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MILLENNIUM CHALLENGE CORPORATION
UNITED STATES OF AMERICA

GOVERNMENT OF CABO VERDE

Ministry of Finance

Cape Verde:

Constraints to Growth, Transformation and Poverty Alleviation

22 July 2010

This document was prepared by the Government of Cape Verde under the supervision of the Ministry of Finance. The Government acknowledges the valuable contributions of the Members of the Consultative Forum, the Focus Groups and the National Task Force.

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Executive Summary

The Cape Verde Constraint Analysis Study constitutes the first phase in the development of Cape Verde's second compact with the Millennium Challenge Corporation (MCC) under the Millennium Challenge Account (MCA) program. The study aims to identify the constraints that hinder economic growth and poverty alleviation in Cape Verde.

The Constraint Analysis exercise is premised on the idea that rapid sustainable economic growth is the most effective way to reduce poverty because growth generates employment and revenues for governments to pursue a social development agenda. Thus, it is important to identify the factors inhibiting higher levels of productive investment and rapid sustainable growth rates which, if addressed, could allow Cape Verde to achieve a significant reduction in poverty. The identification of binding constraints is expected to allow policy makers to better formulate and target policies at the most important constraints to growth.

This study examines various potential factors that drive growth. Specifically, this study examines:

- The Cape Verdean financial sector to assess whether deficient finance (local or international) is a hindrance to growth;
- The complementary factors of production to assess if there is scarcity or weaknesses which may impede growth. The examination focused on human capital, geography (including insularity, size, fragmentation, climate, terrain and natural resources), the quality and levels of infrastructure, and the innovativeness of the economy;
- The macroeconomic and investment climate to analyze if there are risks which hinder investment activities.

An exhaustive and rigorous examination of these factors, supported by primary data and quantitative analyses, was undertaken. These factors were also assessed in comparative context whereby Cape Verde's indicators and performance were benchmarked relative to five peer countries. The findings of the Constraint Analysis study (presented below) can be summarized in three categories: not a constraint (non-constraints), constraint, and binding constraints. The constraints represent the factors hindering growth in Cape Verde. All require actions as the constraints will emerge as binding constraints if not addressed.

The Findings

Categories	Factors
Non-Constraints	• Macro environment is not a constraint given the performance of Cape Verde relative to benchmark countries. • Micro risk is not a constraint, taking into account Cape Verde's relative performance of Cape Verde with benchmark countries.
Constraints	• Access to finance is a constraint, although not binding as yet. Cape Verde has a high level of financial intermediation. It compares reasonably well with the benchmark countries but ranks poorly on getting credit. The challenge is that it could become the most binding constraints if the issues in the sector are not addressed timely. • Human capital is a constraint but not presently binding, based on available data. Cape Verde has good levels of human capital but lacks highly skilled workers and professionals which it needs to build a more entrepreneurial and innovative economy to sustain growth and facilitate transformation. Additionally, there is a mismatch in the supply and demand of labor and the major obstacle for large size firms is inadequately educated workforce. • Telecommunication is a constraint despite the modern telecommunication infrastructure in Cape Verde. However, it is not a binding constraint. Competition in the sector is inadequate, with high cost and limited access.
Binding Constraints	• Geography constitutes a binding constraint to growth and development. It limits agriculture, imposes significant costs on transportation, prevents a unified internal market, and increases the cost of energy and external dependency as Cape Verde is dependent on energy intensive process for water desalination. • Innovation is a binding constraint given the inexistence of an ecosystem for innovation (especially the lack of highly knowledge workers, professionals and entrepreneurs needed for a more entrepreneurial economy) which has resulted in the concentration of exports in low technology products. • Transport, especially inter-island maritime transportation continues to present a binding constraint for growth by limiting the movements of goods and people between islands. It is costly and unreliable. It also hinders the ability of farmers to get their goods to market and for producers to access international markets. • Energy, water and sanitation are linked and remain a binding constraint for Cape Verde. The main issues have to do with: inadequate networks and systems, volatility and high costs, unreliability and frequent outages, the high technical and non-commercial losses in production and distribution, and weak institutional frameworks. All these challenges that affect energy, water and sanitation, in some ways, impose high costs on firms, individuals and the economy. Sanitation is particularly plagued with limited network and access, with potential implications for disease outbreaks, flooding, and tourism sector.

1
Introduction

Cape Verde is often cited as a 'success story' among developing countries as a result of its record of social and economic performance in the last two decades. Indeed, its performance has been so positive that in January 2008 the United Nations General Assembly voted to "graduate" Cape Verde from the list of least developed countries. The country is expected to meet or surpass all the Millennium Development Goals. To be sure, this aggregate performance, while respectable among developing countries and a subject of envy in the African context, masks a number of fragilities.

The positive aggregate performance on the social and economic fronts – for a country considered unviable in 1975 – makes Cape Verde a natural laboratory to test whether and how institutions matter in development. Cape Verde's partial success thus far is also a puzzling case because of the array of inhospitable circumstances and handicaps the country faces. In fact, at the time of the quest for national liberation, many Cape Verdeans and experts alike questioned the wisdom of seeking independence. The concerns were well founded. The nineteen sixties and early seventies were a time when the memories of the ravages of past famines in Cape Verde were not too distant. The threat of another famine was always a possibility, with a very narrow economic base, a limited production capacity, and a dependency on rain fed agriculture. Additionally, Cape Verde faces significant costs of geography due to its insularity, fragmentation and smallness. With these challenges, it was difficult, for many, to foresee the possibility of sustained growth and economic development in the Cape Verdean archipelago. Cape Verde's record since independence has proven otherwise.

1.1 The Agenda for Transformation

The country has entered a new phase in its national development, with new challenges and opportunities. In fact, the main focus of development policy since 2001 is economic transformation.

The government's Agenda for Transformation envisions transforming the Cape Verdean economy into a modern, high income, services-based economy and society. The transformation agenda aims to promote new growth sectors. The effort is to turn Cape Verde into an international platform for knowledge services. Even if the aim may at times seem challenging given the country's present fragilities, the fact of having an orienting strategy and vision has been pivotal in terms of policy formulation and coordination. To turn Cape Verde into a globally competitive services economy, the Agenda for Transformation identifies key strategic areas:

- Tourism: promoting high value added tourism;
- Fisheries: turning Cape Verde into a regional center for processing, marketing, and exports of marine resources;
- Transport: making Cape Verde a regional transportation & transshipment hub for cargo and passengers;
- Cyber Island: promoting a knowledge-based services sector, including business services and outsourcing;

- Finance – making Cape Verde a center for financial and investment services; and
- Culture: promoting Cape Verde as a service "hub" for culture industry.

The Agenda for Transformation is premised on a reflection on how to capitalize on the few natural or comparative advantages the country has – ample ocean, geostrategic location, and a tropical climate. Progress is being made. The next step now is to accelerate the process of transformation. This will however require quickly upgrading the nation's capabilities, in various dimensions, to overcome key strategic challenges.

Achieving the transformation agenda is critical. The essence of the transformation agenda is the expansion of growth opportunities. Cape Verde needs to expand is narrow economic base in order to produce new opportunities for growth which will actually make a major dent on unemployment and poverty. Over the years, Cape Verde has achieved substantial growth rates and made progress on many fronts. But the problems of poverty and unemployment continue to pose challenges for the nation.

1.2 The Study

Given the well known limitations facing the nation and the ongoing global economic crises, it is reasonable to wonder whether or not Cape Verde will be able to realize its agenda for transformation.[1] Will Cape Verde be able to expand growth opportunities and sustain its growth record in the coming years? What will it take? What are the fundamental factors that are hindering or could hinder growth and the realization of the transformation agenda?

These questions are been asked in the ambit of the US Millennium Challenge Account, for which Cape Verde is the first country to qualify to present a proposal for a second compact. The first phase of the compact development process is constraints analysis, which is based on the growth diagnostics methodology outlined by Hausmann, Rodrik and Velasco (2005).[2] This document presents the outcome of the constraints analysis for Cape Verde.

But before presenting the results of the constraints analysis, an overview of Cape Verde's economic performance is presented in Section 2. The constraints analysis methodology and the diagnostics decision tree are presented in Section 3. Sections 4 to 6 are used to present the outcomes of the constraints analysis while the Concluding remarks are covered in section 7.

In undertaking the constraints analysis, it is important to have a select group of countries to serve as comparators/benchmark. We opted to select five countries: Mauritius, Morocco, Senegal, Seychelles, and South Africa. The selection was based on three factors: similarity, aspiration and competition.

[1] These natural limitations arise mainly due to geography and will be explored in-depth in the section four which is focused on constraints analysis.

[2] Ricardo Haussmann, Dani Rodrik, and Andres Velasco (2005), "Growth Diagnostics," Kennedy School of Government, Harvard University (Cambridge, MA).

Similarity: Although Cape Verde is geographically part of the West African region, its challenges and realities are closer to the small island developing states (SIDS), as such it was important to include similar countries such as Mauritius and Seychelles, with Mauritius representing a model of a successful strategy of economic transformation of an island state.

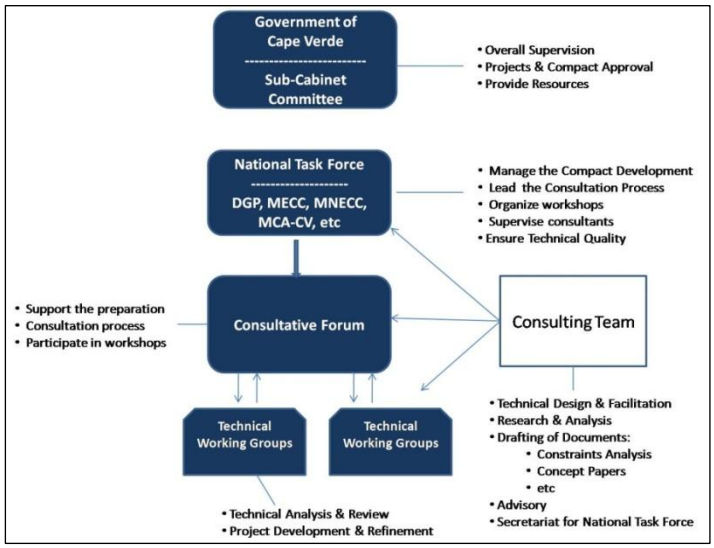
Aspiration: Cape Verde's national agenda is economic transformation. It aims to become an international platform for services. In this regard, Mauritius, South Africa and Morocco are already ahead in some of the areas of interest to Cape Verde, such as transshipment (Morocco and South Africa), and international financial gateway (Mauritius and South Africa). These are three countries that Cape Verde has sought to develop relationships and partnerships to facilitate its transformation agenda. More importantly, South Africa and Mauritius are among the most developed countries in Sub-Sahara Africa (SSA).

Competition: Senegal is the closest country to Cape Verde among the comparators and in West Africa. At some level, they are pursuing similar strategies. Both Cape Verde and Senegal in the West Africa region aim to become the international hub for transportation (passengers and cargo). It is important to see how Cape Verde compares on key issues to better compete in the region.

1.3 The Consultative and Analytical Process

The development of the second compact includes both analytical and participatory elements (Figure 1.1). The day-to-day management is under the management of a National Task Force which is supported by a team of consultants. The participatory elements are the stakeholder team (Consultative Forum) and the expert team (Technical working groups). A technical working group (Constraints Analysis Team) was set up to undertake this study (Constraints Analysis). This team worked in collaboration with the National Task Force and many stakeholders.

Figure 1.1: **Institutional Framework**



Various activities were undertaken in the course of the constraints analysis and they included the following:

Consultative Forum: A consultative forum was undertaken right at the beginning of the process. The forum focused on educating the public on how the second compact will be developed and to obtain a consensus on the way forward. An additional element of the forum was the constraints Analysis. Four teams were created to identify core constraints to growth and poverty alleviation during the forum. The report of the forum served as an input for the constraints analysis.

Discussions with MCC Economists: A teleconference was organized by the MCC country mission in Cape Verde at the beginning of the constraints analysis. The teleconference allowed for the discussion of the constraints analysis methodology and process. Participants included MCC economists in the US, MCC country mission in Praia, and the CA team. Additionally, an MCC mission was in Praia following the submission to review and discuss the initial draft with the Constraints Analysis (CA) Team.

Documentation: The CA Team and the members of the National Task Force undertook collection of important research documents and strategic studies on Cape Verde. Examples include the studies undertaken as part of the first MCA compact, the growth and poverty strategy documents (I & II), doing business reports, enterprise surveys, and sector strategies for review by the CA Team.

Data Collection: The CA Team met weekly and on special cases when there is additional need. The first set of meetings focused on identifying the data that was needed to undertake the constraints analysis based on the guidelines. Stakeholders to work with were also identified and roles assigned within the CA Team on who is responsible for what data.

Focus Groups: Based on the outcome of the first consultative forum and an initial research by the CA Team, six focus group meetings were planned and organized. The focus groups were held on agriculture, infrastructure, energy, private sector, information and communication technology, and capacity building. Each focus group brought together experts from the public sector, private sector and civil society. Invited participants for each were between 10 and 12 people with expertise on the subject matter and the terms of reference for each focus group were to (i) identify the binding constraints for the sector which is hindering economic growth and poverty, (ii) identify lessons from previous attempts to address constraints and if possible from the implementation of the first compact, and (iii) identify possible solutions/interventions to address the constraints.

Data Examination and Analysis: The CA Team studied the documents and outputs of the consultations. The team also undertook the analysis recommended by the MCC guidelines. Among the initial tasks were the development of the diagnostics tree, and the formulation of the criteria and selection of the benchmark countries. Attempts were made to obtain additional data especially for benchmark countries. Data could not be obtained in a few cases, such as the data needed for export sophistication analysis. The team met regularly to review outputs and to identify further charts, graphs and analytical work to be done.

National Dissemination & Validation Workshop: The final phase of this process involved the dissemination of the CA document to stakeholders and experts in Cape Verde to solicit comments and inputs. A second consultative forum was organized to review and validate the findings. A final revision of the CA document was then undertaken. Participants in the validation workshop included members of the Consultative Forum and the Focus Groups.

2
Overview of Cape Verde's Economic Performance

Cape Verde, an archipelago with 10 islands and 5 islets, is about 450km off the coast of West Africa. It gained its independence in 1975 from Portugal. Cape Verde has 4,033 square kilometers of land area and 700,000 square kilometers of Exclusive Economic Zone (EEZ). At independence, there were only two high schools[3] in the country and one hotel with 12 rooms in the capital city, Praia. Its number of health facilities and economic infrastructure from roads, airports to ports were quite limited. Furthermore, Cape Verde has no known natural resources in any significant quantity to-date.

Given these challenges, the early post independence period was focused on building the state and the confidence of the people in state institutions. The state agenda included efforts to democratize education, ensure the delivery of basic social services, and facilitate the development of agriculture to ensure national food security. Emphasis was also placed on reforestation, infrastructure and uniting the nation. A particular importance was attached to ensuring that there will never be another famine in the future of the newly independent state, given the human costs and the socio-psychological implications.[4]

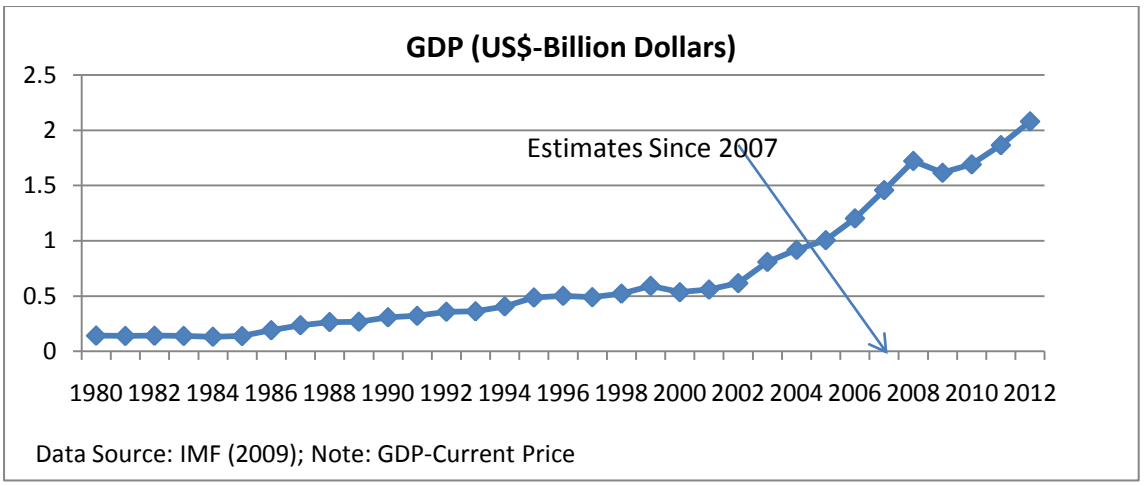
On the issue of food security, and in many other areas such as building a state, the nation has succeeded beyond the expectations of the early days. Rather than concerns about famine, the challenges now are ensuring the sustainability of growth and the acceleration of the process of transforming the Cape Verdean economy.[5] We now focus on two key areas: economic and social development.

2.1 Economic Performance and Sources of Growth

The Cape Verdean economy has performed reasonably well since independence. A review of GDP figures indicate significant rise in GDP. The GDP which stood at about 500 million USD in 1995 reached about 1 billion USD in 2005. 2007 estimates indicate a 50% rise to 1.5 billion USD, and it is expected to cross the 2 billion USD mark by 2012 which will be another 33% rise between 2007 and 2012 (Figure 2.1).

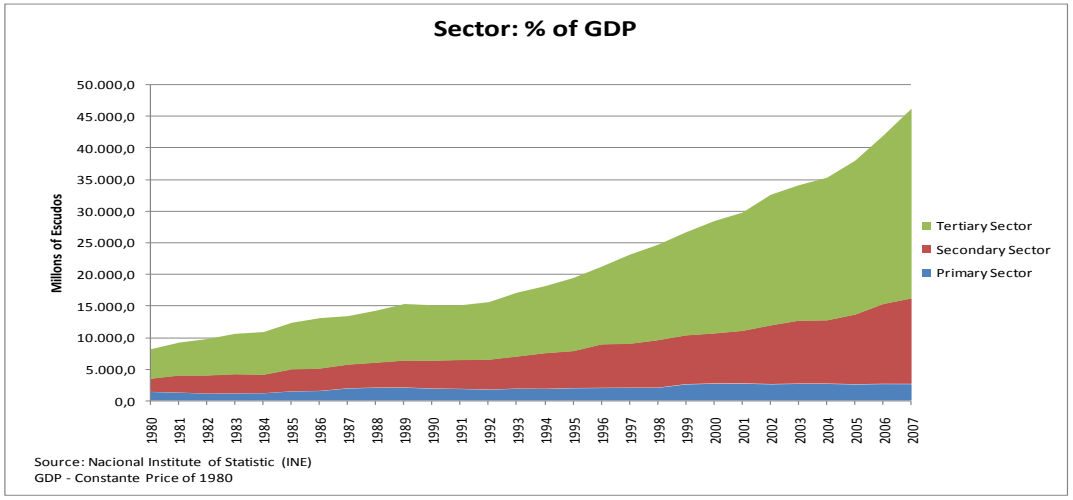
[3] There was one in Praia, Santiago and the other in Mindelo, São Vicente.
[4] The text on the early focus of the newly independent state of Cape Verde was obtained in an interview in 2007 of the President of Cape Verde, H.E. Pedro Pires, who was the first Prime Minister of the nation.
[5] In fact, in his State of the Nation Address to Parliament in July 2009, the Prime Minister of Cape Verde, H.E. Jose Maria Neves, noted that the aim of the government now, given the current global challenges, is to accelerate the process of transformation.

Figure 2.1



The expansion of GDP has also been accompanied by changes in the composition of the economy. The primary, secondary and tertiary sectors have all grown substantially compared to 1980, with the primary sector more than doubling in value while the other two sectors have increased about six folds. In 1980, for example, the tertiary sector was 3.4 times the primary sector. But by 2007, the tertiary sector was 11.4 times the primary sector (Figure 2.2). The tertiary sector remains by far the most important and continues to maintain its 1980 ratio of about 2.2 times the secondary sector as of 2007.

Figure 2.2

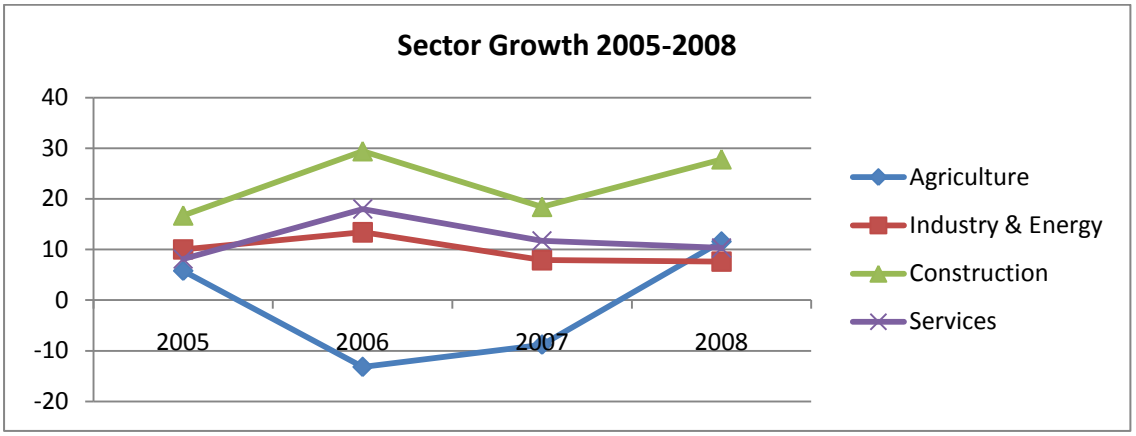


The low relative growth of the primary sector is in large part due to the limitations of agriculture in Cape Verde. Expansion in microfinance, support to rural associations, and assistance with adoption of drip irrigation has led to improved yields in the sector. The National Program for Poverty Alleviation (PNLP) has provided modest investments directly or indirectly to support the sector. Also, infrastructure investment, especially in rural roads, is expanding access to urban markets. The agriculture component of the first MCA compact, Watershed Management and Agriculture Support Project, will, when completed, invests approximately 11.1 million USD to increase the capture, storage and distribution of rainfall water and in extension services. As a result of these improvements, we note a doubling of the value of the agricultural sector since 1980, despite its relative declining share of GDP.

Although yields have improved, agriculture represents less than 10 percent of the GDP and it continues to depend largely on the vagaries of rainfall. Local production only accounts for about 20 percent of food consumption while 80 percent of the nation's food requirements are sourced from imports. The limitations of the agriculture sector can be ascribed to the Cape Verde's arid climate and limited arable land, with only 10 percent actually suitable for agriculture. Rainfall is low and irregular. However, opportunities to raise productivity and expand outputs in agriculture exist in several subsectors. The production of goat cheese, animal husbandry, coffee, wine, grogue (sugar cane rum), vegetables, and fruits are areas which are currently under developed or poorly explored. Significant opportunities for growth in the agricultural sector exist, particularly in transforming local products, moving up the value chain, entering the supply chain of the main tourism operators and partially substituting imports.

Growth in the agricultural sector has been a hit or miss, with data indicating 5.8 percent growth in 2005, an average yearly contraction in the sector of about 11 percent both in 2006 and 2007, and 11.6 percent rise in 2008 (Figure 2.3). The growth in 2008 is expected to continue in 2009. In fact, 2009 is expected to be a good year for agriculture in Cape Verde due to abundant rainfall.[6] Water mobilization is a key determinant of growth and incomes of farmers in the agricultural sector.

Figure 2.3



Data Source: Bank of Cape Verde (various annual publications)

Data suggests that contributions to GDP growth have come mainly from several sectors over the last five years. Among the fastest growing sectors is construction. From 2005 to 2008, the construction sector grew on average by 23 percent, with a high of 29.4 percent in 2006 and a low of 16.7 percent in 2007. The services sector reached a high of 18 percent and a low of 8.1 percent during the same period. Another source of growth is fisheries which represent about two-thirds of Cape Verde's total exports in value in 2009. The embargo on imports of fisheries products from Cape Verde by the European Union from January 2000 to September 2003 created significant problems for the sector. The Government's plan is to encourage continued investments in the sector as part of the efforts to build Mindelo (São Vicente) into an international hub for fisheries processing and exports. Recent investments by Spanish firms in the sector and ongoing negotiations with Chinese investors could lead to substantial growth and internationalization of the sector.

[6] The effect of the rainfall may be tempered though due to the major dengue epidemic in 2009 which affected a large number of the population.

A key element of the services sector is tourism which took off over the last decade (Table 2.1). In 2008, tourism represented about 60 percent of the services sector compared to about 40% in 2001 (BCV 2008). Between 2001 and 2008, total receipts from tourism climbed from 6.539,1 million CVE to 25.334,4 million CVE, witnessing a 287 percent increase over the period and a 21 percent cumulative annual growth rate. The share of tourism in the GDP has also expanded, rising from 9,4 percent in 2001 to 20,4 percent in 2007 before falling by 1 percentage point in 2008 to 19,4 percent. The tremendous growth in tourism contributed substantially to Cape Verde's strong economic performance over the last decade, and it has become a crucial source of foreign exchange earnings and a major employment provider. Tourism also accounts for majority share of the foreign direct investment (FDI) inflows. The tourism sector has also had a major impact on the construction sector, as a result of the development of resorts and hotels and the demand for second homes by the Cape Verdean diaspora and Europeans. The potential for expansion of the tourism sector continue to be high. At present, tourism is concentrated on two islands (Sal and Boa Vista) with significant opportunities for tourism development in the other islands.

Table 2.1

Tourism 2001 to 2008

	2001	2002	2003	2004	2005	2006	2007	2008
Tourism Receipts (Millions CVE)	6539,1	6985,5	8306,1	8495,6	9565,9	17495,4	23495,5	25334,4
Tourism Receipts as % of GDP	9,4	9,4	10,4	10,1	10,4	16,8	20,4	19,4
Tourism as % of Services	41,1	37,7	42,1	40,3	40,4	52,2	59,7	60,8

Data Source: Bank of Cape Verde (various annual publications).

The fear however is that the economic growth might be halted if there is a major decline in the tourism sector (OECD 2009). Tourism is highly susceptible to global economic conditions and especially of the countries where the tourists emanate. In case of Cape Verde, the main source of tourists is Europe. However, the expected major decline in tourism figures for 2009 did not materialize as the decline in Sal was mostly made up for by increased tourist arrivals in Boa Vista. Indications are that some of the projects which were delayed in Sal may be finally seeing some activities while new projects in Sao Vicente and Boa Vista have been launched.

The challenge moving forward is how to rapidly move from what has emerged (mass tourism) to what the nation desires (high value added tourism). That is, tourism sector in which the local economic content and impact is much higher. The agenda is to build a tourism sector that is well integrated into the Cape Verdean economy. This has been a difficult exercise and will require new policy orientation and different types of incentive structure to gradually shift the nation's tourism sector in the desired direction.

