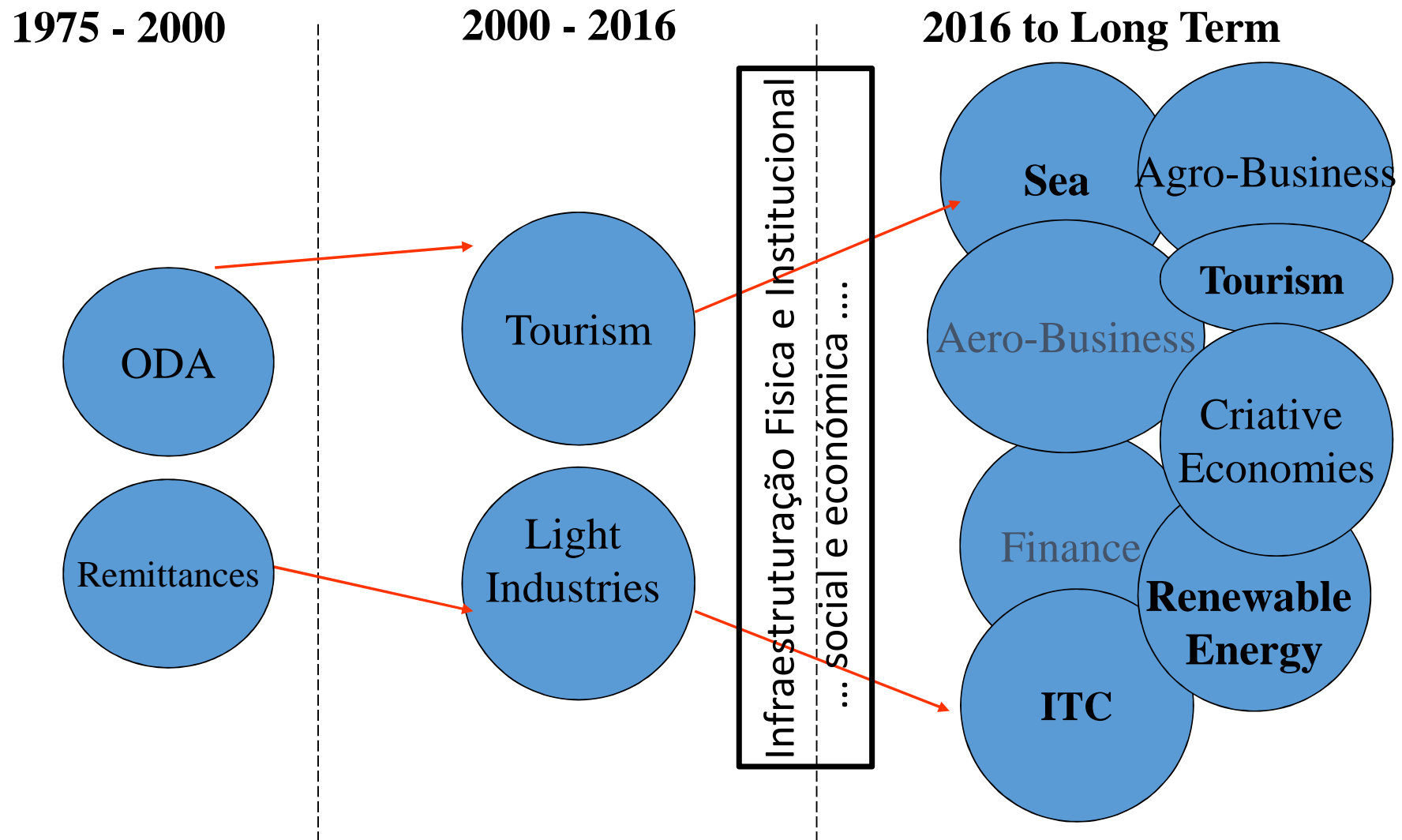
- Why?
- Good Debt Management starts with Good Long Term Debt Strategy ... Linked to a Development Vision
- It is easy to get the money But more important than get the money is to spend well the money ... how you spend the money ...
- Test: if > 70% of a public investment program is physical infrastructure ... 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