2.2 Cape Verde's Relative Performance

Cape Verde is the smallest country in West Africa. It is the smallest in size and has the lowest population. Among the countries in the region, Cape Verde's economy in 2009, as estimated by the Economist Intelligence Unit, is only bigger than that of The Gambia and Sao Tome & Principe (Figure

2.4); while it's GDP per capital however ranks third, behind two resource rich economies, Equatorial Guinea, and Gabon (Figure 2.5).[7]

Figure 2.4

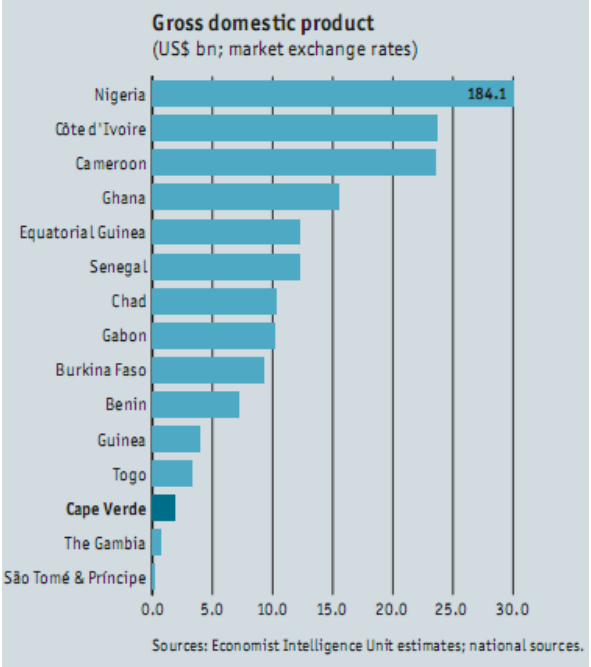
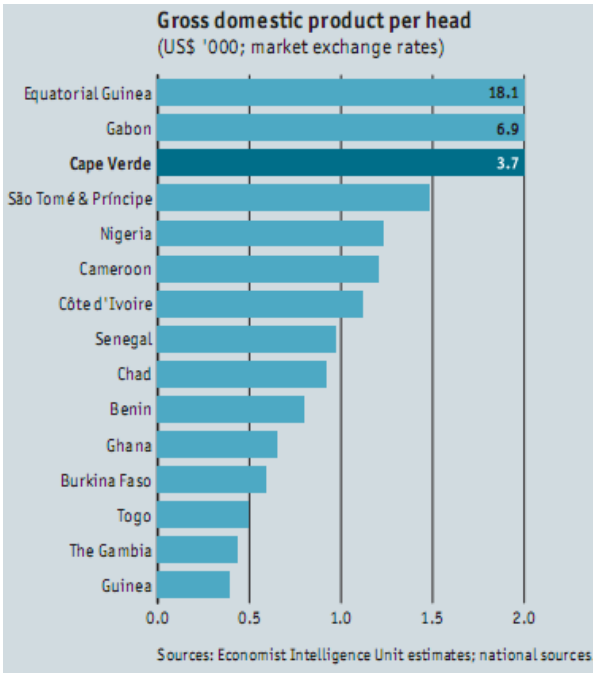


Figure 2.5



Source: Economist Intelligence Unit

Cape Verde is one of the best performers in the region and compares favorably with other West African countries on all development indicators. As a non-resource rich economy, its performance has been spectacular. Cape Verde's per capita GDP grew by about 524 percent between 1980 and 2008. From 2000 to 2008, its per capita GDP witnessed a 179 percent expansion while between 1980 and 1990 the growth was 64 percent and from 1990 to 2000 it was 35 percent.

Table 2.2

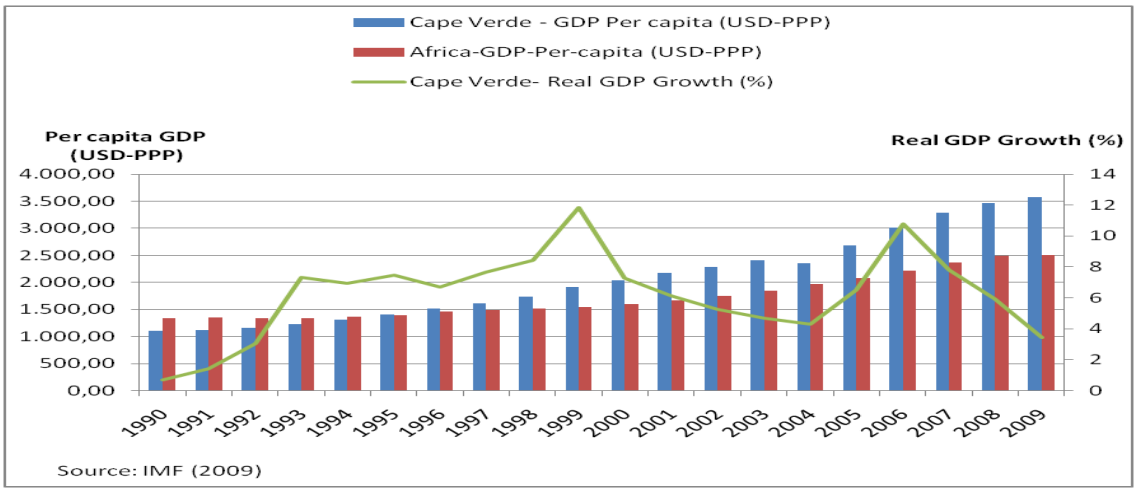
	GDP Per Capita			
	1980	**1990**	**2000**	**2008**
GDP Per capita	547	902	1225	3421

Source: IMF (2009); Note: Current Price USD.

Up until 1990, Cape Verde's per capita GDP lagged behind that of the average in the Africa region. In fact, Cape Verde had one of the lowest GDP at about USD 200 when it gained its independence in 1975 in the region. Cape Verde caught up with the African average in 1995 and has since established substantial gap (Figure 2.6).

[7] Economist Intelligence Unit, *Cape Verde: Country Report*, October 2009.

Figure 2.6



2.3 Explaining Cape Verde's Growth Trajectory[8]

Cape Verde has consistently witnessed positive economic growth since 1990. However, a review of the growth data from the 1990s shows that there are distinctive periods of growth accelerations and decelerations (Figure 2.6 above). 1990—1999 and 2005—2006 were periods of growth spurts while 2000—2004 and 2007—2009 were periods of growth decelerations. The remarkable acceleration of growth between 1990—1999 was in many respects due to the consolidation of the policy and institutional reforms which were launched in the late 1980s. The privatization of most state assets during the 1990s provided substantial resources for the state to undertake expansionary fiscal policies. Additionally, reforms led to substantial inflow of remittances which in turn stimulated construction activities. Combined with these were the substantial rise in foreign direct investment and the rapid growth in tourism over the period. A key outcome of the increased FDI was a rise in exports by about 30 percent in 2000.

The decline in growth rate experienced by Cape Verde between 2000 and 2004 began with developments in 1999. There were key developments such as the rise in the price of oil and the increase in the value of the dollar. Coupled with these were the drought which destroyed most of the 1998-1999 harvest and the fiscal slippages which began to put pressure on the balance of payments from the second half of 1999 as the government expanded its spending to cushion the impact of the drought.

[8] Section relies on various IMF and World Bank country reports. See International Monetary Fund (IMF). *Cape Verde: Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria*. IMF Country Report Nº. 04/304. September 2004; International Monetary Fund (IMF). *Cape Verde: First Review Under the Policy Support Instrument*. IMF Country Report Nº. 07/44. January 2007; International Monetary Fund (IMF). *Statement at the Conclusion of an IMF Mission to Cape Verde*. Press Release No. 09/341. 2009; World Bank. *Did you know that the GDP of many African countries is strongly correlated with rainfall patterns? 2010*. Available at: http://go.worldbank.org/F4PBAMK660

The deterioration in the fiscal balance which started in 1999 worsened in 2000 in the context of the 2001 elections. Overall fiscal deficit including grants deteriorated from 11 percent of GDP in 1999 to 19 percent in 2000. Petroleum price subsidy which amounted to 4 percent of GDP was one of the factors in the worsening fiscal deficit. Other factors included the decline in donor inflows and privatization receipts. Despite the negative developments, growth in 2000 remained strong at 7 percent but lower than the high of previous years. The improved rainfall in 1999/2000 period compared to that of 1998/1999 planting period cushioned the potential decline.

By 2001, the worsening macroeconomic situation had begun to put pressure on the peg of the Cape Verdean Escudo to the Euro. The new government which assumed power in February of that year recognized the need to ensure stable macroeconomic environment. As such, the government committed itself to a substantial reduction in fiscal deficit by proposing revenue generating and expenditure reducing measures. One key measure was the reduction in consumer subsidies which led to a rise in the price of petroleum products by 20 to 25 percent. The terrorist attacks on the US in September 2001 slowed FDI flows and the tourism sector.

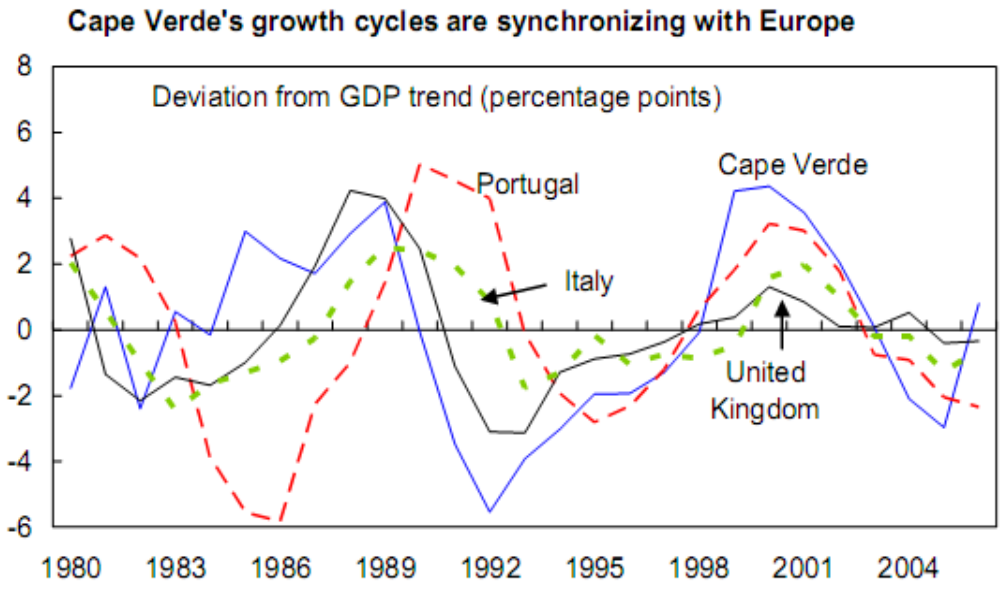
The macroeconomic reforms to ensure stability and establish Cape Verde's credibility with donors took time to yield results. Notwithstanding, growth rate remained on average about 5 percent for the years 2002 to 2004. The reduced growth levels continued until 2004 before a new upward trajectory which reached its peak in 2006 at 10.8 percent. However, 2006 may be an outlier as there was an outsized impact of a NATO military exercise (Operation Steadfast Jaguar) held in Cape Verde. The NATO summer military exercise led to a substantial increase in Cape Verde's export of services in 2006. Other factors which contributed to the 2006 growth were the rapid rise in tourism and FDI. By the third quarter of 2006, for example, tourism exports had almost doubled while FDI increased by around 60 percent compared to the same period of 2005 (IMF 2008).

2007 through 2009 marked a period of multiple international economic crises and coincides with the latest period of growth deceleration in Cape Verde. Among the problematic developments during this period were the substantial price increases for oil products and foodstuffs. The global financial crises also began during this period. Although the Cape Verdean banks were not exposed to the financial problems faced by banks in the US and Europe, the situation impacted on the growth prospects of Cape Verde. Cape Verde is increasingly vulnerable to external developments partly because of the rising share of tourism in the economy, the high level of openness, reliance on ODA and remittances, and the peg of the Escudo to the Euro. These factors are sources of volatility and combined they increase the amplitude and duration of growth cycles for Cape Verde. The reality is that Cape Verde's growth cycle is increasingly becoming synchronized with that of Europe (Figure 2.7)[9]

Looking forward expectations are that 2010 is likely to be the beginning of another period of growth acceleration. Exports, for example, grew about 51,3 percent in the first quarter of 2010 compared to the same period in 2009. The return of investors which began in 2009 is expected to continue in 2010. The recent investments in infrastructure including roads, ports and airports are expected to begin to yield economic benefits and spur a new cycle of growth. As an open economy, the emerging global recovery is expected to also have a positive effect on growth in Cape Verde.

[9] IMF. *Cape Verde: Selected Issues*. 9 June 2008. Washington, DC. Source: www.imf.org

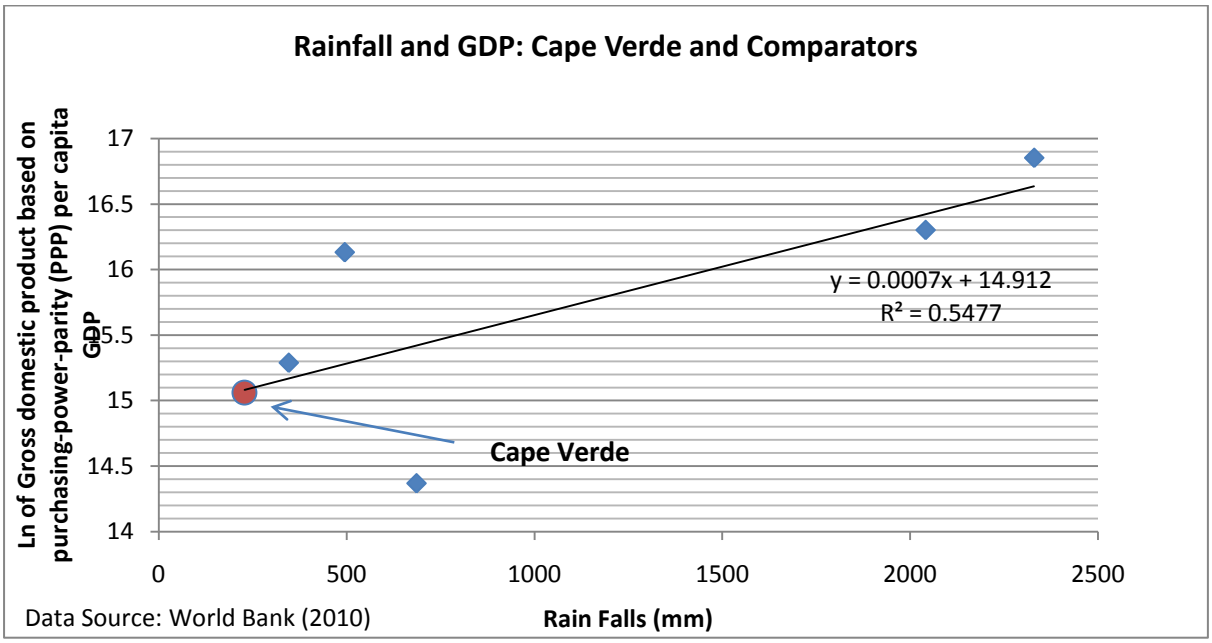
Figure 2.7



Source: IMF (2008)

An additional element in explaining the growth cycles in Cape Verde is agriculture. In fact, a key constant in the volatility of growth rates in Cape Verde is the impact of rainfall on agricultural outputs. Cape Verde continues to rely predominantly on rain fed agriculture with limited land under irrigation. Consequently, good harvest is highly dependent on rainfall and agricultural outputs have an impact on GDP growth. There is a positive correlation between GDP growth and agricultural outputs. This is true for Cape Verde as well as the comparator countries (Figure 2.8). In Cape Verde, the correlation between changes in GDP and changes in agricultural output is 0.288 for the period of 1990 to 2007 and for the 1990s only, the correlation is 0.808. Between 2000 and 2007, the correlation declines to –0.065.[10]

Figure 2.8



Data Source: World Bank (2010)

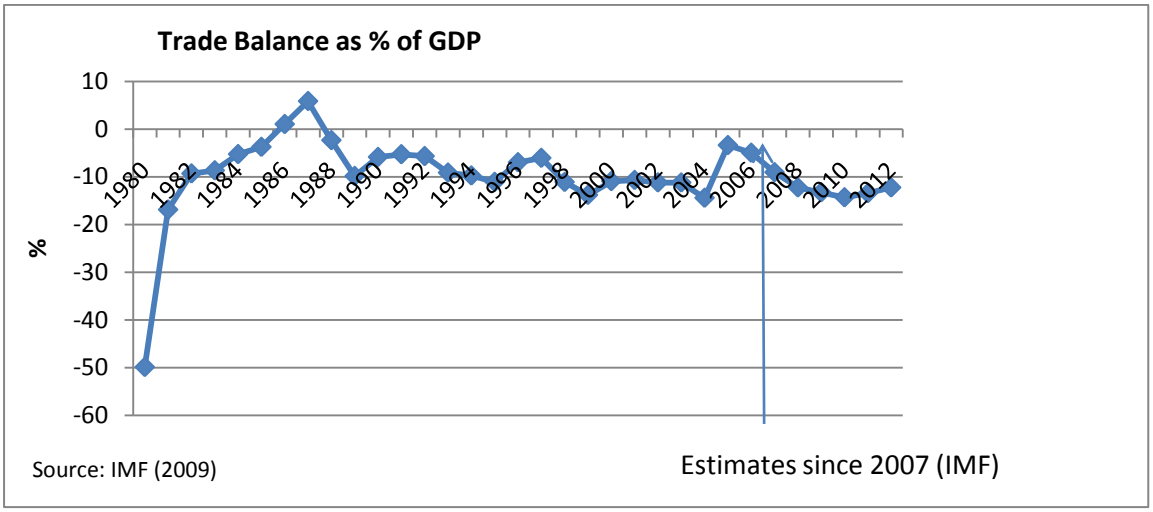
[10] Data used to calculate the correlations were obtained from INE data set.

The relative decline in the weight of agriculture compared to other sectors such as tourism over time may explain the decline in the relationship between agriculture and GDP growth. The continued importance of the sector is partly due to the fact that, at 40 percent, the percentage of the population engaged in agriculture is much higher than its share of GDP (PAGIRE 2010).[11] The volume of agricultural outputs has implications for inflation, imports and government spending. Good harvest ensures less pressure on the prices of food items; it provides an opportunity to reduce imports while also reducing the need to expand government spending to cushion the impact of drought.

2.4 The External Sector

Cape Verde is increasingly integrated into the world economy. Its graduation from the list of least developed countries now requires it to compete successfully in this globalized economy on its own and on the basis of its own internal capabilities. In 2008, Cape Verde became the 153rd member of the World Trade Organization (WTO). Cape Verde is a small, open economy that is highly dependent on world trade and capital flows. Nearly all of the country's investment capital and technology is acquired through trade. Cape Verde's external sector presents a vivid picture of the country's vulnerabilities, notably its dependence on trade, official development assistance, and remittances. Lacking an export base, its trade account is structurally in deficit (Figure 2.9).

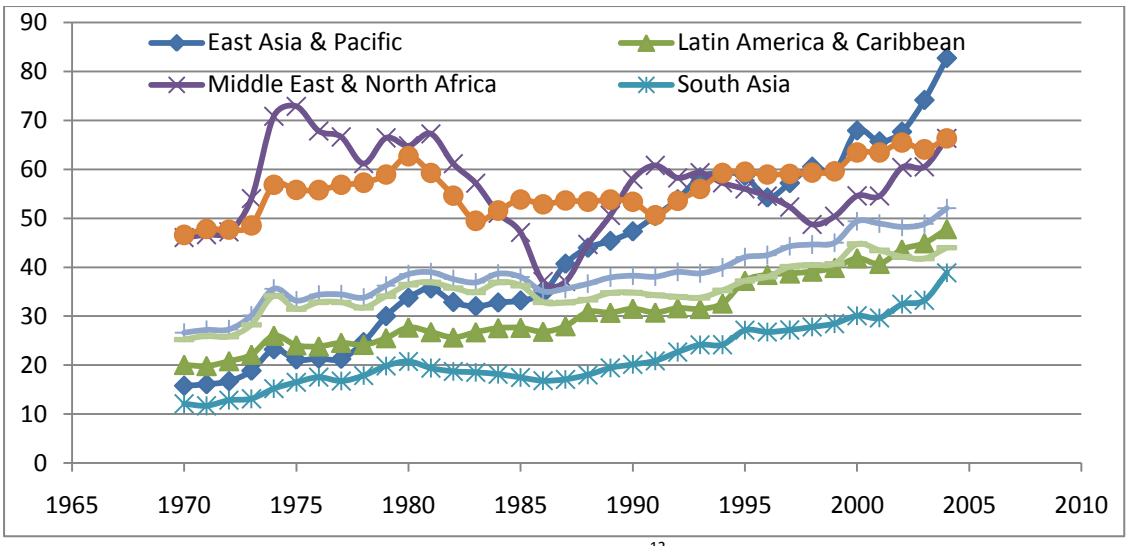
Figure 2.9



Its trade to GDP ratio is perennially high. Like most African economies, Cape Verde is highly trade intensive (Figures 2.10 & 2.11). It has consistently run trade deficits for most of its independence. The last decade is not different (Table 2.3). Cape Verde is however not alone. Among the comparator countries only South Africa had a trade surplus from 2000 to 2002, otherwise its trade balance was in deficits from 2003 to 2007. The others—Mauritius, Seychelles, and Morocco and Senegal ran trade deficits between 2000 and 2007. The Small Island Developing States (SIDS) also ran on average trade deficit through this period. The ECOWAS sub-region, however, managed to run a trade surplus between 2000 and 2007.

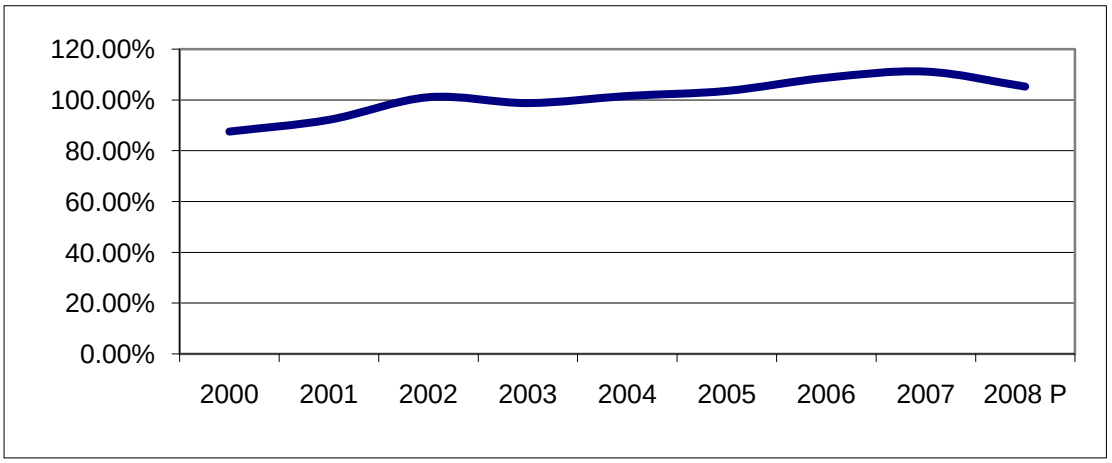
[11] PAGIRE (Volume I): **DIAGNÓSTICO DA SITUAÇÃO DOS RECURSOS HÍDRICOS E DO SEU QUADRO DE GESTÃO** (2010) , Instituto Nacional De Gestão Dos Recursos Hídricos (INGRH), Praia, Cape Verde

Figure 2.10 **Imports and Exports as Percentage of GDP**



Source: World Development Indicators as quoted in Githinji (2009)[12]

Figure 2.11 **Cape Verde: Imports and Exports as Percentage of GDP**



Data Source: BCV

Table 2.3 **Trade Balance**

YEAR	2000	2001	2002	2003	2004	2005	2006	2007
Mauritius	-397.31	-358.74	-357.69	-465.28	-777.84	-1018.47	-1297.42	-1846.82
Seychelles	-149.793	-261.753	-194.218	-138.576	-205.894	-335.927	-375.065	-406
Morocco	-4105.4	-3893.51	-4014.44	-5471.87	-7923.78	-9451.9	-10987.1	-16360.3
South Africa	287.3	1010.6	456.1	-4602.1	-7320.1	-10678.6	-19104.9	-11961.9
Cape Verde	**-219.276**	**-223.922**	**-264.874**	**-337.749**	**-371.312**	**-420.465**	**-521.439**	**-721.216**
Senegal	-632.811	-721.37	-964.4	-1141.64	-1329.13	-1618.93	-1878.03	-2655.93
Small island developing States	-5832.05	-6518.21	-7294.17	-6609.55	-7603.03	-6695.22	-4334.98	-8829.41
ECOWAS	14899.1	3903.565	4172.328	5085.865	12432.5	17660.96	19136.22	8767.564

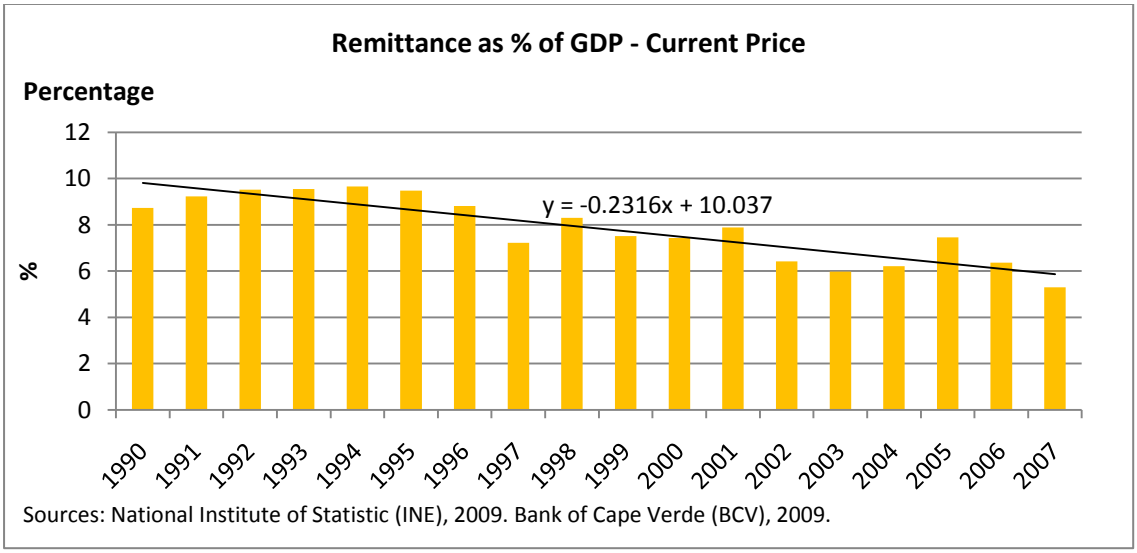
Data Source: UNCTAD

[12] Mwangi wa Githinji (2009) "Is that a Dragon or Elephant on Your Ladder" Sylvain Boko and Dierry Seck (edited) Sector Led Growth in Africa and Implications for Development. African World Press, New Jersey *forthcoming*

In terms of official development aid (ODA), Cape Verde continues to rely on external support but it has entered a different phase in its development path. The emerging reality is that Cape Verde is already witnessing a gradual reduction in external grants, although this might be the result of the global economic decline. An examination of the budget shows that the share of external grants as a percentage of GDP fell from 5.2 in 2006 to 4.6 in 2007. Current expectation is that the share will further decline and will level off at about 3.6 percent from 2010 (OECD 2009).

Remittances have been a lifeblood of the country for generations. Remittance, monetary and non-monetary, has helped the country survive famines and hard economic times. Remittances continue to grow at a slow pace but have begun to decline as a percentage of GDP looking at the data between 1990 and 2007. There is a discernable downward trend despite the fluctuations (Figure 2.12). The decline might also be a result of an emerging shift in structure in remittances towards goods.

Figure 2.12



Sources: National Institute of Statistic (INE), 2009. Bank of Cape Verde (BCV), 2009.

A major decline in remittances will pose a risk given Cape Verde's persistent trade deficits and the fact that for many it is an important source of income. It also will have implications for investment. In fact, since 1980, the trade balance has been in the negative except for 1987. A decline in remittances will also have implications for core sectors such as construction and the banking sector in which deposits by Cape Verdean emigrants represent an important part of the assets. Additionally, FDI to Cape Verde has been on the rise with the growth in tourism over the last decade. FDI as percentage of gross capital formation for Cape Verde is similar to those of the benchmark countries except for Seychelles which has a higher ratio.

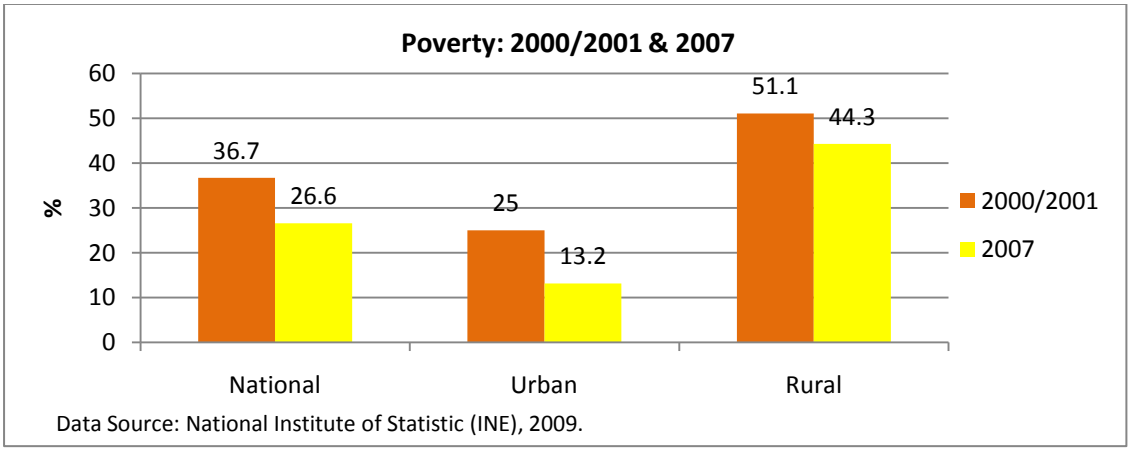
2.5 Trends in Social Development

Cape Verde's economic performance has had significant impact on socioeconomic achievement, especially in this last decade. The focus on human development over the years has led to substantial

progress in the social arena. Cape Verde is one of a few African countries that are on course to meet the Millennium Development Goals (MDGs); it has already achieved some of the goals and is likely to achieve the remainder on or before 2015. Between 1990 and 2007, Cape Verde's Human Development Index (HDI) rose from 0.589 to 0.708, a 1.08% annual rise (UNDP 2009). Compared to the average for sub-Saharan African (SSA) countries, Cape Verde has consistently performed better on the HDI. The rise in HDI tracks the progress Cape Verde has made on several fronts, including expanding literacy, ensuring access to primary health care, and increasing life expectancy.