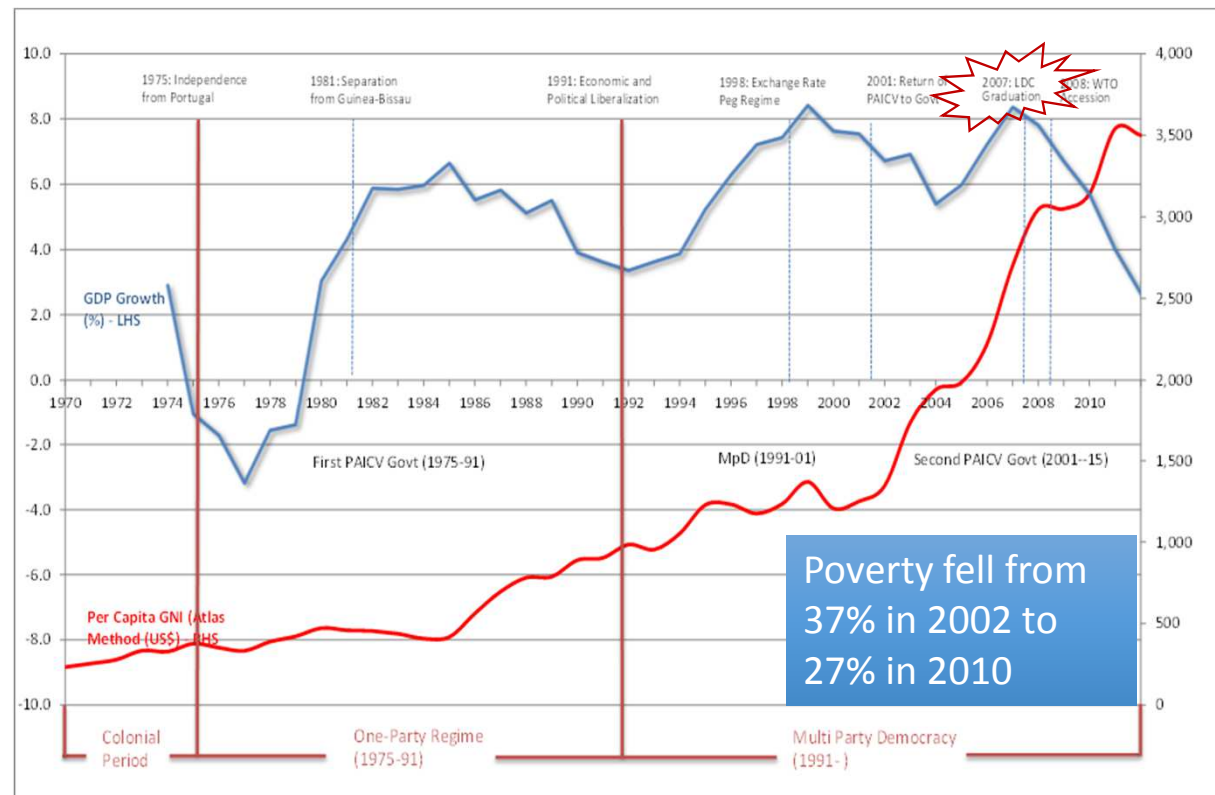


4. Transformation Requires : “Growth Engines ” ... linked to debt strategy



Impressive development

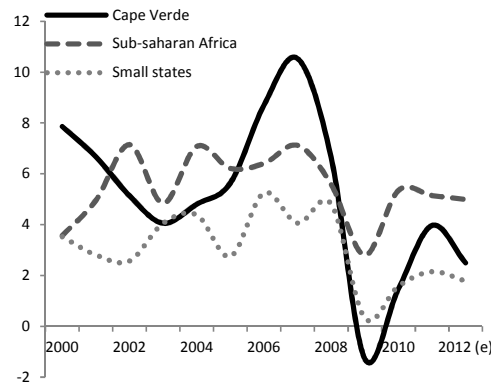
- Why?
- Reforms
- Good Governance
- Political Stability
- Global growth
- FDI in tourism
- Public investment