In terms of poverty reduction, between 2000/2001 and 2007, the national poverty rate declined from 36,7 percent to 26, 6 percent, a decline of 10,1 percentage points (Figure 2.13). Recent review on the progress towards the MDGs indicate that Cape Verde reduced the percentage of people living in extreme poverty from 32 percent in 1990 to 21 percent in 2002 and it is expected to reduce further to about 16 percent by 2014.

Figure 2.13



Data Source: National Institute of Statistic (INE), 2009.

A key challenge however is the concentration of poverty in the rural areas. The reduction in poverty has been more profound in the urban areas where it reduced by almost half between 2000/2001 and 2007, from 25 percent to 13,2 percent. The reduction in poverty over the same period in the rural areas was from 51,1 percent to 44,3 percent. Poverty remains essentially a rural phenomenon. Women are also likely to be poor, especially women headed households in the rural areas. The rural areas where poor are located are areas where opportunities for formal employment are lower and there is higher dependency on farming and artisanal fishing. The persistence of poverty among women is partly due to lack of employment opportunities.

A major shortcoming of the Cape Verdean economy is the ability to generate employment. The rate of unemployment remains high at 18,8 percent in 2008 (Table 2.4). Between 2001 and 2008, the unemployment rate for women was consistently higher than that for men. A new method for calculating unemployment rate was recently introduced in order to harmonize the approach used in Cape Verde with international standards. With the new method, the unemployment rate for 2009 released recently is 13,1 percent. Relative to the average for the ECOWAS region however (whether with the old or new methodology) Cape Verde's unemployment figures are much lower. In some countries in the sub-region, unemployment rate can reach as high as half or more of the labor force.

Table 2.4 **Unemployment Rate**

	2000	2002	2005	2006	2007	2008
Total	**17,2**	**21,7**	**24,4**	**19,5**	**21,6**	**18,8**
Men	10,9	16,35	21,8	14,4	17,8	14,2
Women	23,6	25,4	27,2	25,4	25,7	24

Data Sources: INE - 2000, 2002 & 2007; IEFP - 2005, 2006 & 2008

2.6 Challenges Ahead

The success of Cape Verde to-date is due to many factors. Important element is a robust policy framework and the consistent leadership right from the early days of independence. The support of the international partners through generous development assistance provided Cape Verde the opportunity to pursue its development agenda. Also, the Cape Verdean diaspora which according to some estimates is more than double the number of citizens in the archipelago also made substantial contributions with remittances. The diaspora represents not only a source of remittances but also of ideas and capacity. The success of Cape Verde led to its graduation from the United Nation's Least Developed Countries (LDCs) list in January 2008.

These success factors are also potential challenges. Indeed, Cape Verde faces several challengers going forward. Sustaining its successful path thus far is not guaranteed. We might catalogue these major challenges as: structural vulnerability; external dependency; unemployment, especially among the young population; declining but still high poverty; growing income inequality; and dwindling opportunities for out-migration, and thus remittances.

Cape Verde continues to be highly reliant on aid. The current global economic challenges, Cape Verde's graduation from LDCs list, and the emerging perception that Cape Verde may no longer be a poor nation might in time lead to aid flows reducing substantially. Such an outcome will expose Cape Verde to serious risks due especially to its relatively high debt-to-GDP ratio and its low level of reserves (OECD 2009). As for ODA, we noted above the relative decline of this source of external support. Cape Verde graduation will necessarily mean a further reduction in ODA, despite the grace period of transition. More still, the price of economic success will be that it cannot rely of this source as guaranteed, even though its vulnerability will remain undiminished.

As we noted above, the potential for decline in remittances is also real. The reality is that the Cape Verdean diapora are in some cases entering second and third generation. Over time, ties with the motherland will probably diminish, leading to reduced remittances. Opportunities for emigration are also dwindling as immigration laws become more stringent.

Coupled with these emerging realities is the continued vulnerability of Cape Verde. In fact, Cape Verde's graduation from the LDCs list was secured through meeting only two criteria –per capita income and human development—out of the three. Cape Verde did not meet the third threshold—vulnerability. In reality, Cape Verde continues to be a highly vulnerable country with its high susceptibility to external shocks, be they economic or natural. The United Nations Development Programme (UNDP), in its 2001 study, identified several vulnerabilities. The sources of the

vulnerabilities include agricultural and environmental challenges, over dependency on imports, the added costs of insularity and fragmentation, over dependency on external transfer, and increasing threats from global security and trans-national crime.[13] African Development Bank updated this study in 2007/2008 focusing on the cost of insularity in Cape Verde.[14] The primary conclusion which can be drawn from both studies is that Cape Verde is faced with unique circumstances which complicate the development process.[15]

These factors represent structural challenges that may hinder growth and the process of economic development. They make it all the more difficult to tackle the unemployment and poverty problems. The fact that both unemployment and poverty rates remain high despite good economic performance over the years is an indication that there is a need not only to sustain high economic growth but also to change the nature and quality of growth. Coupled with these is an emerging inequality in Cape Verde. Unemployment, poverty and growing inequality pose significant challenges for the Cape Verdean state. It will require new thinking and a high level of competency and capacity.

Cape Verde's development vision is to transform the economy to become an international platform for high value added services. Making this happen however will require high level technical skills, ranging from management professionals, engineers, scientists to lawyers. It will require building a business friendly environment and addressing the costs of inputs from energy, transport to telecommunications. Additionally, it will require advancing the state reform program to the next level and building the necessary institutional capabilities.

Knowledge workers, high level professionals and entrepreneurs will be needed to build the key transformation sectors to expand the productive base of Cape Verde and qualitatively change the nature of economic growth in a way that sustains deep reductions in unemployment and poverty. These types of skills that needed to build an entrepreneurial economy are currently in short supply. It is also particularly important to seek new ways to integrate the poor and the rural areas into the national economy to facilitate growth and reduce poverty. New efforts will have to be mounted to enhance the capacity and capability of the poor to participate in the economy and enhance their productivity. It will also be necessary to build the required infrastructure to integrate the nation into one national market.

Additionally, high level expertise and capabilities will be needed to significantly shift towards renewable energy as envisioned by the government and to improve the management of the transport sector in order to reduce the high costs of production in Cape Verde. Importantly, highly skilled human capital will also be needed to build competitive and innovative enterprises, expand the productive base of the economy, run a public administration that is efficient and effective, and to reform and manage state institutions to facilitate sustained high economic growth and poverty reduction. In short, achieving the development vision of socioeconomic transformation in Cape Verde must begin with building the necessary capacity and capabilities. We now turn to growth diagnostics, the framework used to undertake the study..

[13] UNDP, *Vulnerability Study, Action Plan for 2001-2010*, March 2001.
[14] African Development Bank Cape Verde: Cost of Insularity. 2008.
[15] African Development Bank, Estudo sobre os Custos da Insularidade em Cabo Verde, Relatório Provisório, 27 Agosto 2007. This study is not yet completed.

3
Constraints to Growth

Successive Cape Verdean governments have been reformers and have achieved the status of a star performer for Cape Verde in the West African sub-region. Compared to other countries in the Economic Community of West African States (ECOWAS) and in Africa, in general, Cape Verde is among the top performers. Its growth in terms of expansion of GDP and increases in GDP per capita are among the best in the continent. Yet, Cape Verde continues to be a highly vulnerable country. It is an open economy that, despite growing fast recently, continues to face significant levels of poverty and unemployment. Sustaining high growth is the key challenge, as its capacity to compete in the global economy as a recent graduate from the list of least developed countries.

Importantly, the efforts to transform the economy and expand its productive base are only at a nascent stage. The development and growth of new high value added services are not guaranteed. The key questions now are whether or not Cape Verde will be able to sustain its growth record and to realize its agenda for transformation in the coming years. These are important questions to ask in an environment where there could be a rapid decline in external grants or remittances for reasons mentioned above. Another "what if" is tourism, which emerged in the last decade as a major engine of growth. What if economic crisis in the countries of origin lead to abrupt decline in the tourism sector?

These factors, coupled with the swings in growth, the persistence of unemployment and poverty, despite relatively strong economic performance, raise the question of what it will take to unleash high growth rate for a sustained period. Specifically, it is important to understand the factors inhibiting higher levels of productive investment and rapid sustainable growth rates which if addressed could allow Cape Verde to achieve a significant reduction in poverty.

3.1 Growth Diagnostics

These types of questions are now commonly asked, with the realization that growth is the central challenge facing developing nations. Rapid economic growth is the most effective way to reduce poverty for two simple reasons: first, it creates employment and secondly, it provides the necessary revenue for government to pursue a social development agenda targeted at the poor. It is important that growth is shared and that the poor are empowered to participate in the economy. This is critical to sustaining growth over the long run. As such, the critical task facing governments and policy makers is how to achieve rapid growth that can have sustained impact on poverty reduction.

Getting this right is particularly important. Lessons from experience, especially in the 1980s and 1990s, from diverse countries in the developing world have shown that it is not particularly easy to ensure sustained growth. Many countries have undertaken institutional and policy reforms with far

less than expected growth effects.[16] In fact, many of the reforms along the lines of the Washington Consensus in many African countries and elsewhere did not meet growth expectations.

Some lessons from this experience are that it is quite unproductive to propose identical growth strategies for countries irrespective of their circumstances. "Photocopied strategies" transported from one country to another tend to lack local specificities and are likely to miss the uniqueness of each nation. Growth strategies must be tailor-made and based on domestic opportunities and constraints. Most importantly, growth strategies must target the most binding constraints. There is no need to try to provide countries with a laundry list of reforms. There is a limit as to what can be done given resource and/or institutional constraints. The fact is that the longer the list the more likely that reforms might not be targeted on the most important constraints to economic activities.

These lessons informed the growth diagnostics methodology proposed by Haussmann, Rodrik and Velasco (2005).[17] The approach is based on the neoclassical growth model. In this model, growth is proportional to private returns to assets that investors can appropriate, and the expected income by private agents is a function of three factors.[18] These factors are (i) the amount of assets of private agents which equals the saving and investment efforts, (ii) the productivity of the assets, and (iii) the share of output generated by the assets that the agents can appropriate. The third factor is referred to as appropriability of returns, and it has to do with the share of returns to private agents after deducting taxes and all other forms of loss, including loss which might be due to inflation, banking crisis, crime, extortion, expropriation or poor enforcement of property rights and contracts/weak judicial system. This model can be represented as follows:

Expected returns = (saving and investment effort)
x (appropriability)
x (productivity)

Accordingly, this framework indicates three categories of growth strategies. They are strategies to increase the (i) saving and investment effort, (ii) expected appropriability of returns, and (iii) productivity of assets through improved technology or innovation. This framework explains the determinants of growth and a process for searching for constraints that may hinder growth.

The framework allows for the search for the answer to the question "what constrains growth?" The Hausman, Rodrik and Velasco (2005) framework indicates the constraints to growth must be caused by at least one of the three factors. The three categories provide the basis for the search for binding constraints. The search is implemented by classifying constraints within a diagnostic decision tree.

[16] Manuel Agosin, Eduardo Fernández-Arias, and Fidel Jaramillo (editors), *Growing pains: binding constraints to productive investments in Latin America*, Inter-American Development Bank, Washington DC, USA. 2009. . See also: Dani Rodrik, *One Economics, Many Recipes: Globalization, Institutions and Economic Growth* (Princeton: Princeton University Press, 2008).

[17] Ricardo Haussmann, Dani Rodrik, and Andres Velasco (2005). "Growth Diagnostics" Manuscript, Inter-American Development Bank.

[18] Ricardo Haussmann and Dani Rodrik. "Self-Discovery in a Development Strategy for El Salvador", *Economia*. Fall 2005. Pp 43-101. Brookings Institute, Washington, DC

The search requires extensive review and analysis of economic data. Evidence can also be obtained through surveys and discussions with stakeholders within the core sectors. The process involves a review under the three broad categories of the growth diagnostics model. It starts with reviewing evidence on whether growth is constrained because private agents cannot get the capital that they need to undertake their business or implement their ideas, or if it is because entrepreneurs do not want to invest as they do not expect to be able to retain a sufficient proportion of the returns to their efforts, or is it because there is insufficient investment in complementary factors of production (human capital, technical know-how or infrastructure, etc).

3.2 What are the Binding Constraints to Growth?

We began the analysis with the diagnostic decision tree. Taking the basic model the constraints analysis team developed a growth diagnostics decision tree for Cape Verde (Figure 3.1).

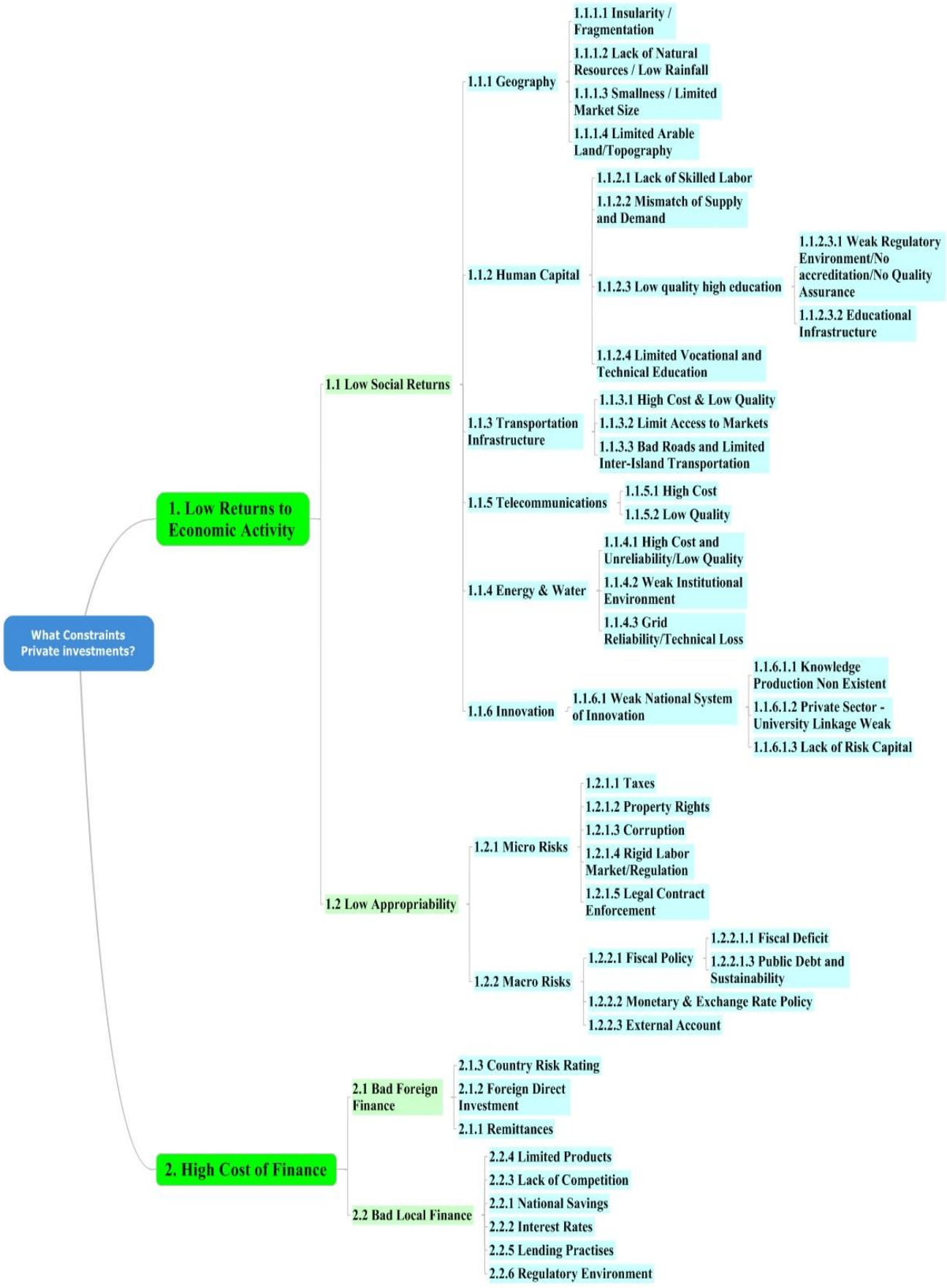
We undertook the search for binding constraints in line with the map of the decision tree. The analyses involved a review of the following potential constraints:

- ***Finance***: A review of the local and international finance to uncover if there is limited access to finance due to among other things underdeveloped financial sector, bad lending practices and/or high costs.

- ***Complementary factors***: An examination of the factors of production to see if there is scarcity/insufficient investments in complementary factors which may impede growth. The search focused on the nature of Cape Verde's geography, its levels of human capital, its quality and levels of infrastructure, and its ability to innovate to ensure competitiveness.

- ***Appropriability***: A review of the macroeconomic and microeconomic environments to see if they might result in low appropriability of returns. On the macro side, the focus is to see if Cape Verde's policy engenders stability while on micro side the focus is on the investment climate to see if it is favorable to doing business.

Figure 3.1 Growth Diagnostics Decision Tree



4
Is it Finance?

The conventional wisdom for some time now in Cape Verde is that finance is a key constraint to economic growth. It is common at very meeting or forum in Cape Verde for finance to be mentioned as a major problem for businesses. The interesting fact is that the private sector and bankers seem to agree with the assessment that finance is a constraint. The assessment differs as to what are the causes. The organized private sector almost always blames the practices of the banking sector. Among their complaints are the perceived high rates of interest and the high collateral requirements. The proffered solutions tend to focus on the need to reduce interest rates and the need to establish guarantee funds.[19] The bankers, on the other hand, tend to highlight the decline in interest rates in recent years while laying the blame at the door of the private sector. Specifically, they blame the quality of projects and proposals (i.e. business plans or lack thereof) that are submitted for financing by the private sector. The reality is however much more complex.

What the study tried to establish is whether or not finance is a binding constraint. We therefore begin with an examination of the financial sector, starting with the market trends.

The government of Cape Verde has undertaken several reforms in the last decade to liberalize the nation's financial market, including reforming the legislation to allow offshore banks. A new reform package is under development which will eliminate the distinction between offshore and onshore banks, and bring all within the same regulatory framework. Overall, the financial sector is reasonably well regulated and the market environment is improving: Cape Verde now has five commercial banks; two insurance firms, a stock exchange; fourteen offshore banks; a social security fund (INPS); and five para-banking institutions. Among the para-banking institutions are SISP, the firm that manages the ATM for banks and Promotora, a venture capital firm whose shareholders include the government and the main bank in Cape Verde. There are also micro credit organizations. A key fact of the Cape Verdean financial sector is that it is dominated by banking. The focus will therefore be placed on the banking sector.

4.1 Consumer Borrowing and Insurance

The number of payment terminals (point of service - POS) in the banking sector has increased from 154 in 2004 to 1006 in 2008 (Table 4.1). The adoption of ATM cards has grown, with the number of ATMs increasing from 37 in 2004 to 109 in 2008. Transactions in volume and value are also on the rise. Visa credit card was introduced in the last quarter of 2004 and the market penetration continues to be limited. By 2006, only about 1458 visa cards had been issued. Insurance penetration in economy remains below 2 percent but it is on the growth trajectory since 2006. Insurance penetration in the economy reached 1,97 percent in 2002, slowly declined to 1,46 in 2006 and then rose to reach 1,52 percent in 2008. Motor vehicle, accidents and sickness insurance coverage represent more than 50 percent of the insurance market (Figure 4.1).

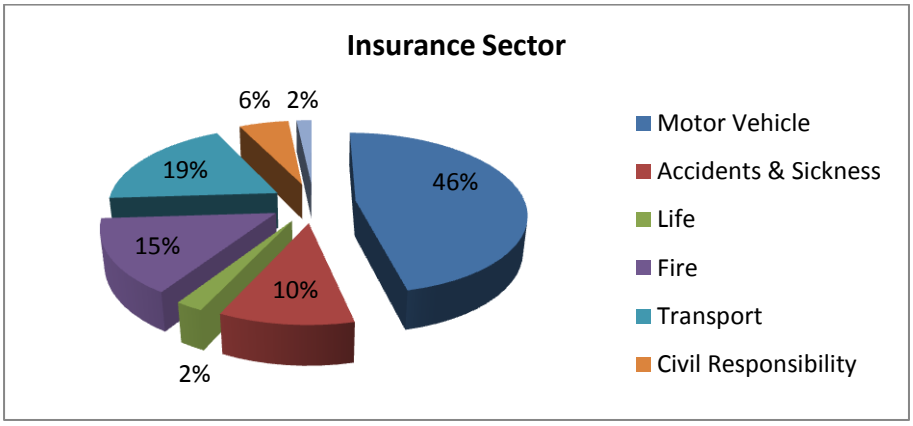
[19] These issues including recommendations were also raised in the Consultative Forum and the special focus group meeting on the private sector organized as part of the consultations for the development of the second compact for Cape Verde.

Table 4.1 **Banking: ATM, POS & Transactions**

	2004	2005	2006	2007	2008
ATM					
Cards Issued	20767	35238	40402	38356	59801
Number of ATMs (accumulated)	37	44	60	85	109
Volume of Transaction (withdrawals)	1067680	1245932	1626443	2178912	2765388
Value of transaction (millions of CVE)	6799,9	8693,2	11491,3	14887,4	18284,0
POS – Payment Terminals					
Number of Payment Terminals (accumulated)	154	212	386	699	1006
Volume of transactions	245345	296045	428576	642418	923042
Value of Transactions (millions of CVE)	1094,95	1393,84	2395,4	3480,5	4896,3

Data Source: BCV Annual Reports.

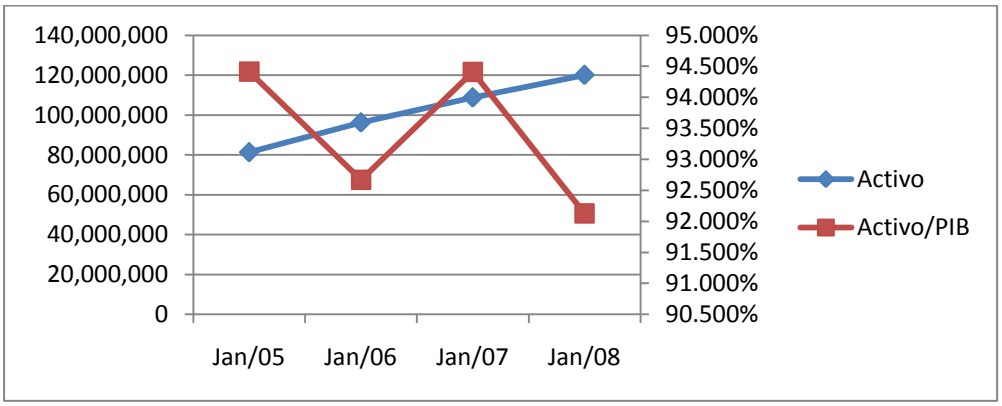
Figure 4.1



Data Source: BCV 2008 Annual Report

The financial sector is expanding and is reasonably trusted. The total value of assets of the banking sector continues to increase, witnessing about 50 percent rise between 2005 and 2008. Liquidity is not a constraint in the Cape Verdean banking sector. The total assets of the banking sector as a percentage of GDP fluctuated between 92 and 94 percent for the same period (Figure 4.2).

Figure 4.2 **Banking Sector Assets (Activo)**



Data Source: BCV

This is an indication that the system is increasingly being used for financial transactions and is increasingly trusted. Additionally, Cape Verde's financial sector is ever more globally integrated with an increasing number of offshore banks, and the investment by foreign banks (mainly Portuguese and Angolan) in the Cape Verdean commercial banks. Data on the flows of inward foreign direct investment (FDI) as a percentage of gross fixed capital formation also indicate an economy fairly integrated into the global banking sector (Table 4.2). In fact, the big firms in Cape Verde tend to turn to international markets to seek financing and loans or issue bonds on the local stock exchange given that the Cape Verdean banks are not able to fund big tourism and real estate projects.

Table 4.2

Inward FDI flows as a percentage of Gross Fixed Capital Formation, by host region and economy

Region/economy	2000	2001	2002	2003	2004	2005	2006	2007	2008
Developing economies	16.0	13.6	10.6	9.7	12.6	11.8	13.0	13.1	12.8
Africa	9.8	20.6	15.9	17.0	15.0	22.6	27.3	27.0	29.0
Morocco	4.4	30.0	4.7	18.4	5.9	9.8	13.0	12.2	9.1
Other Africa	12.5	29.2	23.6	22.5	18.5	27.0	27.9	29.6	36.7
West Africa	22.2	20.9	25.9	21.8	20.6	38.4	61.3	48.1	64.6
Cape Verde	**26.5**	**7.1**	**17.3**	**13.2**	**19.7**	**22.1**	**29.2**	**30.8**	**28.6**
Senegal	6.0	2.9	5.9	3.6	4.3	2.2	9.0	9.2	18.4
Mauritius	26.3		3.1	4.9	0.8	3.1	6.7	17.9	16.8
Seychelles	11.4	51.8	28.2	91.3	13.7	102.2	57.6	76.0	127.3
South Africa	4.4	38.0	9.4	2.8	2.3	16.0		9.5	14.0

Data Source: UNCTAD

Credit information is still limited in Cape Verde like in most African countries. This is a problem. It makes it difficult for banks to have information on prospective borrowers and the prediction of credit worthiness a daunting challenge. Additionally, the basic credit information available is a publicly owned registry of the central bank (Bank of Cape Verde), which covers 23 percent of the population. It is only available to banks, creating issues of information asymmetry in the sector. Cape Verde scored low (2 out of 6) on the depth of credit information in the Doing Business Report 2010 (Table 4.3).

Table 4.3

Country	Depth of credit information index (0-6)	Public registry coverage (% of adults)	Private bureau coverage (% of adults)
Cape Verde	**2**	**23**	**0**
Senegal	1	4.4	0
Mauritius	3	36.8	0
Morocco	5	0	14
Seychelles	0	0	0
South Africa	6	0	54

Data Source: World Bank. Doing Business Report, 2010.

However, its score is better than the average of SSA countries which is about 1. On the percentage of adults covered by public registry, for Cape Verde it is 23 percent while the average for SSA is less than 2 percent. On the other hand, for numbers covered by private bureau, the average in SSA is about 5 percent while Cape Verde does not have a private bureau. Compared to selected African countries, Cape Verde performs better than Senegal and Seychelles in the overall score while Mauritius, Morocco and South Africa score higher on the depth of credit information index. This is likely to change in the near future as a private credit information bureau under development is completed. In fact, under the first MCA compact, funding was made available to provide technical assistance to the private sector associations working to develop a credit information bureau in Cape Verde.

4.2 Access to Finance

Evidence thus far points to an emerging financial market in Cape Verde, with increasing assets base, and a high asset to GDP ratio. Indication is also that the sector is reasonably globally integrated. In fact, despite the widespread concern with respect on the issue of access, enterprise surveys undertaken by the World Bank indicates that the level of financial intermediation is reasonably high in Cape Verde (Table 4.4).[20] On the three questions measuring share of firms with access to finance from financial institutions, Cape Verdean firms are doing reasonable well. Compared to the average for all countries and that of Sub-Saharan Africa, Cape Verdean firms are actually better off with respect to access to finance. More importantly, Cape Verde compared reasonably well to Mauritius, Morocco and South Africa on financial intermediation if the focus is on measuring access.