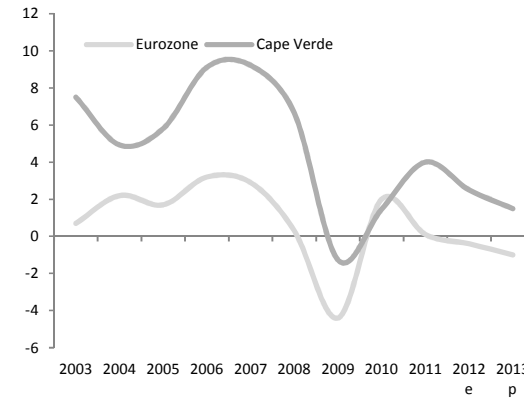
From 2009 to 2015 Slowdown

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

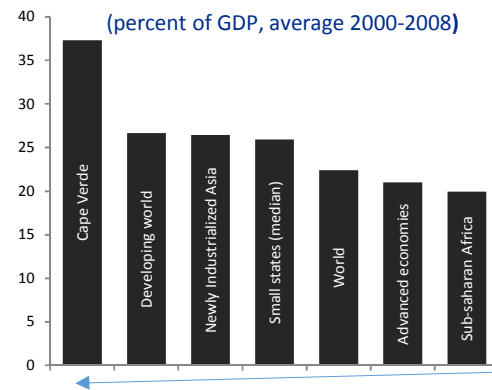
GDP Growth Rates, 2000-12
(percent)



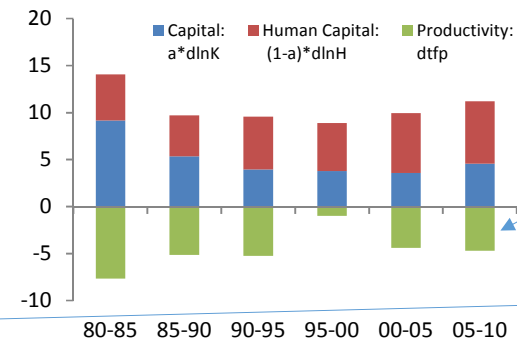
Growth in Cabo Verde and Europe
(percent)



Investment rates in Cape Verde compared to international standards
(percent of GDP, average 2000-2008)

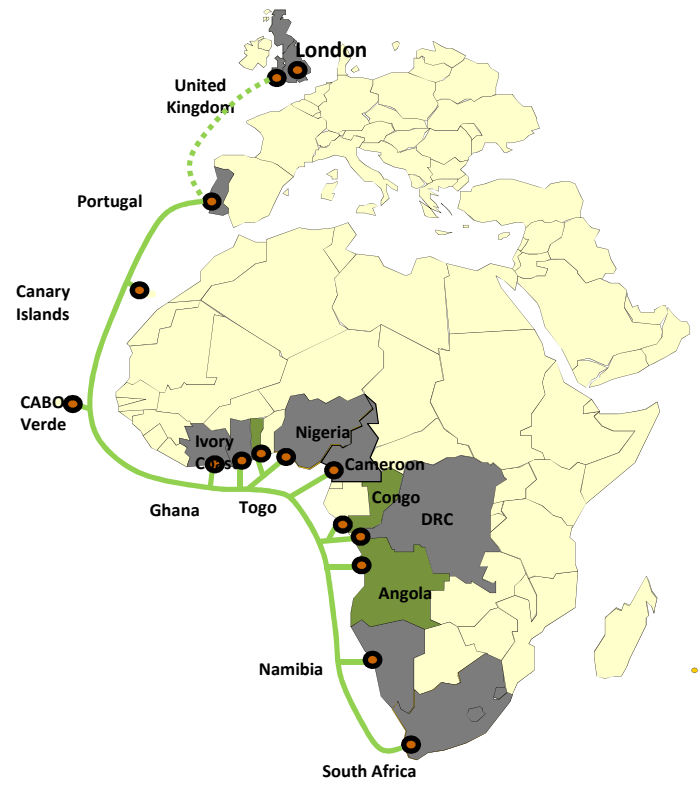


Growth Accounting with Human Capital
(percent)



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

Economic & Social Infrastructure



Four international airports

Modern Telecom infrastructure, including public digital squares with free WIFI

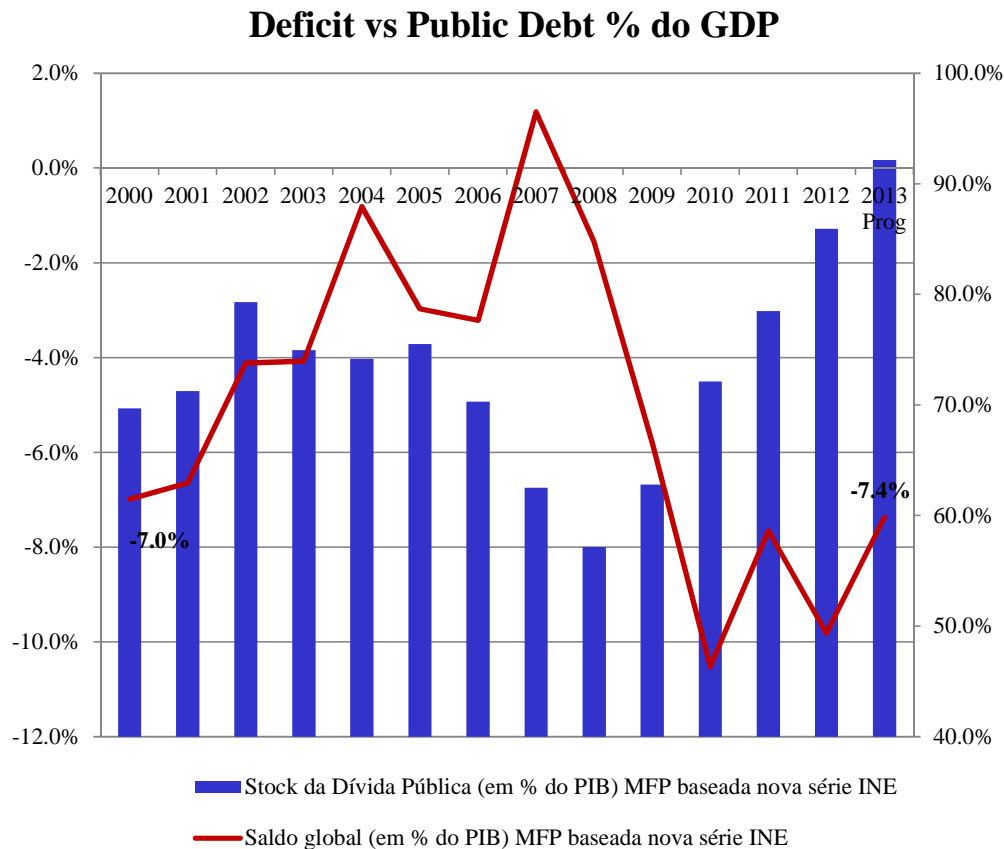
Strong & Clear regulatory framework

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

Energy (Power): 95% coverage rate

MDGs

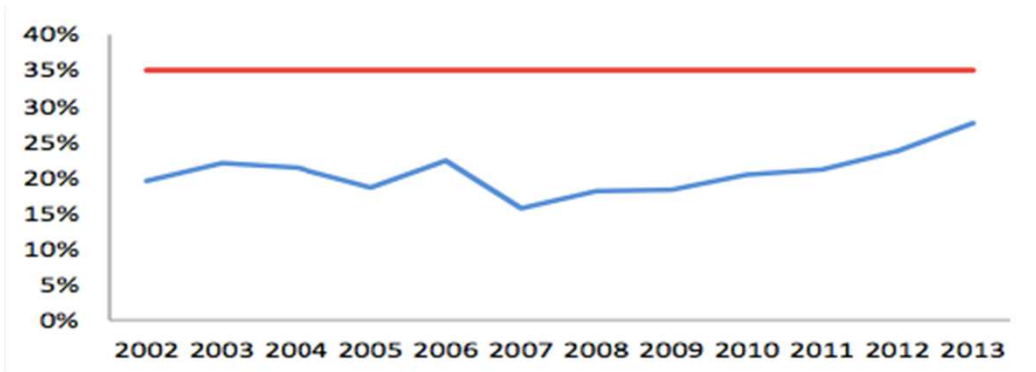
5. A Clear & Sustainable Debt Strategy



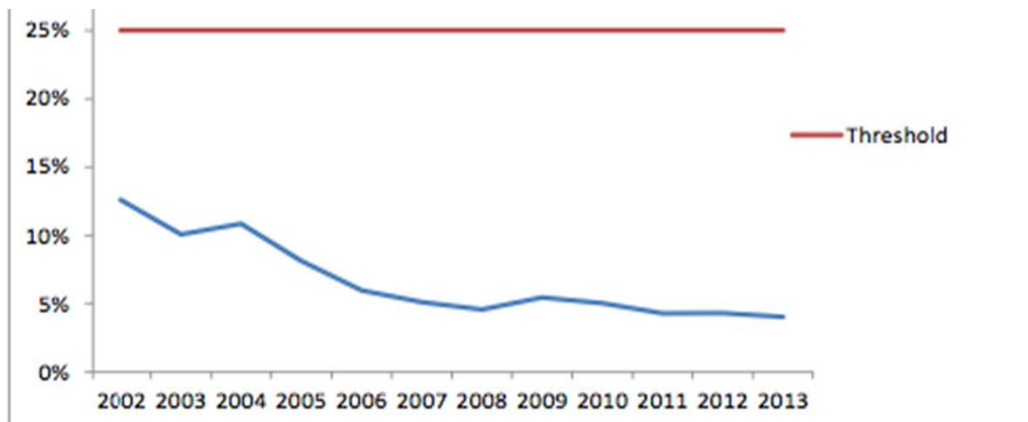
- From 2002 to 2008 create fiscal space and debt space
- Because debt was linked to current expenditures
- From 2008 positive primary balances or around “0”
- Due to peg – external financing to infrastructure the country

5. A Clear & Sustainable Debt Strategy

Ratio Debt Service to Revenues



Ratio Debt Service to Exports



- In short ... we grabbed an opportunity The concessional finance window
- We infrastructure the country “hard” and “soft” ... through 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