Table 4.4 Financial Intermediation

Finance	All Countries	Region (SSA)	Cape Verde	Senegal (2007)	Mauritius	Morocco (2007)	South Africa (2007)
% of firms with line of credit or loans from financial institutions	34.1	21.63	**41.51**	15.25	47.41	33.38	30.09
% of firms using banks to finance investments	23.94	13.05	**35.34**	19.77	37.46	12.29	34.78
% of firms using banks to finance expenses	28.20	19.22	**49.80**	9.59	39.46	30.20	21.10
Value of Collateral for loan (% of loan amount)	143.01	142.60	**176.45**	127.09	59.88	171.24	103.58
% of firms indentifying Access to Finance as a major constraint	31.37	45.64	**36.70**	49.21	46.32	31.60	15.53

Data Source: Enterprise Surveys 2009[21]

The key challenge for Cape Verdean firms is the high collateral requirements for loans by banks. According to the results of the enterprise survey, Cape Verdean banks require firms to provide 176.45 percent of the loan in collateral value. This is higher than any of the comparator countries

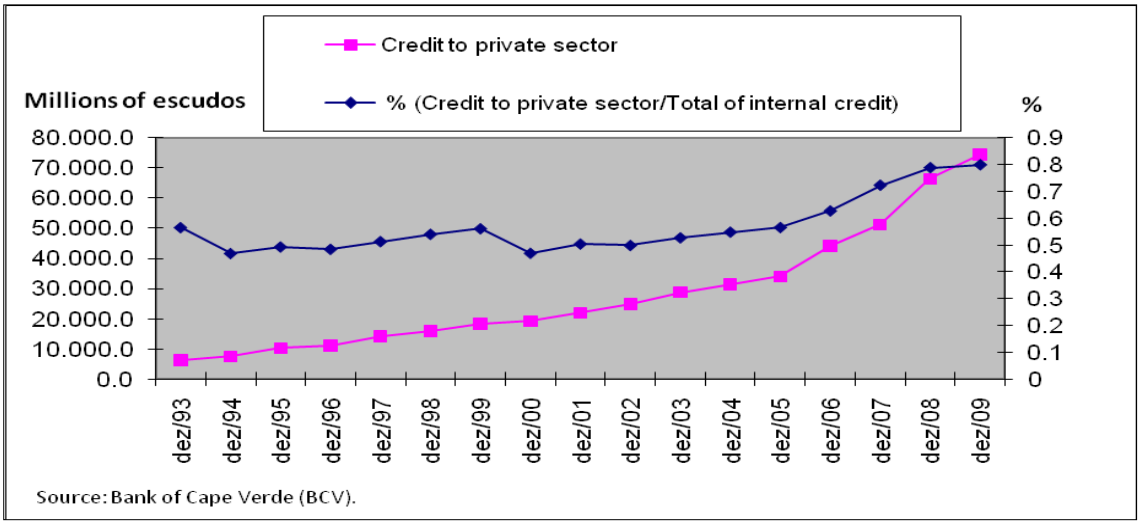
[20] Data was not reported for Seychelles.

[21] World Bank. *2009 Enterprise Surveys*. Source: http://www.enterprisesurveys.org/ExploreTopics/?topicid=7. Last viewed on 21 March 2010.

and the averages reported for Sub-Saharan Africa and all countries. The percentage of firms identifying access to finance as a major constraint is only higher in Senegal (49.21 percent) and Mauritius (46.32 percent). In Cape Verde, 36.70 percent of firms reported access to finance as a major constraint. This is lower than the average for Sub-Saharan Africa and higher than the average for all countries.

Further evidence indicates increasing credit to the private sector. Importantly, Cape Verde's private sector is receiving a rising share of the domestic credit (Figure 4.3). As of December 2009, about 80 percent of domestic credit is made to the private sector rising from less than 60 percent in December 1993. Additionally, as of 2008, the ratio of credit to GDP is 50 percent (BCV 2008).[22]

Figure 4.3 **Credit to Private Sector**



Data Source: Bank of Cape Verde

Increasing credit is an indication of a growing sector. The assets of the banking sector are on the rise (Table 4.5; Figure 4.4). The savings of emigrants has grown substantially since the early 1990s when policies were introduced to encourage emigrants to save in Cape Verde. National savings is also on the increase.

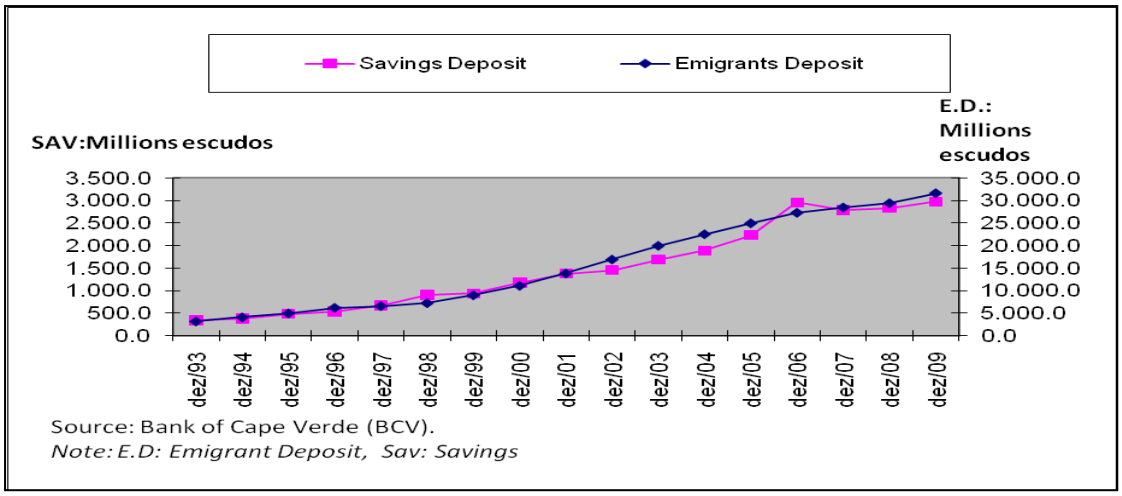
Table 4.5 **The Banking Sector**

	1-Dec-05	1-Dec-06	1-Dec-07	1-Dec-08
Assets	**81,370,577**	**96,278,899**	**108,793,359**	**120,083,552**
Credit	30,605,405	41,424,952	43,807,448	59,147,817
Deposit	68,181,753	81,880,901	92,378,428	99,266,300
Earnings before taxes	**467,568**	**934,117**	**1,676,021**	**1,907,905**
Taxes	69,236	156,084	336,936	336,590
Returns on Assets	**398,332**	**778,034**	**1,339,085**	**1,571,315**

Data Source: BCV

[22] Bank of Cape Verde. *2008 Annual Report*. Praia, Cape Verde.

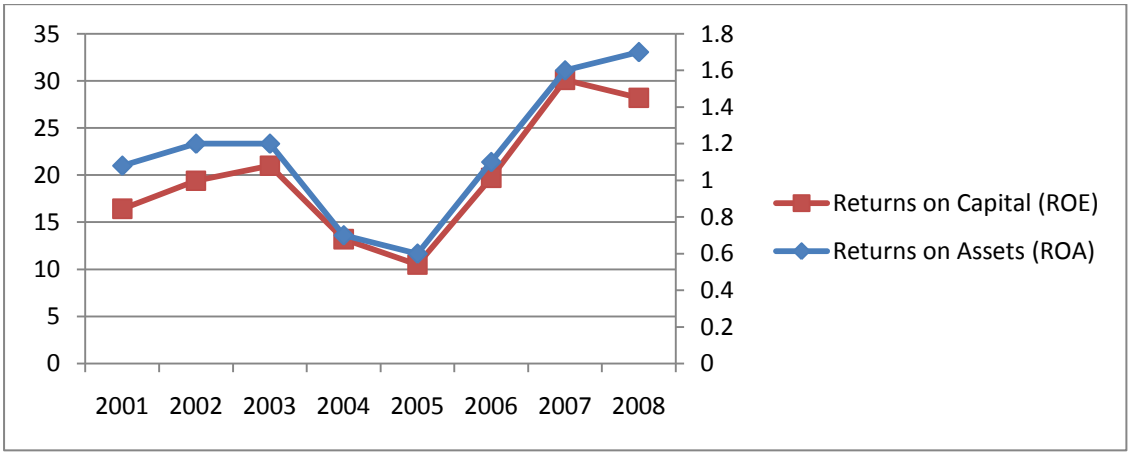
Figure 4.4: **Savings and Emigrants Deposits (millions of CVE)**



Source: Bank of Cape Verde (BCV).
Note: E.D: Emigrant Deposit, Sav: Savings

Between 2001 and 2008 banking sector in Cape Verde performed rather well. In 2001, the rate of return on capital was 16.5 percent and it has grown since then except for 2004 and 2005 when there was a decline and it reached its low for the period at about 10,5 percent; it reached 30,1 percent in 2007 and 28,2 in 2008. The rate of return on assets mirrored that on capital. It started out at about 1 percent in 2001 and in 2008 reached 1,7 percent (Figure 4.5).

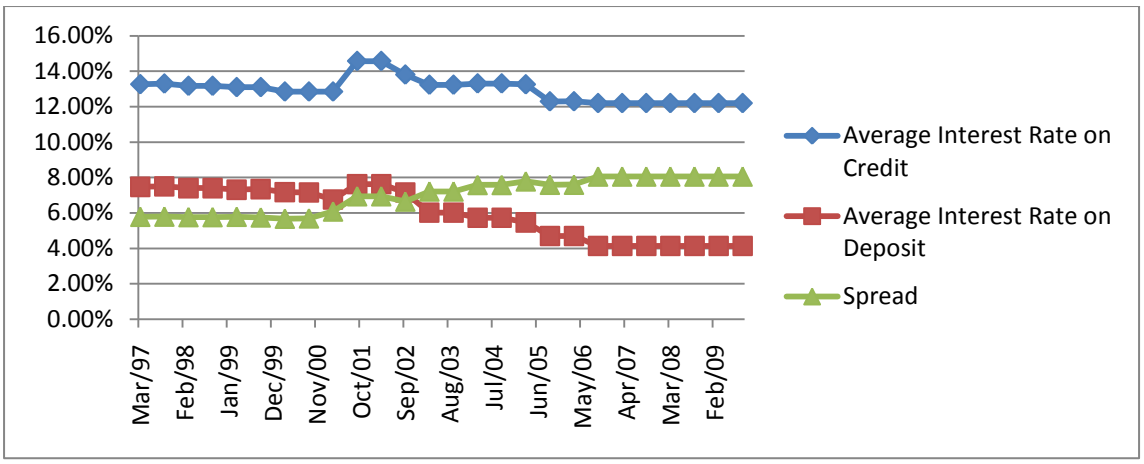
Figure 4.5 **Returns on Capital and Assets** (ROE: left axis; ROA: Right)



Data Source: BCV

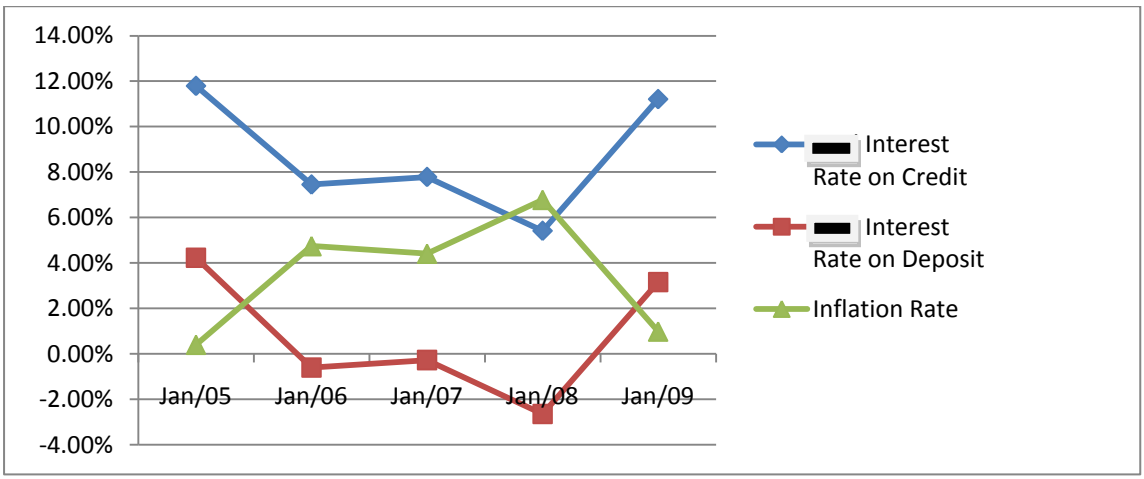
Despite the indications pointing to increasing financial intermediation, the issues of access and high interest rates are continuously raised by firms as constraints. For example, the National Institute for Statistics (INE) reported in a survey in 2008 that 26 percent of commercial establishments and 29 percent of firms in the construction sector indicated having difficulty obtaining finance. Similarly, 18 percent of firms in the construction sector reported high interest rate as a problem. A review of the BCV data on interest rate however indicates a decline in recent years. The rate of interest which was already witnessing a decline in the late 1990s rose to above 14 percent in 2001. The spike may be linked to the decline in FDI to Cape Verde that year and the rapid fall in tourism due in part to the global economic crisis following the aftermath of the terrorist attacks on the US on 11 September 2001. Following the spike in 2001, interest rate began to decline in 2002; it has settled at about 12 percent since 2005 (Figure 4.6). BCV data also shows a rapid decline in interest rate between 2005 and 2008 before a rise again in 2009 (Figure 4.7).

Figure 4.6 **Interest Rates on Debit, Credit and Spread**



Data Source: BCV

Figure 4.7



Data Source: BCV

The trend is towards increased competition, with the decreasing interest rates and lower market share for the market leaders. Relative to the countries in the ECOWAS sub-region, interest rate on credit to firms is much lower in Cape Verde. It is not uncommon to find nominal rates that are above 18 percent, for example. However, at about 12 percent, the perception of high interest rate is not completely misplaced. The interest rate spread in Cape Verde increased from 2001 to 2006 and since then it has flattened, remaining at about 8 percent.

It will be a stretch to ascribe the level of interest rate in Cape Verde entirely to country risk. Cape Verde is generally not perceived as a high risk country. The ratings and international development agencies continue to maintain a positive outlook on Cape Verde. Standard and Poor (S&P), in its recent report, lauded Cape Verde for its efficient democracy, its long track record of political stability, its relatively high human development indicators, and its monetary stability. [23] As noted by Fitch, "Cape Verde ranks third of 75 countries in the World Banks Resource Allocation Index, an assessment of economic policies and public finance management in low income (recipients of lending on IDA, International Development Association, terms) countries." [24] A key part of the

[23] Standard and Poor. Republic of Cape Verde. Global Credit Portal. Ratings Direct. 12 February 2010
[24] Fitch Ratings. Cape Verde 2009.

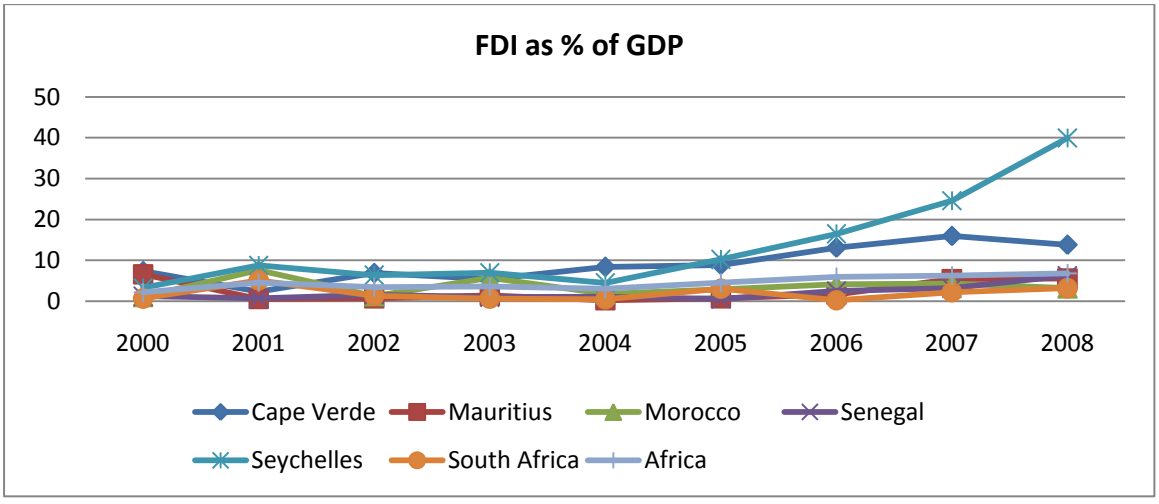
challenge is the limited degree of freedom by Cape Verdean authorities in pursuing a monetary policy as the national currency is pegged to the Euro.

The lack of product innovation and lack of diversity in bank lending have also been identified as key problems. Competition in the banking sector continues to be limited despite progress in recent years. Cross ownership is still present, with, for example, a group in Portugal having major ownership interests in two of the top banks. This is not a recipe for banks to compete on product innovation or diversity. Additionally, Capacity limitation in the sector has also been identified as a key constraint to innovation in the sector.

4.3 Trends in Private Capital Inflow

Foreign direct investment (FDI) has stabilized and in fact construction on several private investment projects has resumed. Over the last decade, FDI into Cape Verde grew significantly. Between 2000 and 2008, FDI into Cape Verde increased year on year except for 2001 and 2003. Average annual growth rate between 2001 and 2008 was 45 percent. Compared to the comparators and the African average on FDI as a percentage of GDP, Cape Verde performed well over the period (Figure 4.8). Only Seychelles performed better using the ratio of FDI to GDP. Cape Verde also performed better than the average of all African countries.

Figure 4.8



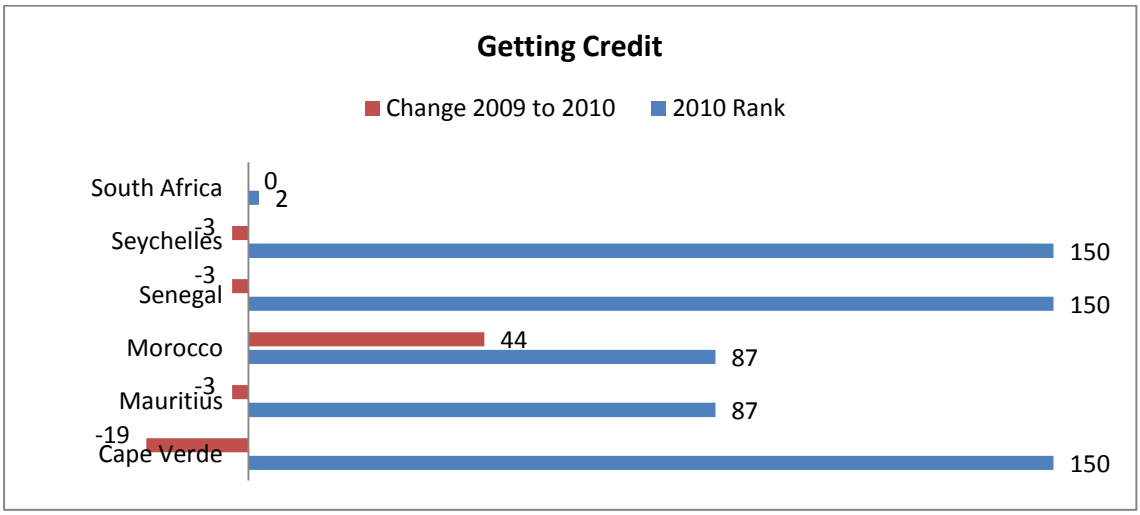
Data Source: IMF

Part of the attractiveness of Cape Verde is the pegging of the Cape Verdean Escudo (CVE) to the Euro. The perception of high interest rates, as concluded by the study on the financial sector under the first MCA compact, may be influenced by the currency peg to the Euro and the perception that rates should converge to about the same levels as in Europe or at least the levels in Portugal.

Based on the foregoing analysis, can the study conclude that finance is a binding constraint? A review of international finance does not indicate a binding constraint. From the dimension of local finance, the evidence is mixed. From the perspective of SMEs, real interest rate is high, and access to finance is a challenge. In fact, Cape Verde's ranking in getting credit is quite low. Cape Verde ranked 150th in getting credit, worse than any of the comparators. Importantly, it declined in ranking by 19

positions between 2009 and 2010 while South Africa maintained is ranking at 2nd place and Morocco improved by 44 positions between 2009 and 2010 (Figure 4.9).

Figure 4.9



Data Source: Doing Business

Yet, the level of financial intermediation is high. As concluded by the studies on the finance and SMEs, under component three of the first MCA compact: "In short, despite the fact that the country has a relatively high level of financial intermediation, a solvent and professional financial system, relatively liquid credit markets and a reasonably well developed mortgage lending market, SME credit is severely limited."

Several reasons can be advanced. But the most important is the concentration of the banking sector. The dominance of the two major banks—Banco Comercial do Atlantico and Caixa Economica—which at one time used to control over 80 percent of the market share has reduced.[25] Despite the decline, however, the two main banks still control a major portion of the market share. The fifth bank is new and it only entered the market in late 2009. The results are inadequate competition, a high cost structure, and limited credit products for borrowers. Inadequate competition does not encourage innovation. The banks do not have much incentive to innovate and to find creative ways to meet demand. The credit procedures are not streamlined and the process is slowed by the need for companies to present adequate documentations, including financial, corporate and business plans.

In an environment where having collateral is the key to obtaining credit, it is critical that property rights be well defined. Almost all lending are guaranteed with built up real estate in Cape Verde. Land can also be used as collateral. However, the nation lacks proper cadastres and thus there are difficulties in the establishment of property rights. In many instances, who has property rights for what land is not clear with multiple claims and complications arising from centuries of emigration and informal land tenure practices among families. As concluded by the studies under component three of the first MCA compact, the difficulty with establishing property rights make it difficult for banks to readily accept land as collateral.

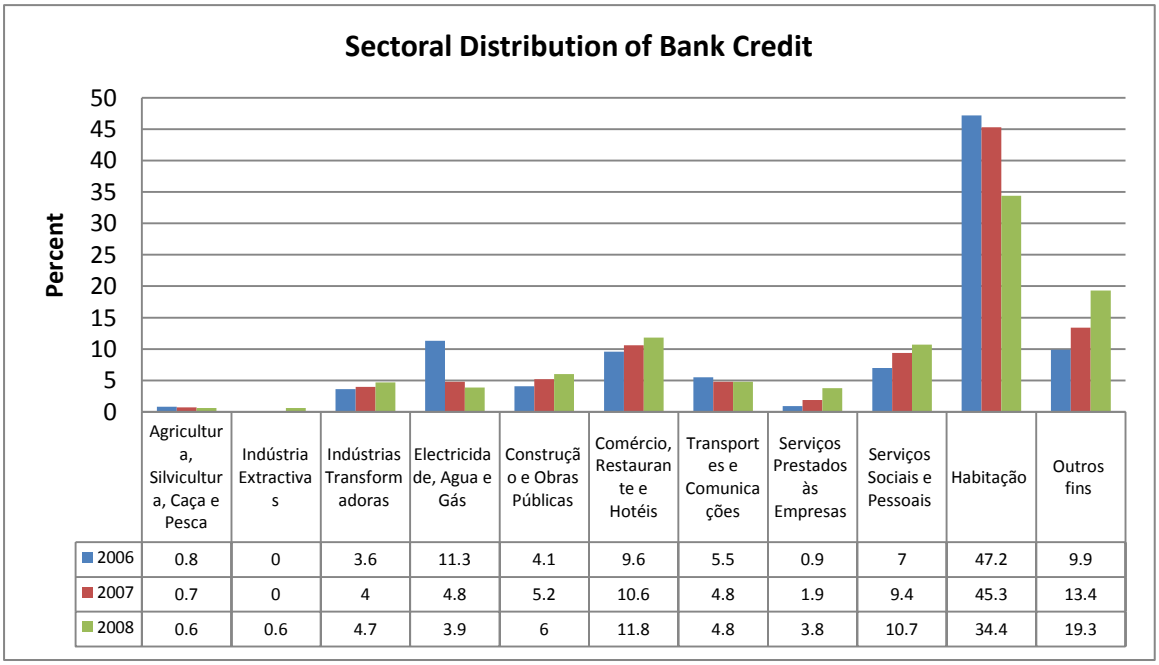
[25] Data obtained from the 2008 Annual Report of the BCV.

The fact is there are no real alternatives in the marketplace for SMEs to obtain financing. The only stock market is new and small. It does not provide an alternative form of financing for SMEs. In fact, SMEs are not eligible for stock market listings given the criteria and only a few firms are actually listed on the exchange and are able to issue bonds. There is only one venture capital firm. Its capital base and operations are quite limited. Additionally, leasing, factoring and other forms of financing are quite underdeveloped in Cape Verde. Essentially, the only game in town is the banks. Compounding the situation is the weak capacity to steer the financial sector in the right direction. This includes capacity to regulate sector and to formulate and implement policies.

A key implication of the inadequate competition is that risk capital is almost inexistent for SMEs and start ups. Yet, Cape Verde is focused on implementing an agenda for economic transformation, based on developing and nurturing new sectors and start-ups. The strategy is aimed at building high value added service sectors and becoming an international platform for services. Successful implementation of the transformation strategy is necessary if Cape Verde is to expand its opportunities for growth and its narrow economic base.

But without a robust financial sector economic transformation will not happen. There is a need for new and innovate enterprises. These firms, however, will not start. They are likely not to have the necessary financial resources to build the capacity to compete in the global marketplace if they do start. The current financial system will not deliver. An examination of the distribution of bank loans by sector shows that agriculture and fishing, extractive industry, transformation industry (manufacturing), and services receive very little. Credit is dominated by loan for housing (personal mortgage), essentially for consumption as opposed to investment to enhance capital formation within the economy (Figure 4.10). Importantly, it is the consumption of goods and products which are not locally produced.

Figure 4.10



	Agricultura, Silvicultura, Caça e Pesca	Indústria Extractivas	Indústrias Transformadoras	Electricidade, Agua e Gás	Construção e Obras Públicas	Comércio, Restaurante e Hotéis	Transportes e Comunicações	Serviços Prestados às Empresas	Serviços Sociais e Pessoais	Habitação	Outros fins
2006	0.8	0	3.6	11.3	4.1	9.6	5.5	0.9	7	47.2	9.9
2007	0.7	0	4	4.8	5.2	10.6	4.8	1.9	9.4	45.3	13.4
2008	0.6	0.6	4.7	3.9	6	11.8	4.8	3.8	10.7	34.4	19.3

Data Source: BCV 2008 Annual Report.

4.4 Summary

In summary, Cape Verde, within the sub-region, has one of the highest levels of financial intermediation. It compares reasonably well with the benchmark countries. But Cape Verde ranks poorly on getting credit. We conclude that finance is a constraint, although not binding as yet. The challenge is that it could become a binding constraint if the issues in the sector are not addressed timely.

Cape Verde's objective is not simply aiming to move along the current development trajectory with high dependency on external financing (aid and remittances). It aims to qualitatively accelerate its process of economic transformation to be able to compete in the global marketplace and become an international platform for high value added services. This requires building an entrepreneurial economy. The SMEs and the aspiring young engineers or entrepreneurs that will lead the critical sectors such as information technology/business process outsourcing do not have the level of collateral needed by Cape Verdean firms to obtain loans. The lone venture capital firm in the market is too limited and may not really be that different from the banks given that a key shareholder is one of the major banks. Similarly, in agriculture, where the opportunity for expanding production exists in several areas and for product transformation (increasing value chains), there is a need for capital. These sectors and the others need risk capital as well as the more traditional capital. Microfinance will not suffice.

Thus, Cape Verde's development trajectory, its agenda for economic transformation, the need to expand its narrow economic base and its low rankings in getting credit compared to comparators, all point to the need for a more developed financial sector. More importantly, they highlight why finance remains a constraint to growth and transformation in Cape Verde.

5
Is it Low Social Returns?

This section assesses the degree to which human capital, geography, infrastructure and innovation constitute binding constraints to growth. Our working assumption is that the social returns of private investments in the economy are augmented or lessened depending on the level of investment made in human capital and infrastructure. Indeed, the very ability of a country to be attractive to private investment, internal or external, may well depend on the quality of factors such as infrastructure, human capital, and geography. It is not simply a matter of having any kind of human capital and infrastructure investment. Rather, what is important is to have the appropriate and forward-looking mix of skills and infrastructure to capitalize on globalization. Investment in these complementary factors is typically under-provided, or altogether bypassed, by the market. Governments step in to redress these market failures. In Cape Verde, like other small island economies, public interventions may take on added significance given the natural costs of smallness and insularity.

These three factors are perhaps inter-related more closely for countries like Cape Verde. Human capital is critical to development and entrepreneurship in two distinct ways: increased worker productivity and innovation spillovers. The latter is especially apropos for a small island economy without natural resources, geographically fragmented, and, which thus only has the creative talents and ingenuity of its people to sell in the world economy. The importance of infrastructure is obvious, especially what we might refer to as the infrastructure of a national innovation system. Physical infrastructure, such as roads, integrates markets and connects producers and consumers. Given its geographic makeup and fragmentation, Cape Verde has challenging infrastructure needs. Geography is the country's biggest handicap that, among other things, makes cost-effective solutions to infrastructure, energy, and human capital a serious challenge.