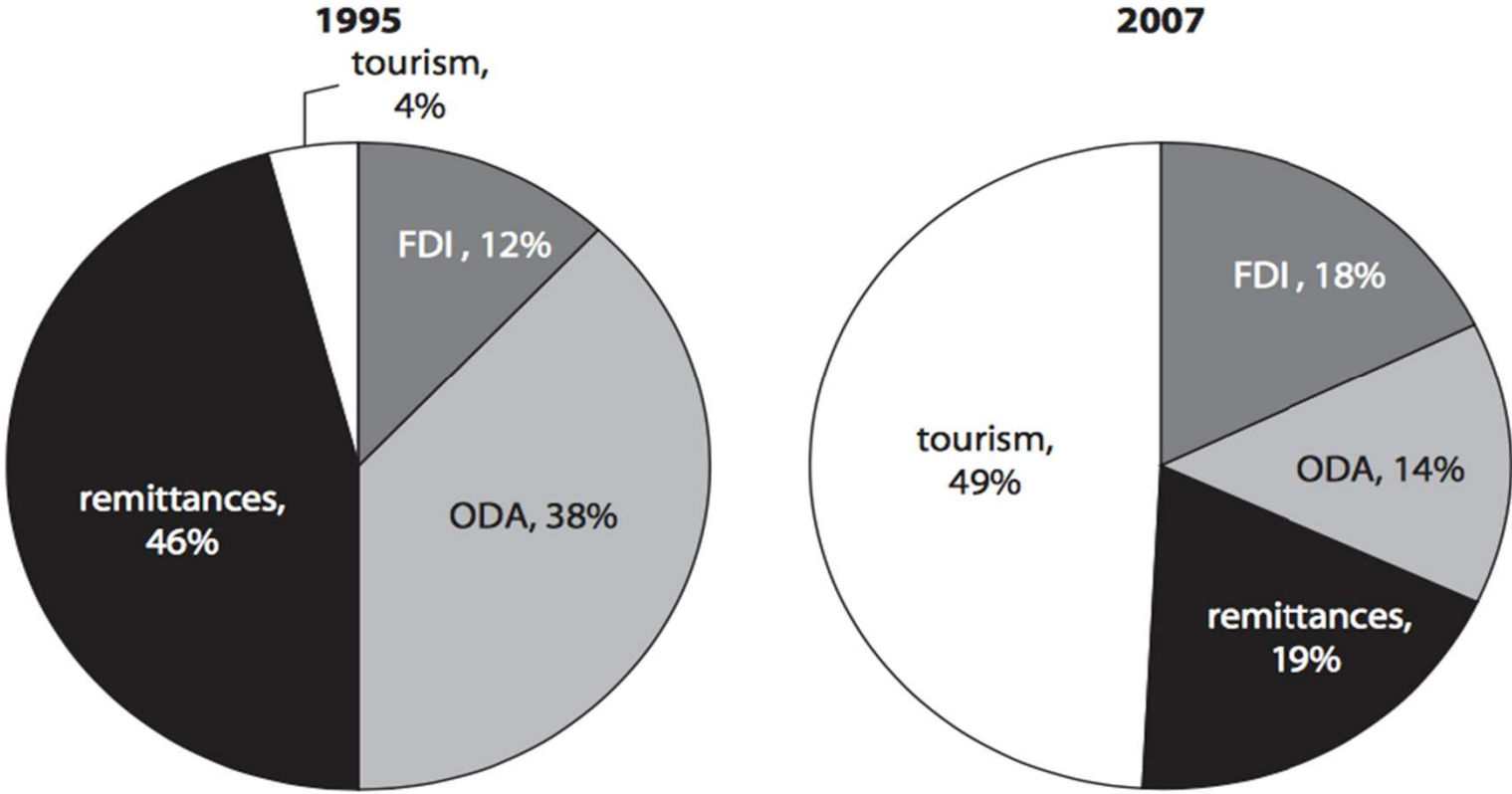
- But to serve it we do need to complete the circle! **“MARKET SIZE”** And close the transformation agenda ... **Strong fiscal competitiveness** ... IBC – Trade, IBC – Services, IBC – Services ...

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



Source: IMF 2008.