5.1 Is it Geography?

Cape Verde's natural endowment is and has always been a challenge for development. Its natural capital endowment – or lack thereof – engenders conditions unfavorable to smooth growth and development. One statistic is sufficient to make the point: Cape Verde imports 80 percent of its food, over 95 percent of its energy needs and just about everything else. Everyday Cape Verde pays a premium for its smallness and geographic liabilities. From the store shelves at supermarkets, to the gas pumps, to the computer retailers, Cape Verdeans pay extra because of the costs associated with their country's natural endowment. The cost of smallness, insularity, fragmentation, and climate is marbleized throughout the economy, and generates structural imbalances. As a micro-state of nine inhabited islands spanning a 300-miles radius and subject to the climate conditions of the Sahel, the basics that permit quick growth and effortless entrepreneurship (energy, water, transportation, telecommunications, and other market-enabling infrastructure) have a cost above the world average, must be duplicated nine times, and are characterized by structural market failures. In this section, we understand a country's natural capital to encompass, among other things: geographic positioning, size and dispersal, terrain and topographical features as they pertain to arable land, and climate conditions.

We should start by noting that its geography is not uniformly negative. As the first European settlement in Sub-Saharan Africa and the major êntrepot (transshipment hub) in the transatlantic slave trade, Cape Verde's geographic positioning has put it favorably alongside the major crossroads of world trade. Indeed, it is often remarked that the country benefits from a strategic location in between four continents and the world two biggest markets. It is within three hours flight to the European Union, Brazil and West Africa, and an easy six hours reach to the North American market. The islands are located 450 km off Senegal – an otherwise ideal location, not too far, not too close.

Based on geographic positioning alone, there is good reason for policymakers in Cape Verde to believe that they can market the island country as a "gateway" to Africa and a "hub" for transportation and offshore services. In addition, there is a specialized literature on small island states that narrates some of the advantages that accrue to small size and insularity. Cape Verde's successful pursuit of tourism as an engine for growth is in no small way made possible by its convenient geographic location, and its largely disease-free, sunny climate. It is easy to reach for European tourists, and its ample supply of 365-days of sun and pristine sandy beaches has made it a popular destination point along the perimeter or "near abroad" for European Union citizens. Whether the tourism-related benefits accruing from this geographic positioning and ideal climate outweigh the net negatives of the country's natural capital is an interesting question. Though insular, the island has not been prone to natural disasters, such as hurricanes or earthquakes (although the main volcano remains active). Finally, from the standpoint of political and security considerations, it is worth noting that the country's geographic detachment from the West African region insulates it from the instability, state failures, ethno-religious violence, armed conflicts, and pandemics that periodically beset the region.

Notwithstanding some of these advantages to its geographic positioning, there are other specific characteristics of Cape Verde's natural capital that have made development policy an exercise in managing vulnerability and smallness.

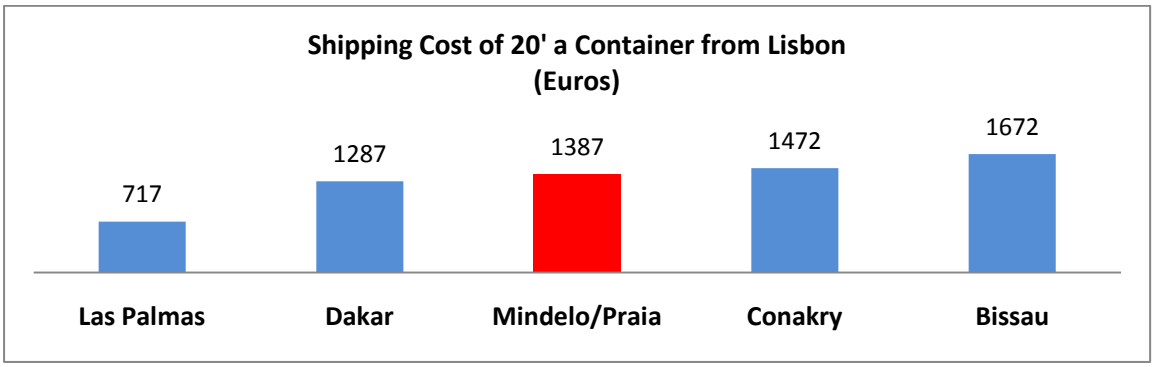
5.1.1 The Cost of Insularity

Cape Verde is a small island country. It is a minuscule economy. Despite being well-positioned alongside the major trade routes in the world economy, its insularity (when combined with its small scale) has proven to be a negative factor. Although not remote despite being insular, it is no longer a stopping or transiting point for world trade, as it used to be in the early days of trans-Atlantic voyage with ships and planes. In other words, insularity does not necessarily have to translate into a costly drag on growth, especially considering the country's otherwise favorable location. It does so in the case of Cape Verde – or is magnified – because of the country's scale and dispersion. Insular countries lack the natural advantages to trade flows that stem from geographic contiguity.

Small island states face high costs for international transportation. Their insularity and small scale translate into higher per unit costs of imports and exports, and this higher cost gets passed on throughout the economy. A factor related to high transportation costs is the infrequency and uncertainty of cargo-bearing maritime transportation. The cost of shipping a 20 feet container from Lisbon to Cape Verde, for example, is almost twice the cost of shipping the same container to nearby

Las Palmas (Figure 5.1). Though strategically positioned, Cape Verde's scale and very limited exports mean that it is simply not a cost-effective stopping point for international shipping. One consequence of the cost and irregularity in cargo-bearing transportation is the uncertainty and unreliability of inventories, a challenge for retailers and consumers alike. This applies to both durable goods as well as foodstuff. It is worth noting a peculiar pattern of rational consumer behavior in Cape Verde today – hoarding. The cost and infrequency of transportation means also that too often imported food items are near expiration, a problem made worse by the fact that internal distribution of such imports faces another inter-island transportation hurdle.

Figure 5.1



Data Source:

5.1.2 Geographic Size, Scale Economies, and Natural Resources

It is well established that small size is an economic disadvantage: dependence on imports, narrow base for production or diversification, limited range of exports, limited ability to manipulate domestic prices, acute vulnerability to external shocks, and high international transport costs. The problem is market size, and all the economic consequences that flow from this. The country's unenviable combination of small population, small geographic scale, and geographic fragmentation constitute a serious barrier to entrepreneurial activity, whether from the standpoint of the absence of economies of scale possible or high transaction costs. At roughly 4,000 sq. km., the country's territorial size is only a shade larger than that of Rhode Island. It means that there is a structural limitation to economies of scale. As a result of its micro scale, coupled with fragmentation, Cape Verde does not have a viable internal market. The lack of scale hinders major external private investments in infrastructure, for example, or induces natural private monopolies. It may also mean that Cape Verde is bypassed as a destination for leading edge technological innovations and knowledge transfer that developing countries acquire through trade and foreign direct investments. As the OECD's *Africa Economic Outlook 2009* observes, Cape Verde pays a significant cost for its smallness, insularity and geographic makeup.[26]

The lack of scale does not only result in high per unit costs and limited competition in the domestic economy. The lack of scale chokes off any possibility for a large scale import substitution. There are simply weak market-driven incentives and opportunities for entrepreneurs to engage in large scale investments, especially ones that could be employment intensive. The combination of small scale and insularity means that Cape Verde is not an attractive destination for the kinds of labor- and

[26] Organization of Economic Development and Cooperation (OECD), *Africa Economic Outlook 2009*, p. 249.

capital-intensive investments (e.g. manufacturing) that have proven to be a very successful ingredient in development catch-up in the global economy. Additionally, the country's micro-scale market limits competition by naturally limiting the number of entrants in any sector. The tendency is toward natural monopolies or duopolies, since the market is quickly saturated and the number of available customers insufficient to provide the necessary returns to compensate the initial investment required. The telecommunications sector is a good example.

As noted above, one economic consequence of small size is high import content. A near total dependence characterizes Cape Verde's relationship to the world economy and, therefore, total dependence on conditions in the world economy. In generic terms, limited size simply means the country cannot produce sufficient volume for its internal consumption needs, for instance food. In Cape Verde's case, the matter is not simply limited size but the absence of natural resources. The country's trade to GDP ratio is 107.6 for 2006-2008. Imports alone grew at 11 percent annually during 2000-2008, while GDP expanded by only 5 percent. Thus, there is everywhere in the economy a built-in smallness premium in the price of all goods. Classical economic theory does not view high import content as necessarily a problem, since it can be welfare enhancing. Yet this is based on the premise that the country is also exporting. Cape Verde's exports are negligible. The country has a structural current account deficit. To cover this high import bill, Cape Verde has to depend on remittances and donor aid, even though the tourism sector is bringing in some hard currency earnings. A side note is warranted here on the smallness premium Cape Verdeans pay. Across some goods and services, the country is typically paying twice or three times the world price because it is actually importing re-exported items via Portugal. The harsh combination of small size, poor climate, and limited terrain for cultivation translate into food insecurity and high dependence on imported foodstuffs.

5.1.3 Geographic Fragmentation and Terrain

The archipelago is fragmented into 10 separate islands, scattered across the Atlantic, with a substantial distance of nearly 200 miles spread from end to end. Thus, it is not simply that the internal market is exceedingly small and insular. The country lacks a unified domestic market. Inter-island transportation in the archipelago historically has been one of the biggest bottlenecks to growth. Inter-island air and maritime transportation in Cape Verde is expensive, insufficient to meet demand, and both suffer from unreliable scheduling. The high cost of air transportation effectively limits access for the majority of the population, and makes goods transportation very expensive. A short round trip journey between the islands of Santiago and Fogo, less than 30 miles apart, costs roughly $150 dollars, or nearly 5 percent of the annual per capita income. The inter-island maritime transport fleet consists of ageing ships more suitable for cargo than passengers. Inter-island ferry service is frequently halted because of mechanical breakdown. The country's small scale, once again, dampens the market incentives for new entrants with modern vessels. A high speed, roll-on, roll-off modern ferry transportation does not exist.[27] Some of the islands (Brava, Maio) often live in isolation because of the unreliability, infrequency or inability to service them by air or sea. The island of Brava can only be reached by water. Put differently, geographic fragmentation is debilitating enough in that it prevents a unified domestic market, exceedingly small as it is.

[27] There is currently a public-private initiative to introduce the first modern fast ferry, scheduled to begin operation in the third quarter of 2010.

The weakness and high costs of inter-island transportation effectively undermines a functioning internal market because of the inability to move goods and people from one island to another with ease and at low cost. This is a critical problem for the big agricultural islands of Fogo, Santo Antão and Santiago. It is useful to compare the costs of inter-island maritime shipping in Cape Verde to international costs. A typical 20 feet container from Lisbon to Cape Verde (Mindelo or Praia) costs about 1387 Euros while the cost of shipping the same container from Praia to Fogo, Brava or Maio is a lot higher. On average shipping the 20 feet container to any of these three islands from Praia, Santiago will cost about 2577 Euros (Figure 5.2). This is about three and half times what it will cost to ship the same container from Lisbon to Las Palmas, twice what it will cost to get it to Dakar, and over one and half times to Bissau (Figure 5.3).

Figure 5.2

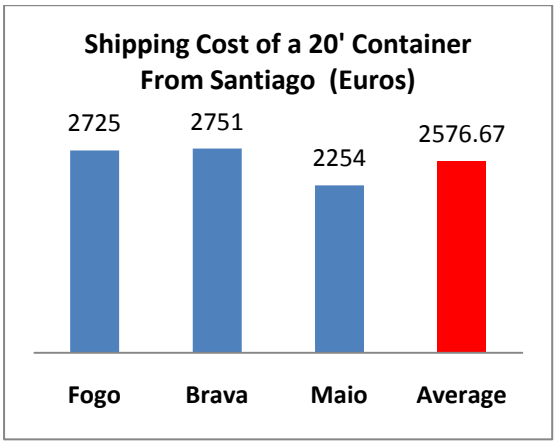
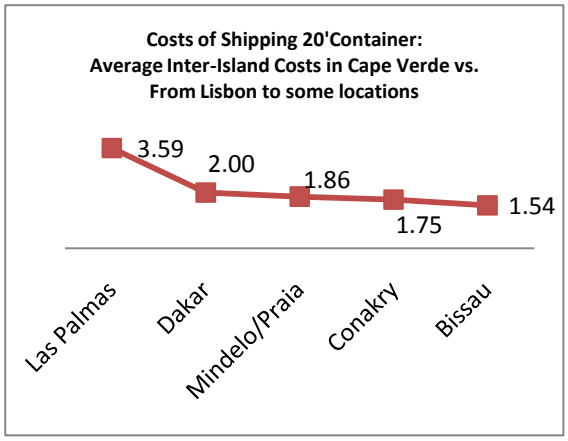


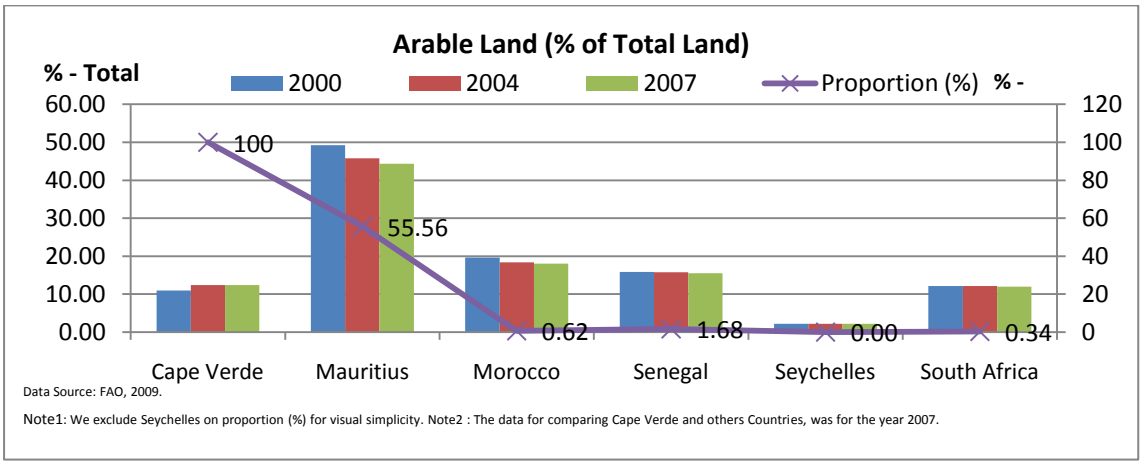
Figure 5.3



Data Source: African Development Bank

Cape Verde's terrain presents another obstacle to growth. First, it is estimated that only 10 percent of the country's land surface is arable. The challenge faced by Cape Verde becomes clear when compared to the benchmark countries (Figure 5.4). Cape Verde is the second most affected among the countries by the problem of arable land. Even though there has been an increase in arable land, it continues to be quite limited. Arable land in Cape Verde is only 55 percent of that of Mauritius in 2007, while it is 0,62 percent, 1,68 percent and 0,34 percent of the arable land of Morocco, Senegal, and South Africa, respectively.

Figure 5.4



Data Source: FAO, 2009.

Note1: We exclude Seychelles on proportion (%) for visual simplicity. Note2 : The data for comparing Cape Verde and others Countries, was for the year 2007.

This means that Cape Verde is simply incapable of being food self-sufficient, holding present technology constant. The country, at present, is able to produce only a fraction of its food needs. The rest must be imported. Second, the terrain itself is a handicap to productive, large scale farming – even if we ignore the present fragmented small-holder land tenure system. With the exception of the three non-agricultural and tourism-dominated islands (Sal, Boa Vista, Maio), the other islands are mountainous and covered by jagged, difficult terrain. The main agricultural islands, Fogo, Santiago and Santo Antão, are serrated by steep, albeit majestic, mountains and difficult to traverse rough terrain. Such terrain makes impossible mechanized farming. Typically, farms tend to be far removed from population centers, adding to the cost and difficulty of working the farm as a lucrative enterprise. On the island of Fogo, for example, the principal productive farms may be 1000 meters up in the mountains and accessible only by foot.

Agriculture in Cape Verde is characterized by subsistence family farms, frequently on marginal terrains, low in nutrients and minimal use of fertilizers. The main crops are maize and beans. Yields are typically poor, about 300 kg/ha for maize and 90 kg/ha for beans. Additionally, rain fed agriculture is the predominant type of farming. It occupies about 95% of the arable land. The production of maize, the only cereal produced in Cape Verde, covers on average about 10% to 15% of the internal consumption of cereals. The supply of basic foodstuffs is ensured by imports (commercial import and food aid) and complemented by national production. Irrigation takes place mainly in valleys and on the lower slopes, and today covers an area of about 2732 ha. The introduction of drip irrigation has brought about some visible gains in production and productivity. About 41,000 households own livestock, both in rural and urban areas. The lack of feed and limited grazing opportunities does not allow high productivity (meat and milk) from livestock. Since 1990s, commercial farming has emerged focused on the production of meat, eggs, milk, and cheese, accounting for about 1,5 to 2,5 percent of GDP between 1993 and 1997.

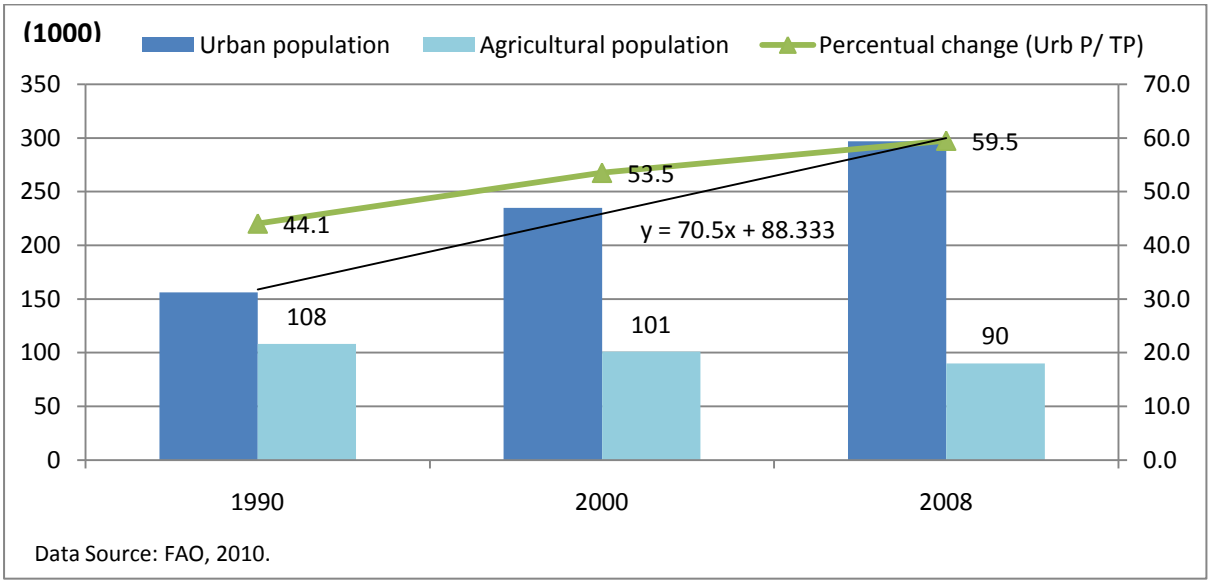
The vulnerability of the agricultural sector is mainly due to the scarcity of natural resources (water and soil) and climatic conditions. These factors, coupled with the inadequate techniques of production, contribute to land degradation and contribute to the extreme fragility of the ecosystem of Cape Verde. Other key constraints facing the sector include: weak cooperative arrangements; lack of local involvement and sustainable management of resources; the low levels of education of farmers and fishermen; inadequate rural infrastructure; the absence of an integrated system of food quality control; limited access to credit; weak institutional capacity for intervention in support of integrated development in rural areas. Moreover, an estimated 50 percent of the family farms are headed by women. The average age of farmers is 50 years. Among farmers, 52 percent are illiterate while only 48 percent have some basic education.

Despite the constraints, agriculture and fisheries continue to play important economic and social roles in Cape Verde. They contribute to food security and provide employment in rural areas. These sectors employ directly or indirectly more than 50 percent of the rural population. They also play a role in stabilizing market prices, particularly food commodities.

However, a transition in the rural political economy has been taking place over the last two decades, resulting in out migration from rural areas and shrinkage of available farm labor (Figure 5.5). In consequence, a distressing, but economically rational, outcome is frequent whereby farmers allow their crops to rot and waste in the fields because the income loss from the high wage they would

have to pay laborers and the high costs of transportation could not be compensated by the low and uncertain income gain from putting their products on the markets. Even when labor or cost of transport is not prohibitive the lack of reliable inter-island maritime transportation simply causes some farmers to lose their harvest. The net result has been the persistence of rural poverty, and difficulty in stimulating entrepreneurial activity in rural areas and outlying islands.

Figure 5.5 **Population**



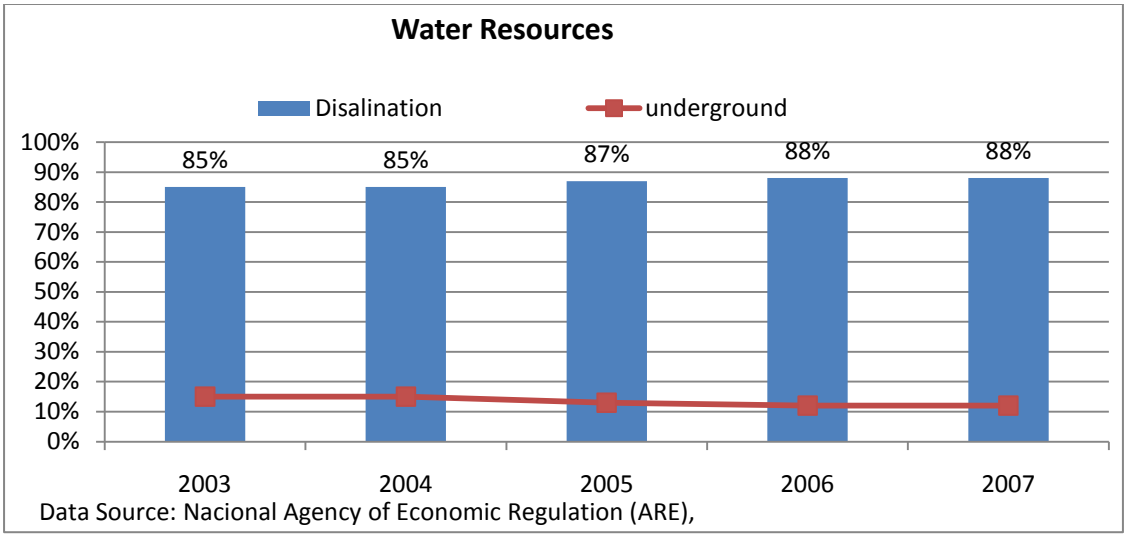
In the last decade, individual families have taken up drip irrigation. Introduced in 1993, drip irrigation was in use in about 350 ha by 2004. Today, thanks partly to the agricultural investments of the first MCA Compact, it has expanded to about 800 ha. However, the adoption of drip irrigation is limited by the high costs. These experiments are still isolated, small scale and decentralized. It is worth noting the successful experiment on the island of Fogo involving a cooperative of farmers growing grapes for wine making. This experiment is noteworthy both for the high quality wine being produced, but also for the successful cooperative model. A final note on terrain points to the issue of poor soil quality. Cape Verde's arable soil is of poor quality, a problem magnified by traditional farming practices and smallholder agriculture that taxes the land.

5.1.4 Climate and Agriculture

Cape Verde is part of the Sahel climate system, and this imposes several climate challenges to the country. Despite being surrounded by ocean, water is Cape Verde's greatest problem. Periodic droughts and famines are seared in the collective memory of its people. Poor and uncertain rainfall is the main feature of Cape Verde's climate. The negative economic impact of climate works its effects primarily through two channels: first, agriculture, which continues to be the main source of livelihood and employment for a significant portion of the population and the major sector tied to poverty alleviation; second, through the cost of energy, which is used to produce and distribute water for household and commercial consumption.

The problem of the quality of the soil, jointly with the problem of low and unreliable rainfall, historically, imposes many challenges for the development of Cape Verde. The climate-related water problem in Cape Verde has peculiar features that extend beyond simply little or no rainfall. The cost is felt throughout the economy, as the underwater level declines and the country relies more and more on energy-intensive desalinization for close to 90 percent of its water needs (Figures 5.6). This is in the context of two troublesome facts: rapid demand pressure as a result of urbanization, tourism and now the popularity of drip irrigation, and continued reliance on fossil fuel energy matrix.

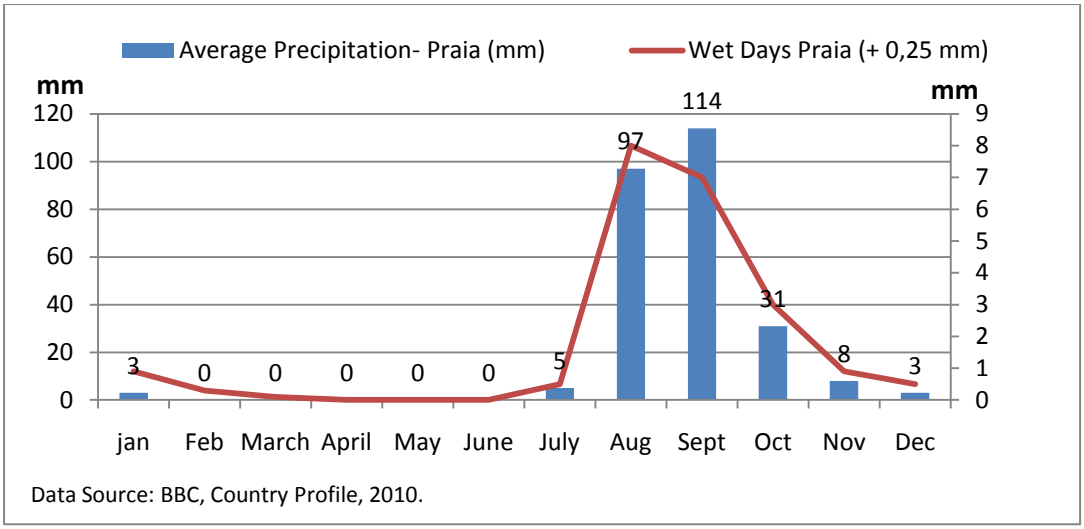
Figure 5.6



Data Source: Nacional Agency of Economic Regulation (ARE),

Second, the rainfall season is typically between July and October, with concentration in August and September. Even more, this two-month concentration of rainfall is not continuous across the sixty days, but concentrated in a handful of days. The following figure shows average precipitation for the capital city, Praia (Figure 5.7). The average precipitation is 230 mm/year. However, it is unevenly distributed spatially and temporally, and is characterized by cycles of drought and torrential rains. The problem of the islands is not only low level of precipitation, which is 70%-80% concentrated in two months, but, also, the irregularity and uncertainty. An occasional stretch may witness rainfall lasting a day or across two days. This leads to a third feature of rainfall in Cape Verde: intense tropical downpours and torrential rains, which in some cases can reach an index of 590 mm in Fogo. The end result is erosion, farm and crop damage, as well as damage to the roadways and buildings. The work of MCA-I to build dikes and water retention infrastructure has improved the situation in some localities on some islands, but it is not sufficient to address the national problem. Thus, an embarrassment of riches of a precious resource not only causes a good deal of economic damage, but no infrastructure is in place to retain as much as of the runoff as possible for future use. The government has in 2009 developed a program to build dams throughout the country to capture and store rain water.