6. The Final Test: Stage of Development

Stage of development

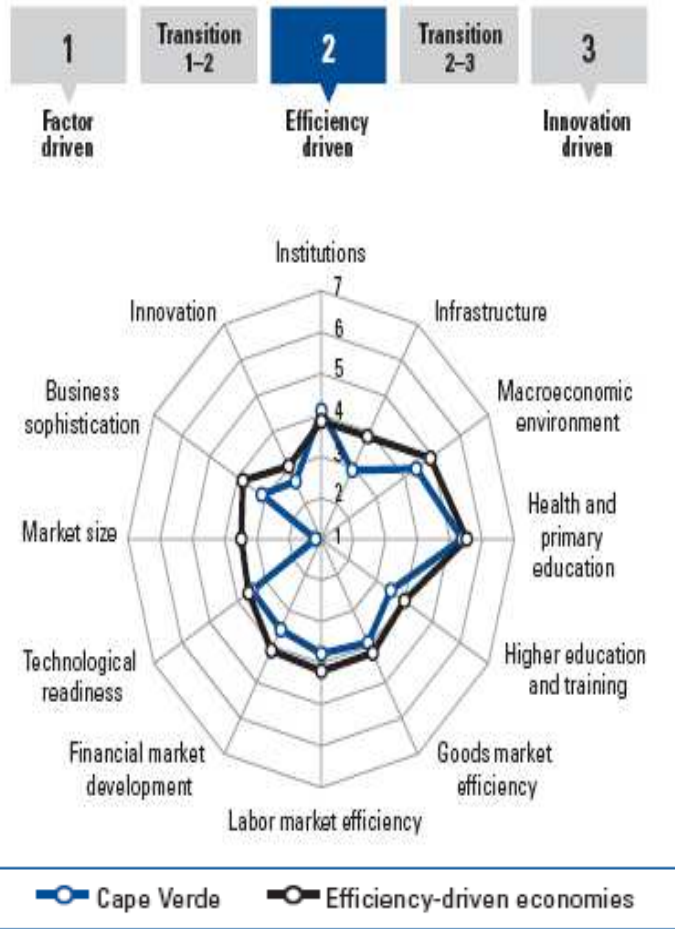
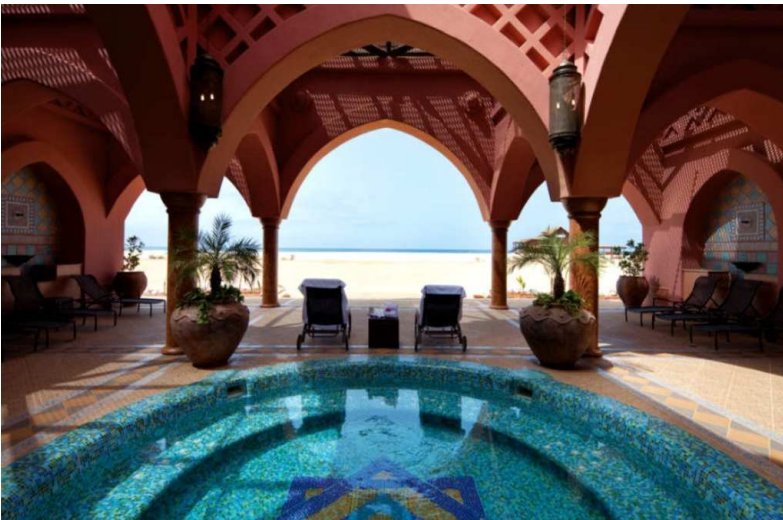


Table 2: Countries/economies at each stage of development

Stage 1: Factor-driven (37 economies)	Transition from stage 1 to stage 2 (24 economies)	Stage 2: Efficiency-driven (28 economies)	Transition from stage 2 to stage 3 (18 economies)	Stage 3: Innovation-driven (35 economies)
Bangladesh	Algeria	Albania	Argentina	Australia
Benin	Angola	Belize	Barbados	Austria
Bolivia	Armenia	Bosnia and Herzegovina	Brazil	Bahrain
Burkina Faso	Azerbaijan	Bulgaria	Chile	Belgium
Burundi	Botswana	Cape Verde	Croatia	Canada
Cambodia	Brunei Darussalam	China	Estonia	Cyprus
Cameroon	Egypt	Colombia	Hungary	Czech Republic
Chad	Georgia	Costa Rica	Latvia	Denmark
Côte d'Ivoire	Guatemala	Dominican Republic	Lebanon	Finland
Ethiopia	Guyana	Ecuador	Lithuania	France
Gambia, The	Honduras	El Salvador	Mexico	Germany
Ghana	Iran, Islamic Rep.	Indonesia	Oman	Greece
Haiti	Jamaica	Jordan	Poland	Hong Kong SAR
India	Kazakhstan	Macedonia, FYR	Russian Federation	Iceland
Kenya	Kuwait	Malaysia	Slovak Republic	Ireland
Kyrgyz Republic	Mongolia	Mauritius	Trinidad and Tobago	Israel
Lesotho	Paraguay	Montenegro	Turkey	Italy
Madagascar	Philippines	Morocco	Uruguay	Japan
Malawi	Qatar	Namibia		Korea, Rep.
Mali	Saudi Arabia	Panama		Luxembourg
Mauritania	Sri Lanka	Peru		Malta
Moldova	Syria	Romania		Netherlands
Mozambique	Ukraine	Serbia		New Zealand
Nepal	Venezuela	South Africa		Norway
Nicaragua		Suriname		Portugal
Nigeria		Swaziland		Puerto Rico
Pakistan		Thailand		Singapore
Rwanda		Tunisia		Slovenia
Senegal				Spain
Tajikistan				Sweden
Tanzania				Switzerland
Timor-Leste				Taiwan, China
Uganda				United Arab Emirates
Vietnam				United Kingdom
Yemen				United States
Zambia				
Zimbabwe				

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
- Metering/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

Insularity Index			Vulnerability Index		
	Pays	II	Pays	IV	
1	Micronésie	8,707	1	Maldives	2.569
2	Palau	3,317	2	Micronésie	1.339
3	Maldives	2,147	3	Nauru	884
4	Marshall (Iles)	2,044	4	Malte	789
5	Nauru	1,429	5	Marshall (Iles)	678
6	Kiribati	1,409	6	Tuvalu	426
7	Seychelles	1,079	7	Seychelles	194
8	Tuvalu	0,923	8	Kiribati	182
9	Malte	0,623	9	Palau	152
10	Tonga	0,560	10	Barbade	147
11	Saint-Kitts-et-Nevis	0,517	11	Grenade	92
12	Cook (Îles)	0,500	12	Tonga	79
13	Grenade	0,352	13	Saint-Kitts-et-Nevis	77
14	Antigua-et-Barbuda	0,346	14	Saint-Vinc.-et-Grenad.	66
15	Sainte-Lucie	0,256	15	Sainte-Lucie	62
16	Bahamas	0,255	16	Antigua-et-Barbuda	54
17	Cap-Vert	0,239	17	Maurice	53
18	Barbade	0,226	18	Comores	50
19	Saint-Vinc.-et-Grenad.	0,216	19	Cook (Îles)	44
20	Sao Tomé-et-Principe	0,209	20	Sao Tomé-et-Principe	40
21	Vanuatu	0,207	21	Cap-Vert	25
22	Dominique	0,196	22	Jamaïque	23
23	Salomon, Îles	0,187	23	Haïti	19
24	Comores	0,157	24	Dominique	18
25	Samoa Ocid.	0,137	25	Trinité-et-Tobago	15
26	Jamaïque	0,093	26	Samoa Ocid.	8
27	Maurice	0,087	27	Répub. Dominicaine	6
28	Trinité-et-Tobago	0,071	28	Chypre	6
29	Chypre	0,070	29	Bahamas	6
30	Haïti	0,064	30	Cuba	5
31	Fidji	0,062	31	Salomon (Iles)	4
32	Cuba	0,052	32	Vanuatu	4
33	Timor-Lest	0,047	33	Timor-Lest	3
34	Répub. Dominicaine	0,034	34	Fidji	3

IV.1.1.1 - Composição e Indicadores da Dívida Pública 4º Trimestre 2017
(em milhões CVE)

	4º Trimestre 2015	4º Trimestre 2016	4º Trimestre 2017
Saldo da Dívida Pública	197.372,6	210.726,0	215.013,3
<i>% do PIB</i>	124,4%	129,0%	126,4%
Dívida Externa	151.374,5	158.209,7	158.449,6
Dívida Interna	45.998,1	52.516,3	56.563,6
Total Desembolsos	23.624,4	21.668,5	21.742,8
<i>% do PIB</i>	14,9%	13,3%	12,8%
Dívida Externa	12.363,8	7.068,4	9.398,7
Dívida Interna (Emissão)	11.260,6	14.600,0	12.344,1
Total Serviço da Dívida	11.252,2	12.208,3	12.877,0
<i>% das Exportações</i>	17,2%	16,7%	16,3%
<i>% das Receitas do Estado</i>	37,2%	37,8%	35,9%
<i>% das Reservas Internacionais</i>	22,5%	20,5%	22,1%
Dívida Externa	4.155,2	4.361,7	5.002,7
Dívida Interna	7.097,0	7.846,6	7.874,3
Memória: PIB do ano	158.699,1	163.381,4	170.052,7
Exportações	65.575,7	73.322,4	78.951,8
Receitas do Estado	30.252,5	32.303,9	35.908,9
Reservas Internacionais	49.998,0	59.692,3	58.200,0