Figure 5.7 **Precipitation in Praia**

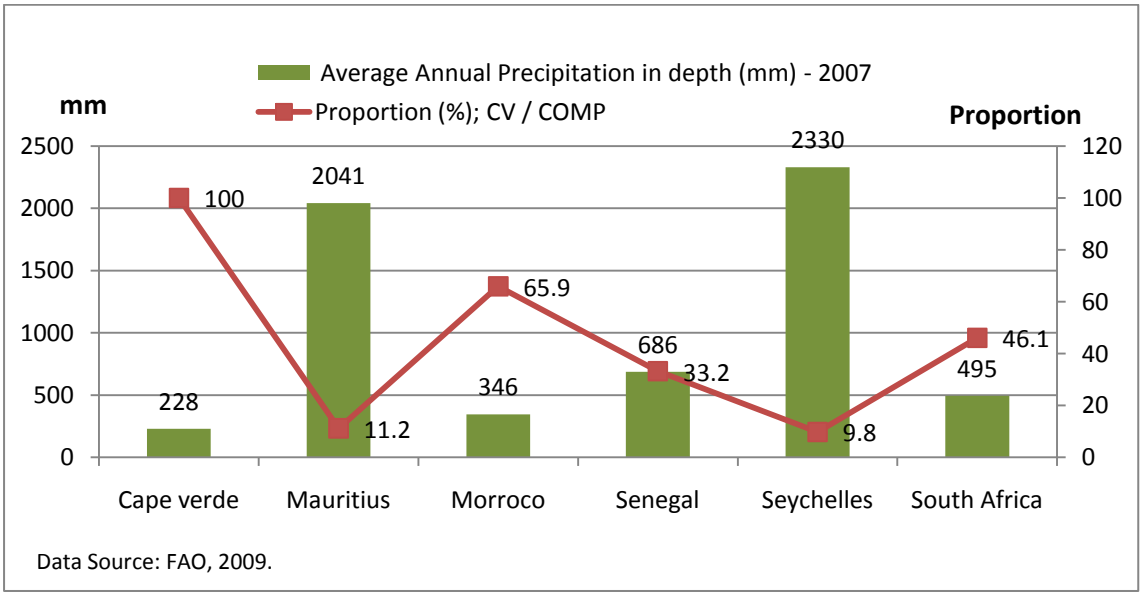


Data Source: BBC, Country Profile, 2010.

In the mountainous agricultural islands, such as Santiago and Santo Antão where the tall mountains are able to capture air moisture, the problem of rainfall (or soil moisture) is less severe, though all the islands are subject to periodic droughts. There are some differences in precipitation between the islands: for Sal and Boa Vista, precipitation is, on average, less than 100 mm/year, and both are considered extremely arid islands. For São Vicente, São Nicolau, and Maio, precipitation is, on average, between 100mm and 200 mm/year, and they are considered arid islands. Finally, in Santo-Antão, Fogo, Santiago, and Brava, precipitation, on average, is between 200 mm and 500 mm, and these islands are considered semi-arid.

Average precipitation in Cape Verde is much lower than that of the comparators: only 11,2 percent of the total precipitation in Mauritius, and 9,8 percent, 65,9 percent, 33,2 percent of the precipitation in Seychelles, Morocco and Senegal, respectively (Figure 5.8**)**.

Figure 5.8



Data Source: FAO, 2009.

5.1.5 Geography Summary

In summary, geography constitutes a binding constraint to growth and development for Cape Verde. It is clear that certain advantages may accrue from smallness in the international system and global economy. In a generic sense, smallness translates into agility to respond to market niches and opportunities. Yet in the unique case of Cape Verde, the economic disadvantages of smallness far outweigh the advantages. Similarly, the other aspects of geography—insularity, fragmentation, bad climate, jagged terrain and lack of natural resources—make it difficult to ensure growth. They are major obstacles which must be addressed as they constitute binding constraints.

First, agriculture in Cape Verde, which remains important despite its relative decline in GDP shares, suffers from a number of bottlenecks and structural limitations due to geography. Beyond limited arable land, rough uphill terrain, and soil quality, there is the crucial issue of scarce rainfall and water resources management. Making matters worse for farmers – and thus the potential employment benefits of farm work – is the difficulty of bringing products to market because of intra- and inter-island transportation bottlenecks. Not only does it impact growth, there are direct implications for poverty in the rural areas that are dependent on agriculture for their livelihoods.

Second, the problems of geography impose significant costs for transportation. It makes transportation to Cape Verde and movement of goods and people between the islands a highly costly exercise. In fact, the already difficult access to foreign markets is aggravated by high transportation costs**.**

Third, it increases the cost of energy. Desalination, which Cape Verde, must rely upon for close to 90 percent of its water needs is highly energy intensive and costly as most of the energy has to be imported in form of fossil fuel.

In fact, the challenge for development policy makers in Cape Verde since 1975 has been how to best manage the binding constraint which geography posed to growth and development.

5.2 Is it Human Capital?

Economic growth is determined not just by capital, but also by labor. In the age of the knowledge-economy, the significance of labor's technical, productive, and intellectual contribution is magnified. Cape Verde's social performance, especially as it applies to education, has been consistently positive since 1975. It has invested in human development, allowing it to be on pace to meet or surpass the Millennium Development Goals. It has one of the highest literacy rates among developing countries, and among the highest indicators of female literacy. In sum, the country is known for its human capital.

Today, the country faces radically different human capital needs. To make a qualitative jump up the ladder of development, and to sustain it, will require a major retooling of the level, quality, and relevance of its human capital stock. Economic success and national competitiveness in the modern global economy is based primarily on the ability of each country to harness the skills, energies, and creative capacity of its people. The globalized world economy, of knowledge-intensive horizontal

production and services, puts increasing demand on the human capital endowment of countries. This endowment has always been a critical factor since at least the start of the industrial age. It is the critical factor given the scale, speed, fluidity and inter-connectedness of the global economy. It is the decisive factor determining whether a country can compete and drive to catch-up in the system, or whether it will be left by the wayside. It is a decisive factor in a country's ability to attract, capture and reconvert the gains that accrue from globalization.

There are both historical and dynamic reasons why we expect scarcity of qualified human capital in a country like Cape Verde. First, brain drain has been an historical characteristic of Cape Verdean society. Cape Verde has one of the highest rates of brain drain in Sub-Saharan Africa as measured by the percentage of highly skilled individuals among emigrants. While not all the outmigration consisted of skilled or higher education people, up until 2009 the majority of Cape Verdean university students received their education abroad.[28] Second, Cape Verde in the last twenty years has been growing and modernizing rapidly, involving a substantial increase in physical capital. More still, it is important to view the human capital question in Cape Verde in a dynamic light. Not so much in the backdrop of the recent growth, but in view of where the country wants to go and needs to go. Its 2008 graduation from the list of least developed countries means it has to move towards relying on its own internal capacity for development and to be competitive and attractive in the international economy. Similarly, its Agenda for Transformation, the ambitious, high speed growth strategy to bring Cape Verde into the next higher phase of its development, also requires a different quality and makeup of skills and capacity.

5.2.1 Returns to Education

The issue of human capital in Cape Verde is complex. At first glance, some indicators suggest that human capital is not a critical constraint. On the one hand, the indicators on schooling, health, and workforce training appear to argue against human capital as a constraint. So too does the levels of unemployment. Observational evidence suggests some degree of fluidity and mobility for highly educated individuals. Roughly 20 percent of the state's annual budget is devoted to education.

A widely used estimate for returns to education is the Mincer regression. A major impediment in Cape Verde is the availability of updated and relevant data, especially household income or specific surveys on employment and educational attainment. Up to the moment of writing this document, we were unable to locate robust and unified data on total number of university graduates in Cabo Verde, by degrees as well as areas of study. We were also unsuccessful in obtaining robust data on total number of Cape Verdeans, by year, area and degree, who pursued their education in foreign universities and returned. More still, we do not have accurate data on Cape Verde's "brain drain," the number of Cape Verdean university students who study abroad but never return or return only to emigrate. For example, such data may give us a clearer picture of the supply of tertiary graduates, the degree of matching between areas of training and market needs, and whether foreign university graduates have lower unemployment rates than domestic graduates. The last

[28] For an informative study see: Arlinda Manuela Santos Cabral, *Brain Drain, Oportunidade ou Ameaça: Universitários Migrantes, Redes Globais, e Retorno Social do Investimento Educativo em Cabo Verde* (Master Dissertation, Universidade de Nova Lisboa, 2009)

household survey available is from a 2000/2001 survey. We used the data to run the Mincer regression in the hope that it may give us a general idea of whether the results in Cape Verde are consistent with the generic expectation of returns to education in developing countries.

The household survey from 2000/2001 contains a sample of 3135 individuals. We estimate the Mincerian regression by schooling level[29] due to the lack of data on years of schooling by head of household. We divided the level of schooling into four categories, namely: 1st group: those that never attended school; 2nd group: those with basic integrated education; 3rd group: those with Secondary or Intermediate Schooling; and finally the fourth group, those with Bachelors degree or higher. For this variable (schooling grade), we introduce three dummy for the second, third, and fourth group (Table 5.1).

Table 5.1 **Mincerian Equation by Education level**
Dependent Variable: log (salary)- 1º Model

Independent Variable	Value	t-value	Robust t-value#
Constant	11,348 (0,0322)	351,73*	349,14**
D1 (one for the second group and zero otherwise)	0,495 (0,0393)	12,59*	12,43**
D2 (one for the third group and zero otherwise)	1,402 (0,052)	26,75*	27,16**
D3(one for the fourth group and zero otherwise)	2,361 (0,089)	26,31*	35,74**

Note: * and ** significant at 5%. *R^2= 0,274. D-durbin=1,72. F-Statistic = 395,36 (Pr=0000).*
 # represents estimation using White Heteroskedasticity-consistent Standard Errors.

The empirical findings indicate a high returns to education in Cape Verde for the years analyzed. Ceteris paribus, individuals that never attended school were the least paid. The wage differentials starts at 49,5 percent in favor of those with basic education[30], 140 percent for those with secondary education, and 236 percent for those with college education compared with those without any schooling. The results of the Mincer regression also indicate wage differentials among those that are educated. Specifically, those with secondary education earns about 90,7 percent more than those with basic integrated education while those with at least undergraduate degree earns about 95,5 percent more than those with secondary education.[31] Essentially, the conclusion that can be made is that education matters and the higher the level the more returns.

[29]We use the individual age as a proxy for experience as we did not have the years of schooling. The years of experience is usually calculated by the following formula: Exp = age-years of schooling – 6 years

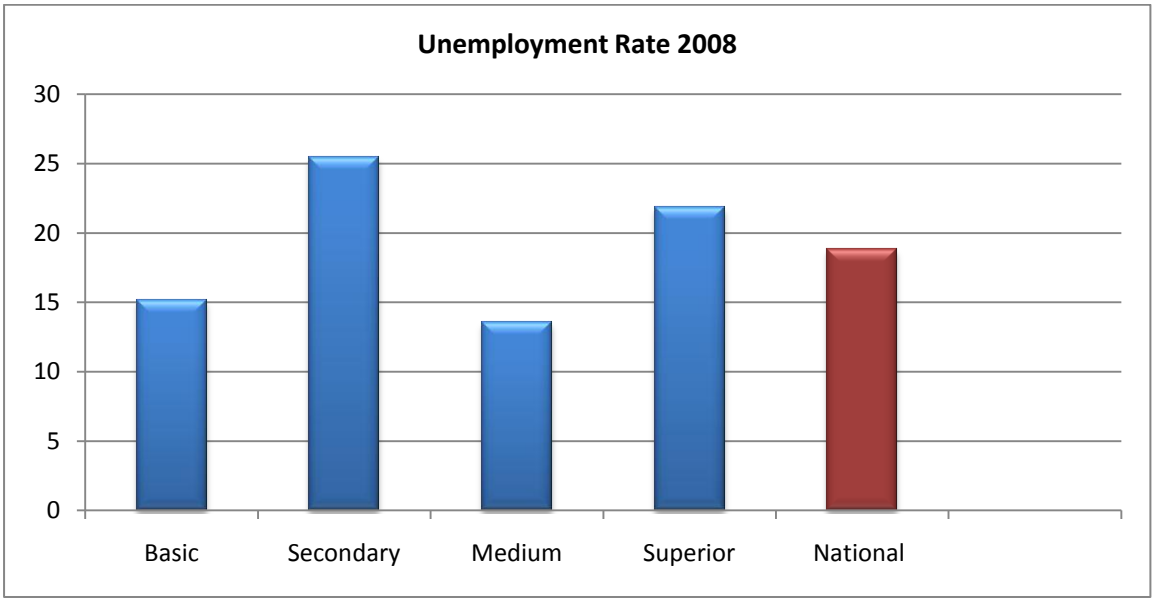
[30] A more efficient calculation method could be used to derive the exact percentage, see Robert Halvorsen and Raymond Palmquist (1981), American Economic Review, 70 (3), pp 474-475.

[31] Although there is a good insight about the differences between the levels of education, i.e., between those that are not the comparator group, when we use the differences between the coefficients of dummy variables, we cannot prove if the differences are statistically significant. To get these statistically significance others regressions is needed, see Wooldridge (2000).

5.2.2 Distribution of Unemployment by Educational Levels

Another indicator of whether human capital is a critical constraint is to examine unemployment rates across different levels of education. If there is a skills premium in the economy, suggesting shortage of critical skills, we should see very low unemployment rates among individuals with higher degrees. However, the data from the National Statistical Institute (INE) show high, double-digit levels of unemployment among university graduates, a shocking figure of 22 percent in 2008, up from 13 percent in 2006 and far above the national unemployment rate of 18.8 percent (Figures 5.9; & 5.10).[32] The unemployment rate for holders of higher education degrees is lower than the rate for high school graduates (25.4%), but higher than that for individuals with post-secondary training (13.5%) or "curso médio." More still, while the overall unemployment rate has been declining since 2006, the rate has been increasing among tertiary degree holders. Data presently available does not discriminate levels of education among the more active and mobile population strata, 15 to 35 years old, to assess if there is a skills shortage only in this group. The data does not allow us to tease out whether the unemployment rate is higher or lower for holders of higher education than the group average. It is worth pointing out that the overall unemployment rate for the 15-24 age group is very high (31%).[33]

Figure 5.9

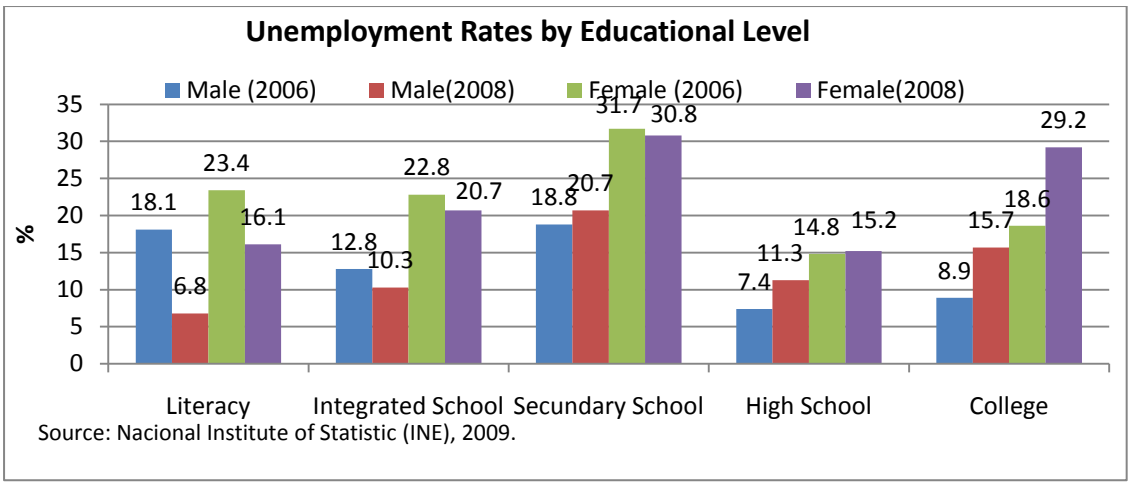


Data Source: INE

[32] A caveat, however, is that the formula for calculating unemployment was recently changed in 2010 in line with international practice. The old methodology sued until 2009 does not focus on those looking for job alone but based on asking whether or not a person is working. The fact is those that are not looking for work, or those that might be underemployed or self employed are typically counted as unemployed with the old methodology.

[33] INE, 2008.

Figure 5.10



Source: Nacional Institute of Statistic (INE), 2009.

Does the data give us a true picture of returns to education in Cape Verde, or does it suggest peculiarities in the labor market, or structural transitions in the economy? Does it provide us a useful guide for where Cape Verde wants to go in the future and the critical skills it will need to get there and sustain it position in the new global economy? How best to interpret this data? A static analysis argues against a conclusion that human capital is a binding constraint. The question of human capital in Cape Verde forces us to widen our lens beyond a static analysis.

Time does not permit a more fine-tuned analysis into the unemployment data according to levels of education. We suspect that a disjunction, or mismatch, may be occurring between market needs and available employment opportunities, on the one hand, and available skilled labor. First, it is worth repeating the peculiar recent growth pattern of Cape Verde, which has been of high-speed growth but with sustained high rates of unemployment. Second, the type of tertiary training and skills that young Cape Verde are getting may not be relevant to current, rapidly changing market needs. Universities still do not have career information and job placement services, and the general direction of employment only provides partial information on current and projected job market trends. Cape Verde may be producing too many graduates in social sciences when the market today may, for example, require more civil engineers and financial analysts. The unemployment rates provide a reasonable hint regarding this fit between market needs and skills relevance. Note the much lower unemployment rate for post-secondary vocational-technical training ("medium"), which are usually three to eighteen months specialized occupational training programs. Third, another likely trend in the Cape Verde labor market may be that tertiary education holders over-qualify for bulk of the jobs being produced by the services-based economy at this stage, such a lower paying, lower skills jobs in the tourism and construction sectors.

5.2.3 Human Capital as a Constraint

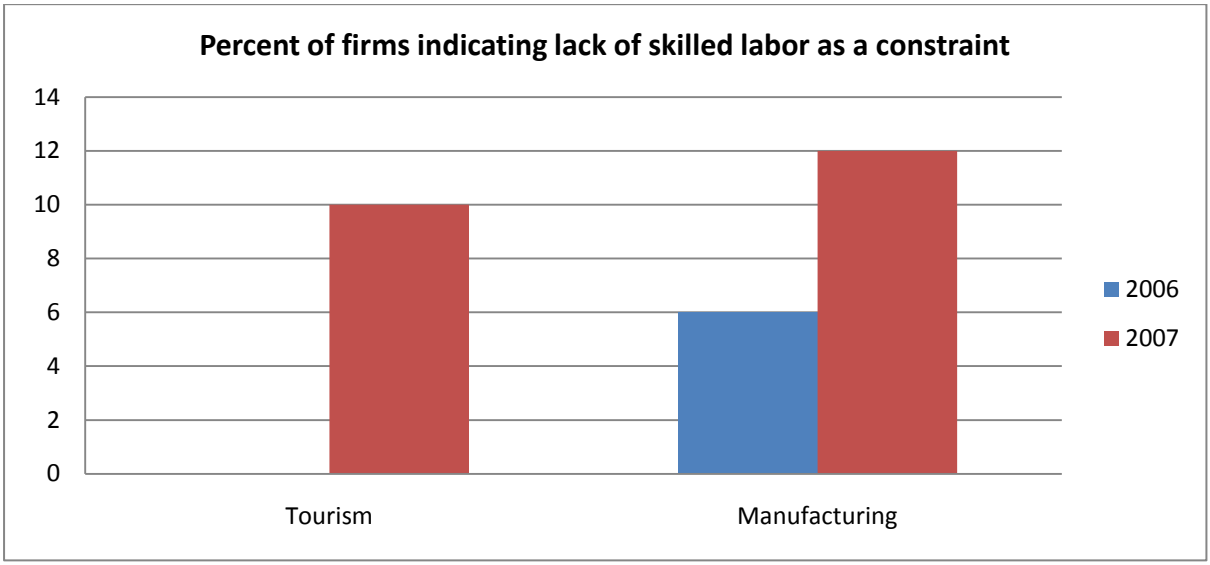
Cape Verde today enjoys a relatively high level of basic human capital when compared to countries in the region, and it does well in relation to the comparators. The reality though is that the human capacity available today could potentially become the key challenge in the near future. Therefore, despite the educational achievement, human capital continues to require a major attention if Cape Verde is to be able to realize sustained high economic growth and its agenda for socioeconomic

transformation.[34] The problem of human capital as a constraint in Cape Verde can be summed up as follows.

5.2.3.1 Shortage of Specialized Skilled Labor

First, there is presently a scarcity of specialized skilled labor. A glance at any random construction site in Cape Verde quickly reveals the makeup of the workforce (migrants from continental West Africa). Some of this is clearly driven by cheap-wage preferences of employers. However, discussions with some business owners affirm their needs for specialized skilled labor which they can only find abroad. This was the case at the national consultative forum and the focus group meeting with the private sector, both organized as part of this constraints analysis. In the INE surveys of 2006 and 2007, 10 percent of firms in the tourism sector identified the lack of skilled labor as a problem as opposed to zero percent in 2006. [35] For the manufacturing sector, the percentage of firms identifying lack of skilled labor as a problem rose from 6 percent to 12 percent between 2006 and 2007 (Figure 5.11).

Figure 5.11



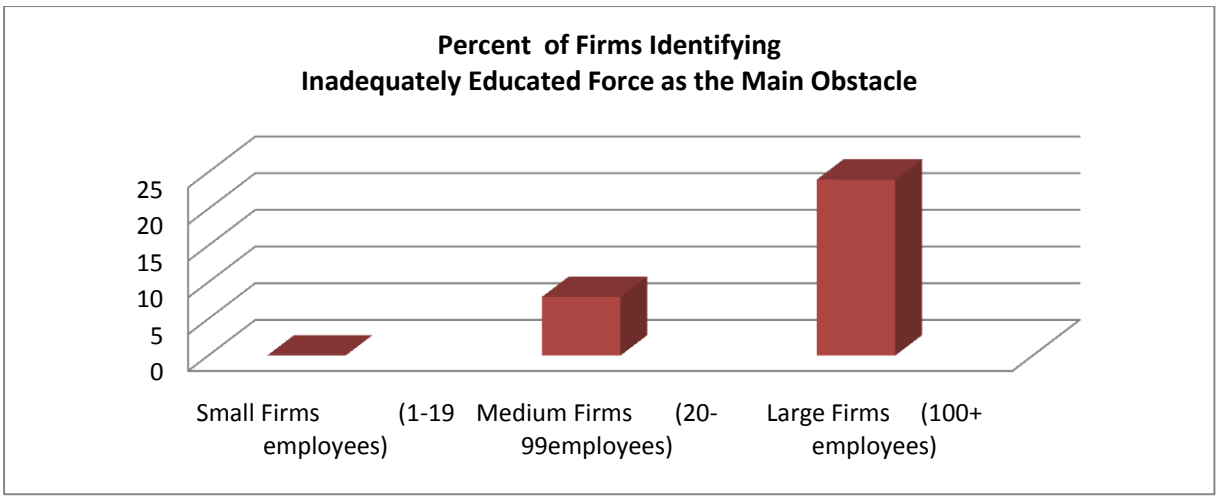
Data Source: INE

The picture changes however when one takes a look at disaggregated data from World Bank's enterprise survey. The survey suggests inadequately educated workforce is not the main obstacle for small firms with 1 to 19 employees. However, it is for medium size and large size firms. Essentially, the larger the firm size the more likely that inadequately educated workforce is the main obstacle. Specifically, about 25 percent of large firms and 8 percent of medium size firms identified inadequately educated workforce as the main obstacle (Figure 5.12).

[34] Similar argument was made by Jørgen Carling (2008), *Policy Challenges Facing Cape Verde in the Areas of Migration and Diaspora Contributions to Development,* International Peace Research Institute, Oslo (PRIO) April 2008.

[35] INE. Inquérito de conjuntura

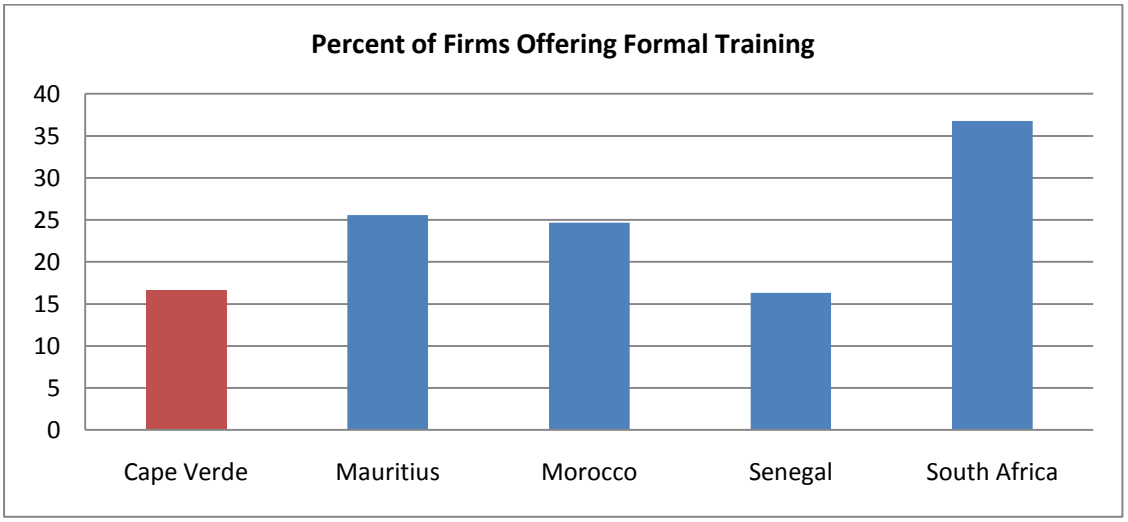
Figure 5.12



Source: Enterprise Survey

Firms are expected to put in place workforce training if inadequately educated workforce is a constraint. Enterprise Survey on Cape Verde, however, reports a much lower percentage of firms (16.6) providing formal employee training compared to South Africa, Mauritius and Morocco. Only in Senegal, among the comparators, that a lower percentage of firms offer formal training than in Cape Verde (Figure 5.13). Will the percentage of firms offering formal training not be higher if human capital is a binding constraint?

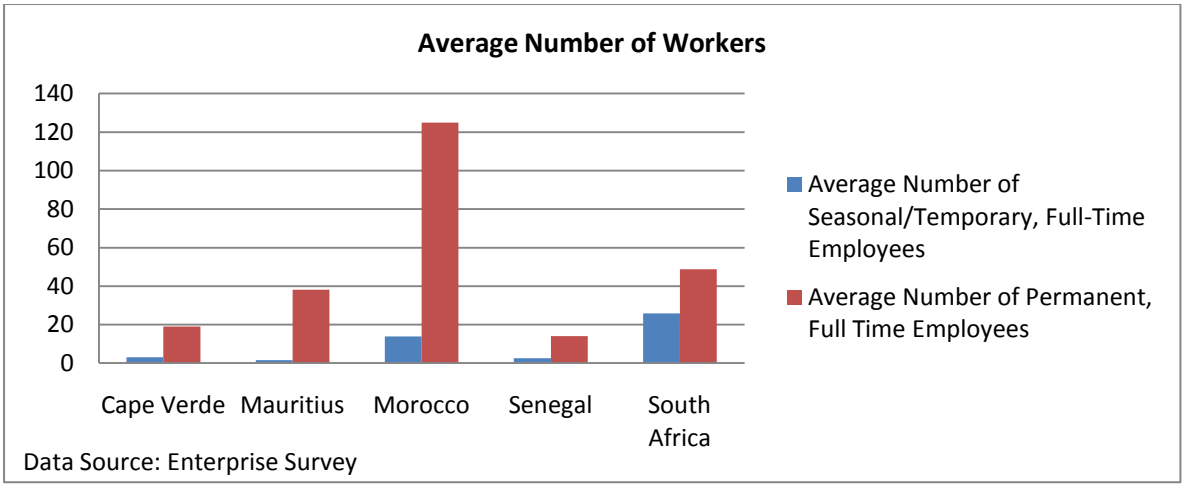
Figure 5.13



Data Source: Enterprise Survey

However, caution is warranted on the data on formal training by firms. Firms in Cape Verde are typically smaller and may not have the resources to offer formal training. Firms in the country also typically hire a much lower percentage of full time workers (Figure 5.14). Rigid labor laws create disincentives for full time, long term hires, making it difficult to gauge the true skills premium and distribution of unemployment. Observational evidence from the large commercial banks shows an organized and continuous in-house training program for new employees. Similar evidence from the major construction firms revealed a human resources training program, even if without the in-house capacity to offer such training.

Figure 5.14



The shortage of specialized skilled labor will increase exponentially as key sectors such as tourism-related sectors expand, and as new sectors (such as renewable energy, and financial services) promoted by the government's Agenda for Transformation emerge. The type, quality, and level of education and training do not correspond to the real needs of the market nor the new direction of the economy and governance as defined in the Agenda for Transformation. There is no pool of available specialized skilled labor for the emerging sectors (renewable energy, banking and finance, business process outsourcing, information technology, real estate), and nor is there a national plan in place to address this problem. Workforce and technical-occupational training must be revamped and oriented based on a clear national strategy, selective sector-based approach, and long term needs. For a country increasingly vested in tourism, language training needs to be made a priority. English and French have been reintroduced as required languages in primary and secondary education, but there is no language requirement for university graduation. Moreover, the common practice remains to subject students to both languages, calling into question their ability to learn any effectively.

5.2.3.2 Mismatch in Skilled Labor Supply and Market Needs

Second, the limited data we have suggests, there is a mismatch between skills available and the needs of the market. The combination of fragmented geography, a growing, internationally-oriented services sector requiring specialized and language skills, and transactions costs stemming from the absence of any kind of information clearinghouse for employers and potential employees, means that the labor market in Cape Verde does not function efficiently. University education is new in Cape Verde, and the universities are yet to build the necessary capabilities to offer good technical and engineering programs. The result is over supply of graduates in liberal arts when the economy requires technicians, engineers and scientists.

5.2.3.3 Managerial Skills

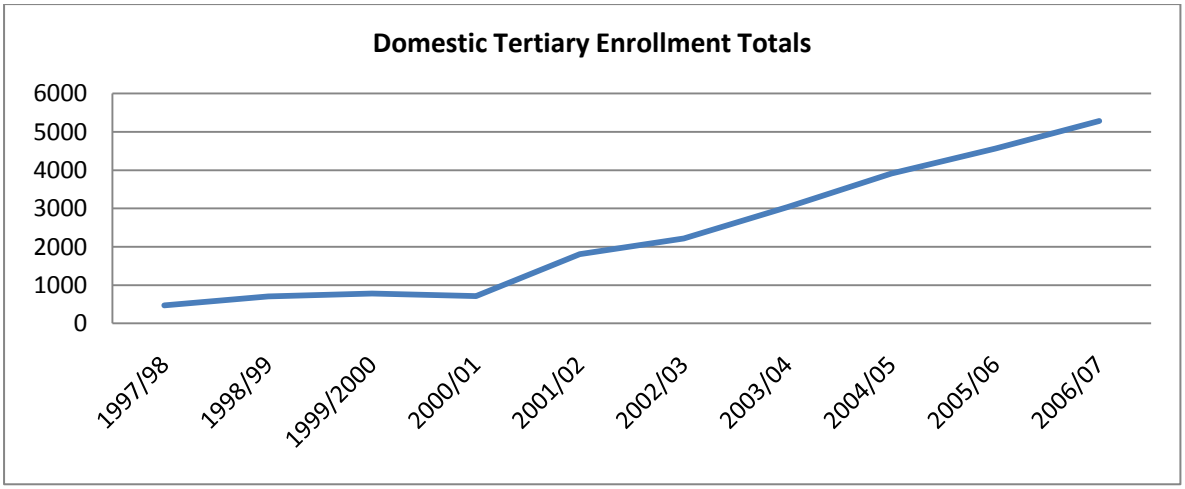
Third, sustained private sector development, plus the pressures for internationally competitive business models, requires a qualitative advance in managerial capacity of the national business class, including middle-level administrators and project managers. The available supply of people with tertiary education remains small, even more so if we disaggregate holders of tertiary education into

fields relevant for the growth areas of the economy and the needs of public sector modernization. In general, in both the private sector and public administration, there is a noticeable shortage of qualified middle-level cadre. For example, certified individuals in core areas such as project management are non-existent in the country. There is a dearth of department heads, planners, and program directors in public administration with degree training suitable to their functions. Policy formulation, planning, and evaluation, at national and local levels, occur without individuals trained in a university program on policy analysis. A major push is underway, led by the Ministry of Finance, to establish a technical unit on monitoring, evaluation, and policy impact analysis, but the country does not have a readily available pool of individuals trained in these specialized skills. The newly established School of Business and Governance, the key public institution expected to supply such trained cadre, does not have (as of this writing) a single professor with a masters or doctorate degree in public administration or policy analysis.

5.2.3.4 Supply of Tertiary Education Skills

Fourth, there is an under-supply of individuals with tertiary education. A 2008 survey by INE reports that only 4 percent of the active population possessed a post-secondary degree. It is suggested that there are not more than two dozen doctoral degree holders in Cape Verde. The supply of higher education in Cape Verde is both new and fragile, confronted with both serious quality issues and infrastructure weaknesses. Internal rate of return on education data from the OECD countries show clearly the economic (earnings, productivity, tax revenues, innovation) and non-economic (voting and civic action, volunteerism, health, less crime, and social externalities) advantage of higher education. Based on decades of data from human capital theory, there is no reason to expect that these advantages to higher education do not hold true also for a country like Cape Verde. The main concerns for a small island country are to plan well, create incentives to privilege certain areas of study according to market trends, guarantee international quality standards, and to avoid over-supply. The demand for higher education has experienced a sharp increase in the last decade. The demographic composition of the population, together with the immediate numbers of secondary enrollment, points to greater pressures on supply of tertiary education or occupational and professional training alternatives (Figure 5.15).

Figure 5.15



Data Source: INE

The higher order managerial and leadership skills mentioned above can only be provided by a quality higher education system. A knowledge-based economy requires a different level and mix of skills. More importantly, quality tertiary education must be an essential component of a bold strategy to establish a national innovation system that nurtures scientific research, technological absorption and innovation, R&D, and strategic policy management and planning. To implement successfully its Agenda for Transformation, Cape Verde will need entrepreneurial and innovation skills, and thus the necessary quality institutions that nurture and produce these skills.

5.2.3.5 Quality of Higher Education

Quantity of higher education is not the main problem in Cape Verde. As of December 2009, there were nine university-degree granting institutions in the country, one is public and the rest are private. For the first time in 2009, the number of students attending higher education in Cape Verde exceeded those going out for studies. The problem of tertiary education in Cape Verde is quality. As such, tertiary gross enrollment or graduation rates may be a misleading measure. Related is a problem of relevance and demand-driven programs of study. Cape Verde does not yet have a national system of higher education accreditation and quality assurance. Private tertiary institutions appear seemingly overnight without first passing through an established licensing and accreditation process. An effective oversight system does not exist. Under consideration currently is a package of laws that will provide a legal framework for university education in Cape Verde. Schools have yet to establish an externally-validated and audited quality assurance system. Internal evaluations, including student evaluation of teaching, are novel and infrequent practices.

5.2.3.6 Physical and Technology Infrastructure

A related component in the problem of quality in tertiary education is infrastructure, primarily as it relates to library resources, laboratories, equipment, and e-learning infrastructure. It is common for universities in developing countries, especially in the Africa region, to have severe deficiencies in physical, scientific and technology infrastructure. Universities in Cape Verde have varying needs in physical infrastructure. All the universities appear to face a common problem – limited or rudimentary laboratory infrastructure. Students in the natural sciences, civil engineering, accounting, information technology and media arts are going through their studies without the applied learning in laboratory.

5.2.4 Human Capital Summary

In summary, an examination of the available data does not conclusively indicate that human capital is a binding constraint for Cape Verde. But we can conclude that it is human capital is a constraint.

The Mincerian regression does show that there is an education premium. However, the data is dated and obtained from a survey undertaken in 2000/2001. Unemployment data does not show distortion in favor of those who are highly educated. In fact, unemployment rate is higher for the most educated cohort of the labor force than the national average. But there is a problem in the middle, the vocational and professional skills. Unemployment data indicates this might be a constraint as the rate of unemployment for this cohort is less than the national average.

Another source of evidence is the private sector. There is a high percentage of mid and large size firms indicating that inadequately educated workforce as the major obstacle. Furthermore, despite the fact that Cape Verdean firms tend to be relatively smaller and have limited number of staff, about 16 percent report having formal training programs for their employees. The situation however differs when looking at disaggregated data and the focus is on large firms (100 employees or more); with about a quarter indicating that inadequately educated workforce is the main obstacle. Also during the consultations undertaken for this constraints analysis the mismatch of skills and the inadequate skills were among the key constraints highlighted by the private sector.

Additionally, Cape Verde is in a unique situation and is faced with challenging circumstances. Its economy is narrow. It is highly vulnerable and dependent on external flows. Importantly, as a recent graduate from the list of LDCs, Cape Verde is expected to begin wining itself from aid, diversify its economic base, and create the internal capacity to be internationally competitive.

It is in response to these challenges that Cape Verde formulated a strategy to become an international platform for high value services. Success however will require specialized skills and human capital. Cape Verde will not be competing only with its neighbors in West Africa. It will have to compete build an entrepreneurial economy and compete with the best in the world. Given the results of the Mincer regression, the employment bias of those with vocational education, the survey result indicating that inadequately educated workforce is the main obstacle for 25 percent of the big firms, and the rising figures of firms in the tourism and construction sectors also pointing to inadequate education and skills as obstacles, human capital has become a constraint. And, it is poised to becoming a binding constraint to the effort to qualitatively move Cape Verde from where it is now to where it needs to be in the longer term.

5.3 Is it Infrastructure?

In this section, we examine the question of infrastructure to see if it is a binding constraint. We focus on energy, transportation, and telecommunications. Efficient, sufficient, and quality infrastructure is a key ingredient for growth and competitiveness. Good quality and generally available infrastructure is associated with high GDP. Over the last decade, the government of Cape Verde has invested huge sums of money in infrastructure development. A key example is the first MCA compact which is mostly devoted to infrastructure: ports and rural roads. Also, the countercyclical program embarked upon by the government in response to the global economic crisis was a major increase in the investment budget and the share devoted to infrastructure. Building and upgrading the infrastructure is a necessary element and a key ingredient for Cape Verde's economic transformation and societal modernization agenda.

The question whether infrastructure is a critical constraint to growth in Cape Verde merits a discriminating analysis because real progress has been made. Cape Verde has benefitted from a boon in basic infrastructure – new roadways, extensive paving of existing networks, new international airports, seaport expansion, reinforcement of energy production capacity, and a relatively modern telecommunications network. Most, however, have already surpassed their capacity because of rapid growth in demand.

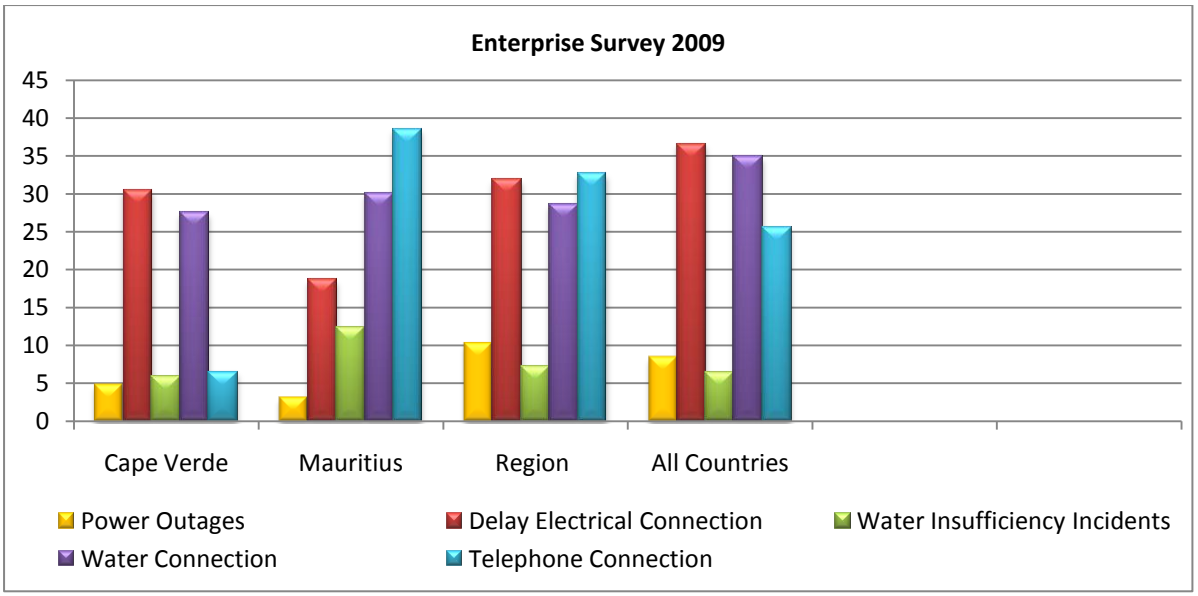
For a small developing country, Cape Verde's infrastructure is respectable. Even in the energy sector, it is not a horror story. However, for a country with sustained high-growth aims and an ambitious transformation agenda to bring it to the next level of development, much more and better is required. A summary assessment of the question of infrastructure may be simply that it is inadequate for the country's current and projected growth trends, unevenly distributed among the islands, and it is an overall infrastructure that suffers from poor quality and high cost. We judge specific segments of infrastructure, such as transportation and energy, as critical constraints to growth.

5.3.1 Infrastructure Quality and Reliability

There are several international comparative rankings on overall infrastructure quality, such as the World Economic Forum's *Global Competitiveness Report*, but Cape Verde is usually not one of the countries surveyed. Reliable and internationally comparable surveys on the quality of various infrastructure components in Cape Verde do not exist. A partial picture is presented in the World Bank's Enterprise Survey (Figure 5.16).

Cape Verde's infrastructure performance on the World Bank's Enterprise Survey is average. On some items, it compares favorably next to the star of the small island economies, Mauritius. Indeed, in terms of number of incidents of water insufficiency and days of delay for mainland telephone connection, Cape Verde scores very well across the board, and bests Mauritius. These figures always have to be treated with more care, however. For instance, the water insufficiency indicator may in fact look impressive, but it hides the fact that a significant portion of the population remain without access to clean water (44%) and sanitation (57%), or the fact that nearly every residence and business enterprise take on the additional expense of buying and maintaining water reservoir tanks.

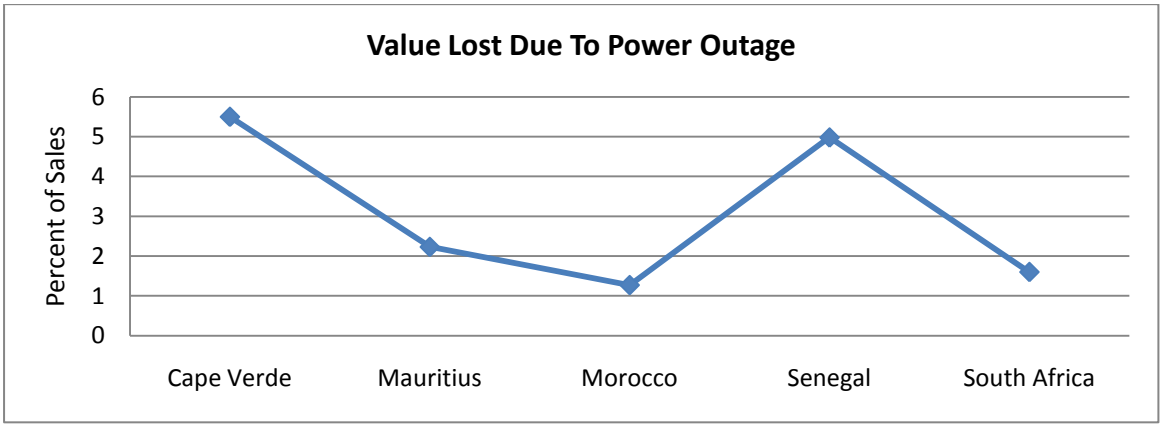
Figure 5.16



Notwithstanding, Cape Verde is prone to much fewer power outages per month (4.87) than the rest of the region (10.30) and all countries (8.48), but slightly higher than Mauritius. Though Cape Verde

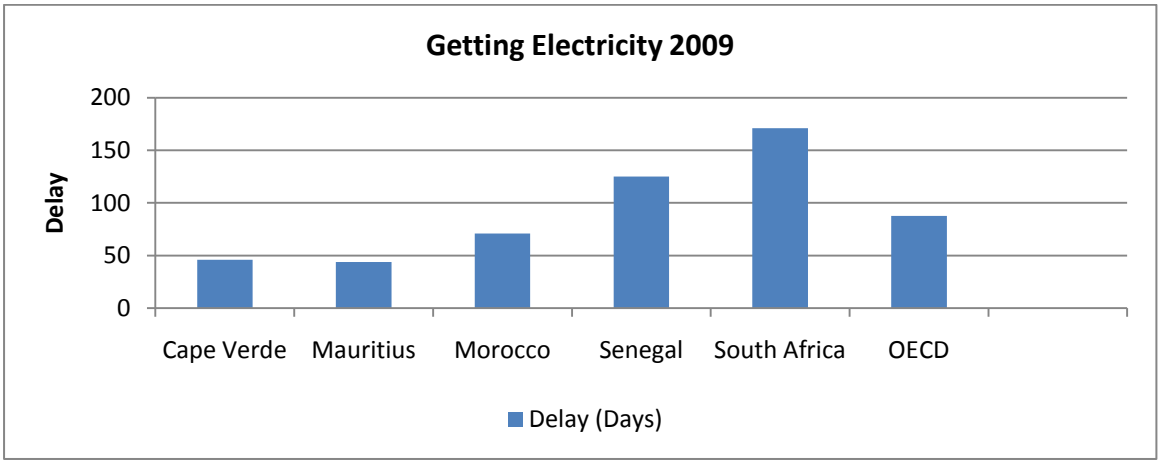
scores well relatively, these power outages still translate into lost productivity and damaged goods and equipment. Indeed, it ranks poorly in the Survey in the category of value lost due to outages, far higher than the world average and those of the comparator countries. In the companion survey on Getting Electricity, Cape Verde performs well. Cape Verde does better than the average of the OECD countries and all comparator countries except for Mauritius on delay in days for getting electricity (Figures 5.17 & 5.18).

Figure 5.17



Data Source: Enterprise Survey
Note: 2009 data for Cape Verde & Mauritius; all others 2007

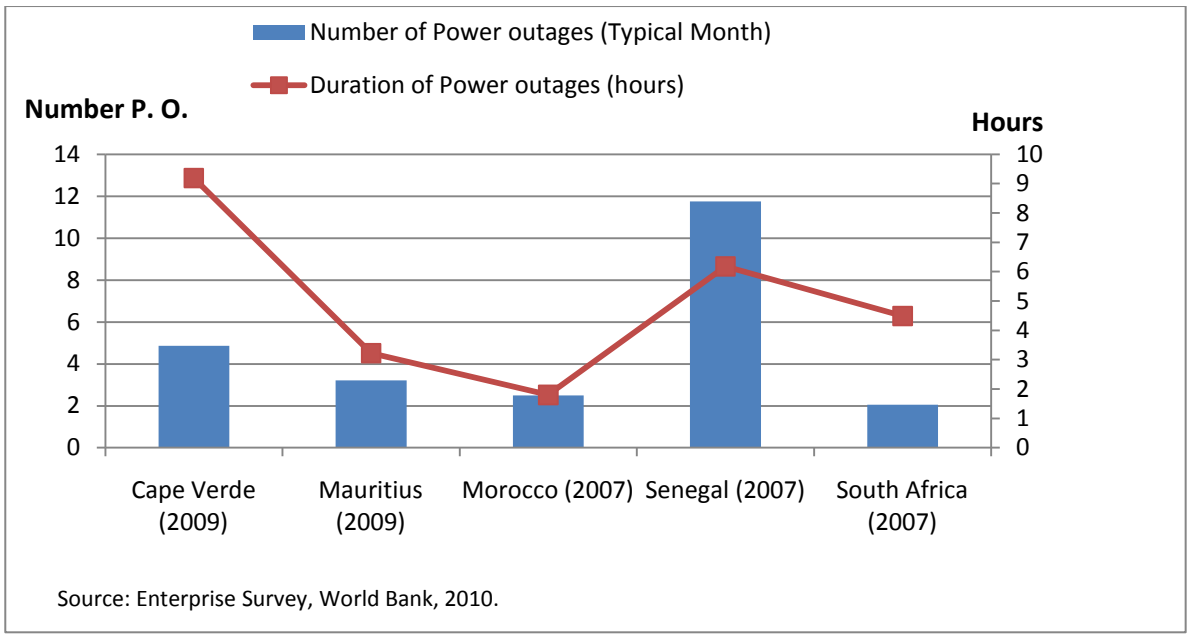
Figure 5.18



On the quality and reliability of energy infrastructure, Cape Verde is outperformed by all the other comparators except Senegal. Nevertheless, with respect to electricity outages, the comparative data indicates that power outage is not a chronic problem. It is estimated that the average number of monthly power outages in developing countries is 18.[36] Cape Verde's monthly average of 4,87 outages per month thus compares favorably. However**,** Cape Verde has a longer duration of power outages relatively to the comparator countries. From the standpoint of an enterprise, this means losses of production and sales (Figure 5.19).

[36] World Bank, *Getting Electricity: A Pilot Indicator Set from the Doing Business Project* (Washington DC: World Bank, 2010).

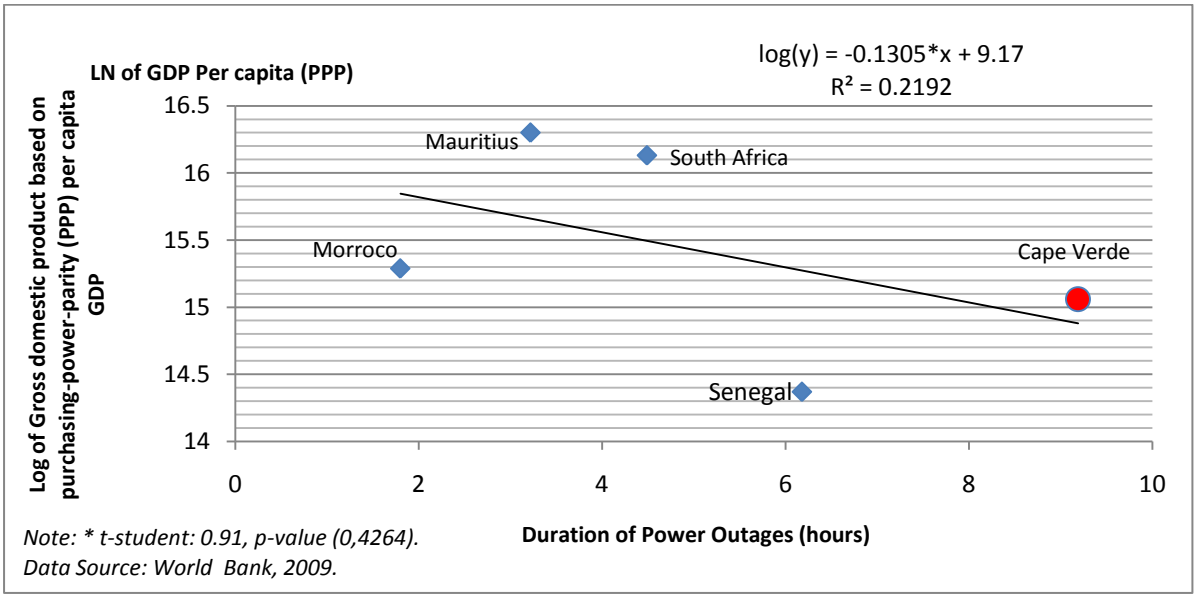
Figure 5.19



Source: Enterprise Survey, World Bank, 2010.

To get a better idea about the implications of the challenges of the energy sector for growth in Cape Verde, we undertook two cross country regressions. The first regression examines the relationship between the log of GDP Per capita (PPP) versus the duration of power outages (hours). The result indicates a negative correlation between duration of power outages and GDP per capita (PPP) (Figure 5.20).

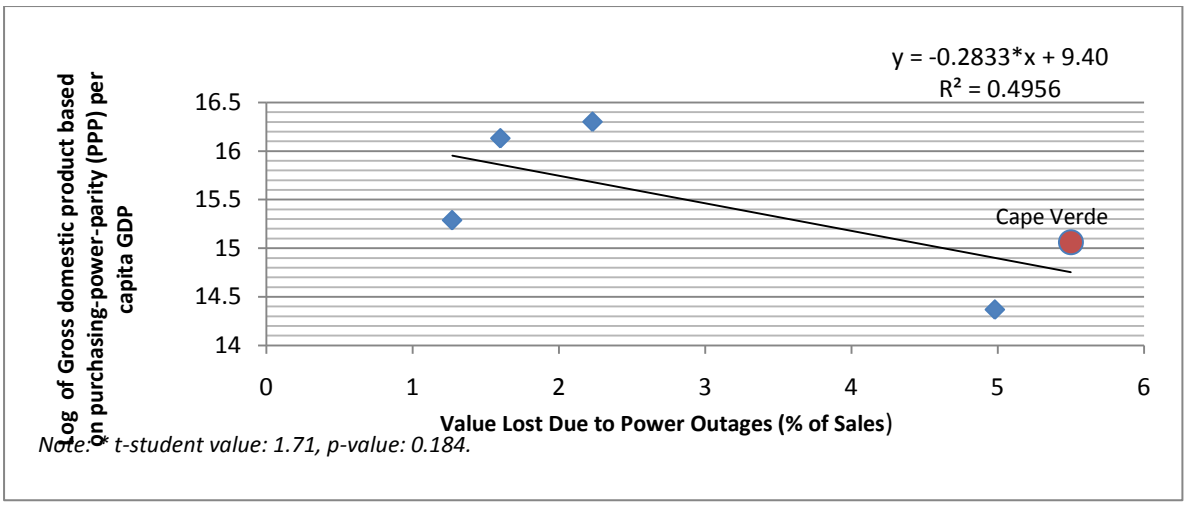
Figure 5.20 **Duration of Power outages (hours) versus Log of PPP GDP Per capita, USD**



*Note: * t-student: 0.91, p-value (0,4264).*
Data Source: World Bank, 2009.

The negative relationship between these two variables shows the inefficiencies in the energy sector as having a negative impact on the GDP Per capita. The weakness in the energy sector is clearer when we analyze Cape Verde's position vis-á-vis the comparators on the related loss due to power outages. The result shows that Cape Verde suffers a bigger loss due to power outages than any of the benchmark countries (Figure 5.21).

Figure 5.21 **Value lost due to Power outages (% Sales) versus Log of PPP GDP Per capita, USD**



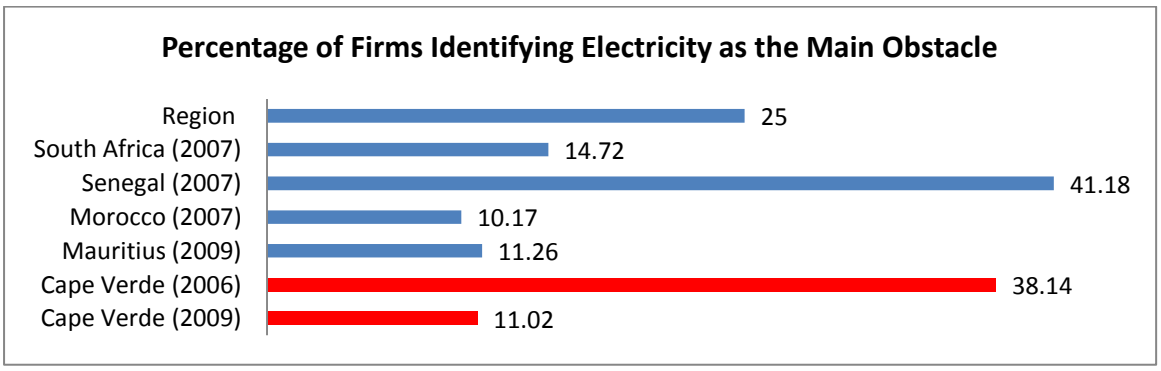
*Note: * t-student value: 1.71, p-value: 0.184.*

5.3.2 Energy Infrastructure - A View from the Private Sector

Energy is the key. A country must get the basics right before it can hope to put in place all the other ingredients for growth. Energy cost and reliability presently constitute a major challenge for the Cape Verdean economy. Electricity was cited by businesses in 2009 as the third biggest constraint among the top ten main obstacles. This is an improvement since 2006 when it was cited as the top constraint in the business environment, but it remains a major problem area. Energy costs are high in Cape Verde, given the high dependency on foreign sources. Cape Verde imports nearly all of its needed energy. The electricity production system is under pressure, given the rapidly growing demand and system fragility. The rapid growth of the tourism sector together with fast expanding urbanization and changing consumer lifestyles daily test the system's ability to meet demand.

However, the energy sector is improving. Since the government renegotiated and regained a majority shareholding in the energy production company, Electra, significant investments have been directed at the sector. Power reliability has improved compared to 2006. In 2009, for example, 11,02 percent of firms identified electricity as the main obstacle, down from 38,14 percent of firms in 2006. This is a significant improvement. This compares favorably with Mauritius and the region, where 11,26 percent and 25 percent of firms, respectively, indicated electricity as the main obstacle. Cape Verde also compares reasonably well with South Africa and Senegal where only the result for 2007 is available (Figure 5.22).

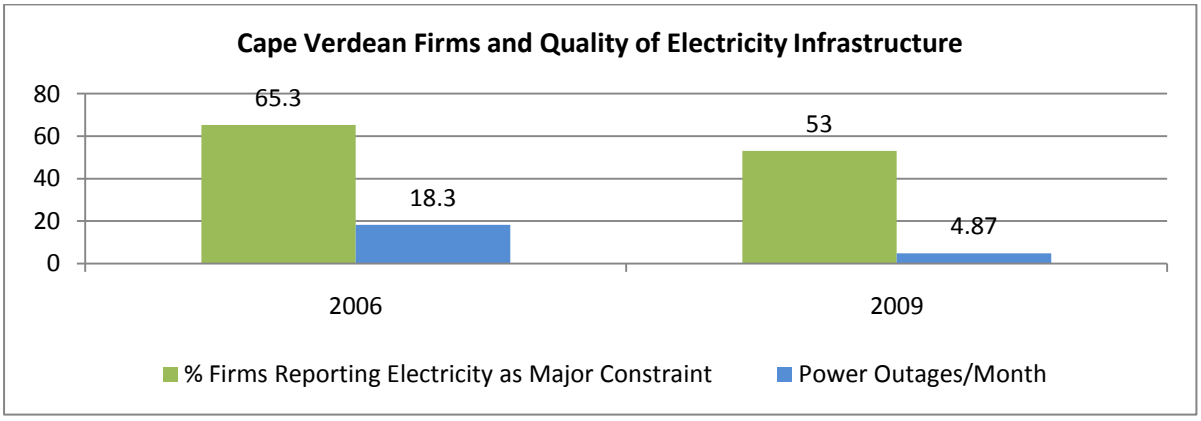
Figure 5.22



Source: Enterprise Survey, World Bank, 2010.

This is not the complete picture. The same Enterprise Survey showed that 53 percent of firms reported electricity as a major constraint in 2009, down from 65,3 percent in 2006. What this shows is that there is a high percentage of firms concerned about electricity, especially costs and power cuts. However, it is in line with the downward trend due to improvements in the sector. The same data also shows a downward trend in the number of monthly power outages from 18,3 in 2006 to 4,87 outages in 2009 (Figure 5.23).

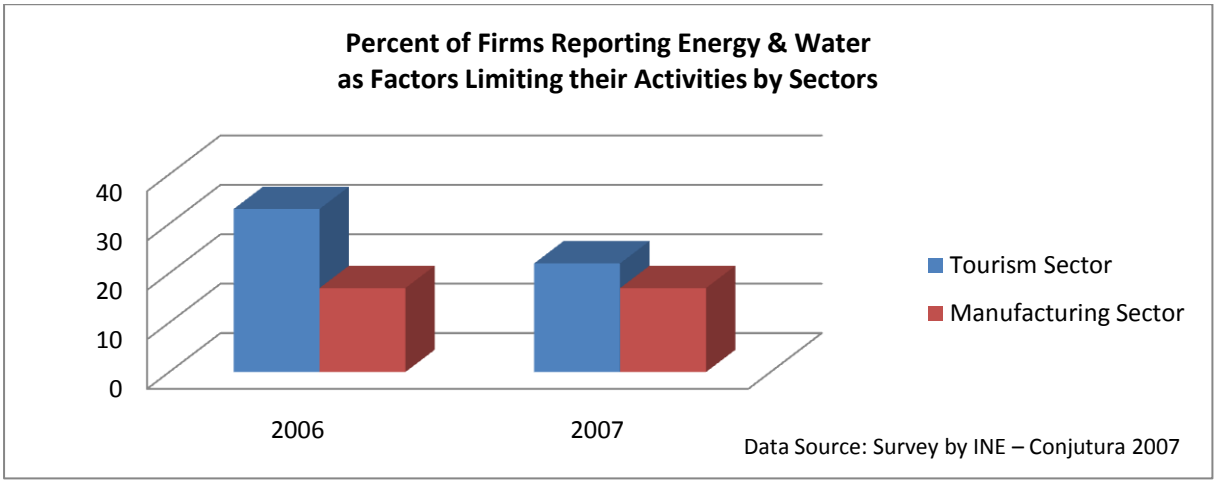
Figure 5.23



Source: Enterprise Survey, World Bank, 2010.

The fact that Cape Verdean firms see energy and water as a major constraint has also been confirmed by INE. Surveys by INE in 2006 and 2007 show that energy and water were cited by the tourism sector and manufacturing firms among top factors limiting their business (Figure 5.24). Such facts are worrisome given the central importance of tourism in the economy and the country's ambition to become a "Cyber Island," establish itself as an international financial services platform, and to attract business outsourcing. Transforming the economy as desired by the government and the Cape Verdean population is impossible without first solving the basic issue of supplying sufficient, cheap, and reliable energy. It makes it difficult to build competitive firms and attract investors. Beyond the implications for the transformation agenda, the energy situation in Cape Verde has several implications.

Figure 5.24



For firms, at over 5 percent of sales, as indicated in the previous section, value lost as a result of power outages is higher for Cape Verde than all the other comparators except for Senegal. Loss of working hours as a result of power outages is also a problem as it affects worker productivity and value added. It is particularly costly because of the long duration of power cuts. In addition to income and productivity loss, firms have to invest a substantial amount of money to produce power for their own use, using generators.

Thus, tourist hotels and resort villages have built-in plants to produce electricity and portable water. In similar vein, generators are now a common fixture in nearly every commercial establishment, big and small, government buildings as well as homes of the wealthy. In the short run, and as a stop-gap solution, these are rational and useful solutions to deal with the inadequacy and unreliability of the energy infrastructure. Yet, these are individually and collectively costly, and present long term challenges to a unified national solution. There is a risk that these individualized solutions, because of the sunk costs the investment represents, may dampen both the incentives and bottom-up pressures to adopt a national solution that redresses both the composition of the energy matrix as well as the question of reliability.

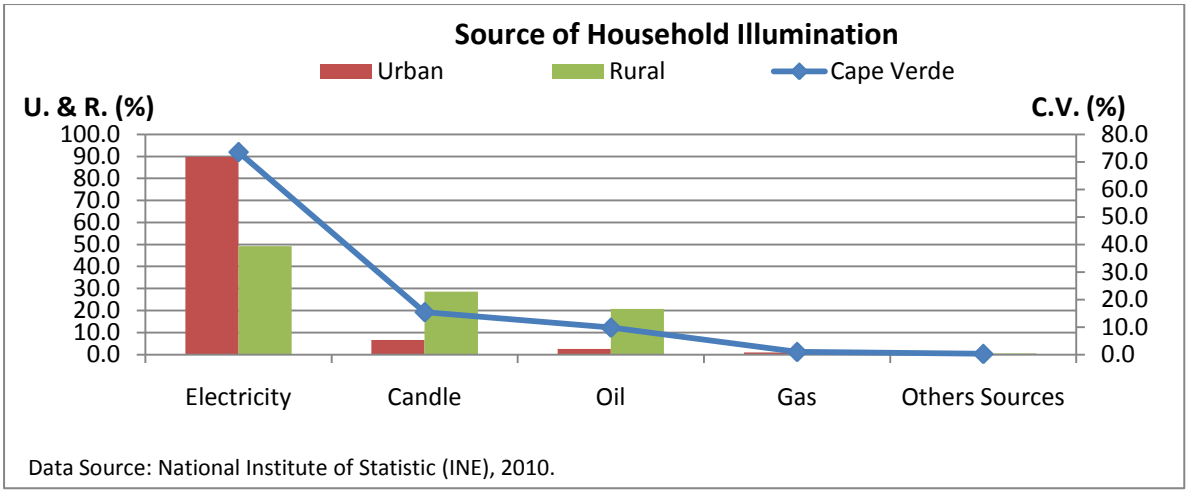
The decentralized, uncoordinated patchwork of individualized energy solutions is costly for the nation. In fact, a key import item in Cape Verde is generators. Running generators is a not cheap alternative to the national grid given the cost of buying petrol/diesel and maintenance. This is not efficient given the sizeable amount of redundancy and lost economies of scale when each firms and individuals have to find their own solutions. The realities for Cape Verde are increased cost of factors, lower profitability and reduced employment.

5.3.3 Energy Availability and Access

We focus here primarily on electricity. In 2009, the main power company, Electra, generated 285.8 MWh of electricity, with 97.9 percent from diesel, 1.9 percent from wind, and 0.2 percent from solar. Electricity production has been growing steadily, about 7 percent annually, in the past five years. In terms of availability and coverage, an estimated 73.6 percent of the population in 2006 has access to the electricity supplied by the Government enterprise Electra (Figure 5.25). According to data supplied by Electra, an estimated 87 percent of the population in 2009 is connected to the grid. This national average, of course, hides a persistent asymmetry among the islands. The islands of Sal, Boa Vista, São Nicolau, and Brava have 100 percent coverage. In contrast, the islands of Fogo, Santiago and Santo Antão have less than 83 percent coverage.[37] Of the remaining population, 15.4 percent uses candle for lighting, and 9.8 percent uses oil as a source. The proportion of the population with access to energy supply has been increasing over the years.

[37] Data from Electra, 2010.

Figure 5.25

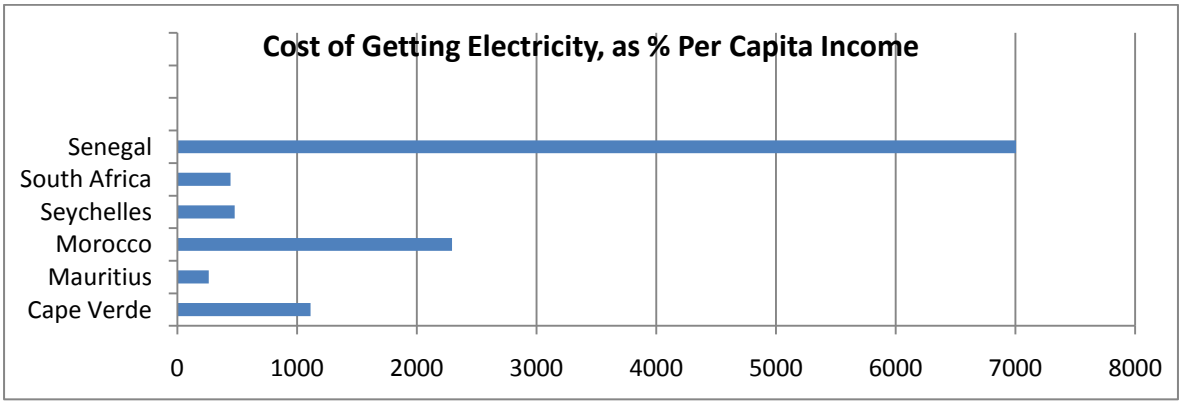


Data Source: National Institute of Statistic (INE), 2010.

Coverage does not equal access. A key bottleneck in this regard is the fact that energy costs are high in Cape Verde. The World Bank estimates the total average cost of electricity in Cape Verde during 2001-2008 to be 23¢ (US cents) per kWh. The US Department of Energy estimates that the kWh cost of electricity in the US is 11.5 cents. The economic regulatory agency of Cape Verde, the Agência da Regulação Económica (ARE), estimates the residential kWh cost of electricity in Cape Verde to be ECV$22.77 escudos, or 27.8 US cents.[38] This is only a shade higher than the average for the ECOWAS group.

Estimates from the *Doing Business* project on the cost of getting electricity, however, show a favorable performance for Cape Verde (1,112 percent of per capita income) relative to the regional averages for Sub-Saharan Africa, Middle East and North Africa, and South Asia, but excessively high compared to the OECD and Latin American countries (Figure 5.26). [39] The cost of getting electricity in Cape Verde is reasonable when compared to neighboring Senegal, a key competitor in the market of hub and offshore services. However, its costs compare poorly with the model island economy of Mauritius that has successfully adopted the strategy of becoming a gateway to Africa, and a technology- and services-driven integration into the world economy.

Figure 5.26

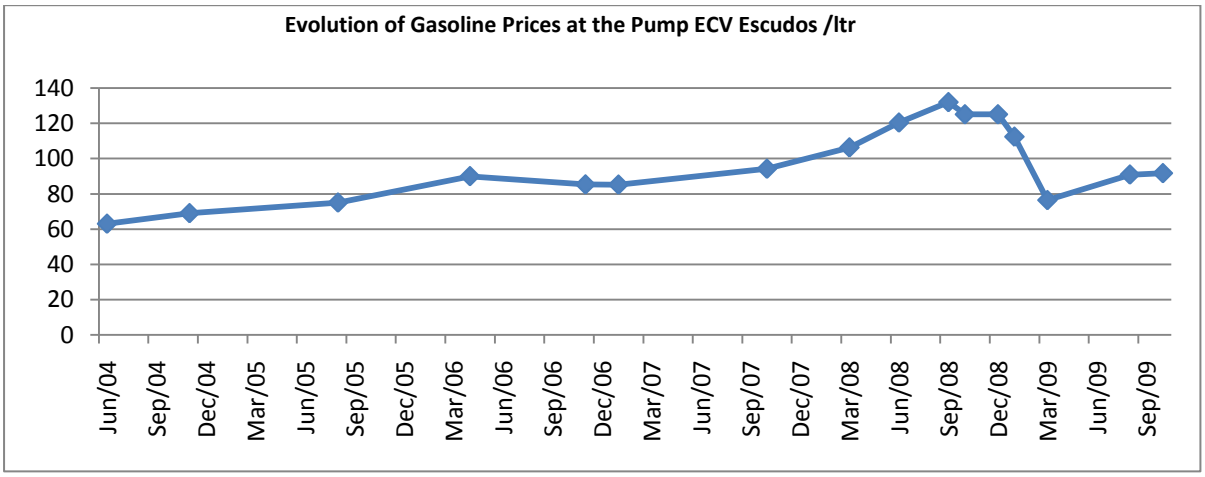


Data Source: Getting Electricity, Doing Business Project

[38] Authors' calculation, based on US Dollar trading at ECV $81.80 on 1 April 2010.
[39] The indicated cost is not only the connection fee but include all the other variable costs for a 3-phase, 4-wire, 140KVA (kilo-volt ampere) connection.

Some of the factors that induce the high costs are obvious. They include imported fossil fuel dependency, duplication and per unit production costs as a result of geographic fragmentation (Figure 5. 27). There is, however, also a hidden cost factor resulting from energy loss. Loss in the system come in two forms: seepage from grid degradation and faulty maintenance and, secondly, from widespread commercial loss (including theft). The World Bank estimates a 17 percent loss rate from generation. In its 2008 Annual Report, Electra reported a loss rate of 26.8 percent, an increase from 2007. The loss rate on the Island of Santiago was 36.5 percent. Grid degradation, old transmission lines, poor maintenance and repair, and equipment problems plague the system, thus leading to loss. Theft is a major problem, primarily in the capital city, where informal urbanization and slum settlements have been expanding rapidly.

Figure 5.27



Source: Agência de Regulação Económica (ARE), 2010.

The weak generation capacity and the high distribution loss are symptomatic of the larger institutional challenges facing the energy sector in Cape Verde and by extension the water and sanitation sectors. The organization of the sector from its combination of various municipal systems continues to be a problem. In many circumstances, the role of the municipal governments that continue to be involved in the provision of utilities services, energy, water and sanitation, are not clear. Managing the sectors is a challenge without a clear cut demarcation of responsibilities and control. Government understands the problem posed and have in the case of power production moved for consolidation and launched a program to produce energy in only one location on each island and from that central location distribute power around the island. Also, the organizational and managerial weakness besetting the principal electricity and water producer in the country, Electra, is a key element of the problem facing the sector. The result has been inability to stem production and sales loss in addition to ensuring adequate system to collect revenue from its clients. Addressing the challenges facing the sector will require dealing also with the managerial and human resources dimension, including regulatory and policy making capacity. One approach so far is sub-concession contracts with firms to produce power in islands such as Boa Vista.

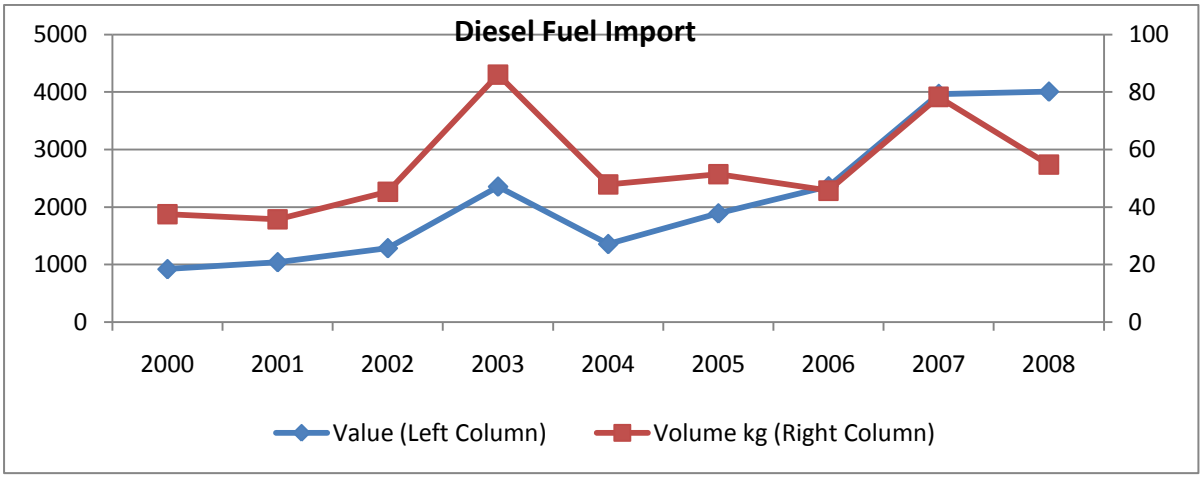
The capacity to manage and regulate the sector is crucial. At this time, weak national capacity to manage and regulate the energy sector remains a challenge. Energy costs and availability, not to mention the degree of the country's external energy dependency, have as much to do with the country's ability to conserve and efficiently use its energy resources. This is a huge and critical area

in Cape Verde, but it remains unchartered. The environmental and economic reasons for action are obvious. For example, in the booming construction sector, there are no regulatory injunctions, municipal codes or industry-based guidelines or practice requiring or promoting energy efficiency in buildings. Similarly, there is no national legislation or regulation to require energy efficiency compliance for household appliances or automobiles, all of which are imported.

5.3.4 Energy Dependency

One of the consequences of the actions and inactions in the energy sector over the years is Cape Verde's dependency on imported fossil fuels (Figure 5.28). This high dependency translates into vulnerability to external price volatility and shocks, as occurred in the summer months of 2008. Diesel fuel constitutes the largest single category of all fuel imports, typically ranking in the top four imports every year. In terms of consumption of the energy produced and distributed to the public grid, some 9 percent was consumed for desalinization purposes in 2008. This allowed Electra to produce 17,080 m^3/day of water, or over 4 million m^3 for the year. Residential consumption of electricity has thus far assumed the largest share, roughly 34 percent in 2005 figures, while industry and agriculture have typically consumed 26 percent of the power generated.

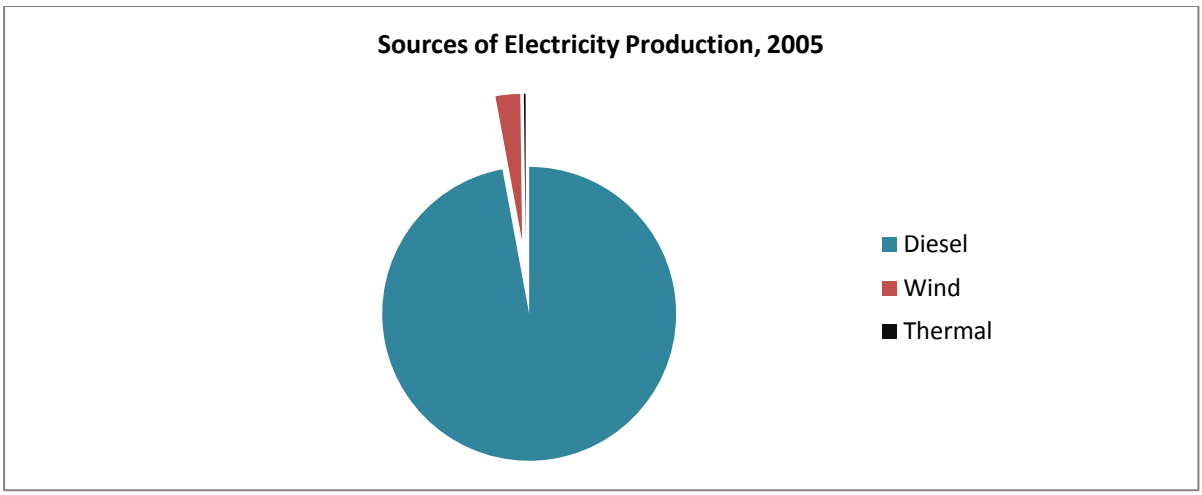
Figure 5.28



Data Source: Cape Verde Customs, 2010.

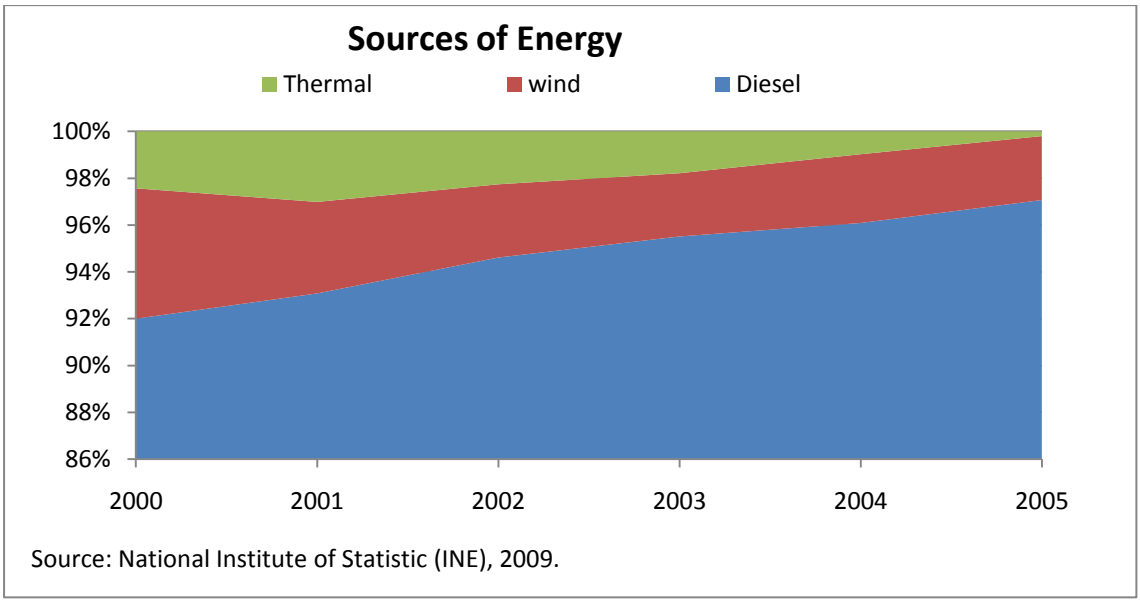
Cape Verde's geographic positioning and climate, all else aside, offer the country an inexhaustible supply of potential energy sources: 365 days of sun and wind, and nearly 600 miles of coastline, and an EEZ of 700,000 sq. km. Dependency on imported fossil fuels is expected to continue into the near future, although some investment projects in renewable are in the pipelines. In terms of electricity production, for example, the present installed capacity of Electra is about 88,258 kW. An estimated 97 percent of total installed capacity for electricity generation relies on diesel fuel which must be imported (Figure 5.29).

Figure 5.29



Fuel imports perennially constitute the largest single import group. Imported fuels power not just cars and businesses, but it is the primary energy source for electricity and water production. In 2008, the country imported over 6.5 billion escudos of fuels (diesel, fuel oil, propane, natural gas, gasoline), compared to 4.3 billion in iron and steel and 2.8 billion in cement, the number one and three individual items respectively (Figure 5.30).

Figure 5.30



Source: National Institute of Statistic (INE), 2009.

The economic implications of this energy dependency are well known, not the least of which is the utter vulnerability to volatile energy prices. Since 2008, the Government has embarked on an ambitious renewable energy plan. At present, renewables constitute a negligible share of the energy matrix. An ongoing wind power project will add about 25 MW to the national grid in 2011. The aim of the government is to ensure that 50 percent of the power supply is from renewable sources by 2020. As such, the country will need to build up the human capital with the technical, engineering, managerial, and policy skills necessary for the sustainable energy sector.

5.3.5 Energy, Water and Sanitation

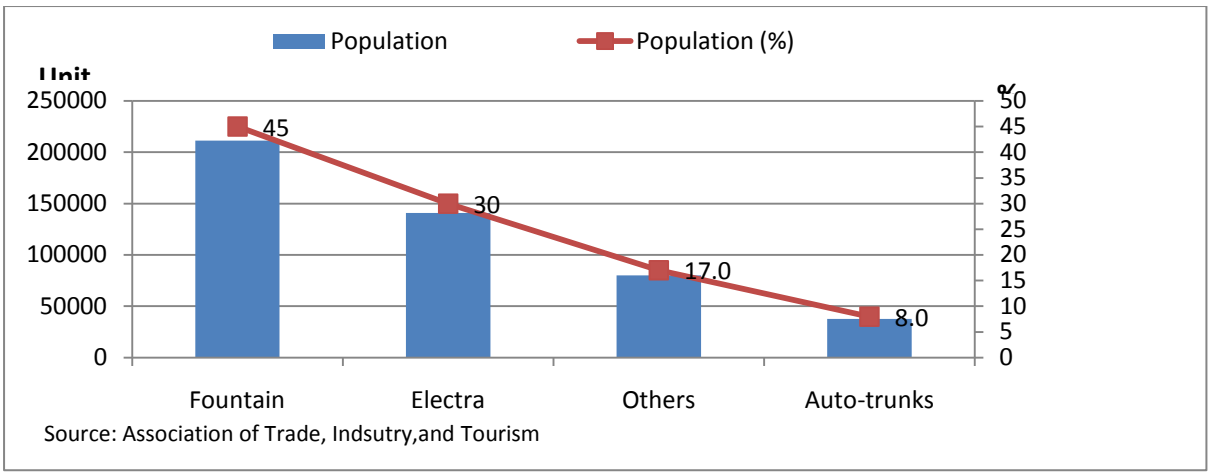
Water and energy are inextricably linked in Cape Verde. Thus, the economics of energy production are about the same as the economics for water production, being that close to 90 percent of usable water in the country is produced through energy-intensive desalinization process. For many, the water challenge in Cape Verde is an energy problem. Water is everywhere as the country is right in the middle of the mid Atlantic. However, what is needed is abundant and cheap energy to transform sea water for household, industrial and agricultural use. This has been a challenge because energy in Cape Verde is characterized by high cost, inadequacy, deficient maintenance, outdated plant and equipment, excessive service delay. Energy and water in terms of availability, reliability and costs, usually tops the list of factors that businesses cite as a constraint on their operation.

This reality is in part due to the nature in which the sector emerged over time. Energy and water production started as a patchwork, with individual municipalities setting up their own power generation and water desalination plants, distribution and management. These were mostly consolidated into one firm, Electra, as part of the privatization efforts in the 1990s. The municipal governments received a share in the newly created company; the central government also retained a share while what remained was sold to a group of Portuguese firms, which retained majority shareholding. But disagreements on pricing, lack of investment and deteriorating power supply led to a series of negotiation in which Electra was finally ceded back to the government. The privatization, the transfer of public monopoly to private monopoly, and weak institutional capacity (including management and regulatory) contributed to the difficulties in the sector.

The link between energy and water in Cape Verde has ensured that these issues also impact on water supply and management. While, for example, Electra has the sole concession to distribute water it does not have the same monopoly on production. Electra only has the production right in the major metropolitan areas. In the other smaller and less populated municipalities, the municipal governments are involved in water production. Altogether, there are also four groups—Águas de Ponta Preta Lda , Aguas do Porto Novo, Serviço Autónomo de Água do Maio, Serviço Autónomo de Água de Santa Cruz—desalinating water in Cape Verde. This, however, does not include the large touristic hotels with their own facilities for producing desalinated water.

The institutional deficiencies and fragmentation in sanitation might actually be worse, with responsibilities and control not clearly delineated, rules and policies not fully implemented, and with many municipalities with their own solution. Control rest in some cases with Electra and in some areas municipal governments are in charge. Although access to portable water and modern sanitation infrastructure is growing, there are major gaps (Figure 5.31).

Figure 5.31 **Sources of Water**



Source: Association of Trade, Indsutry,and Tourism

Data obtained from recent surveys also provide an indication of the sources of water for Cape Verdeans (Table 5.2). According to the new water sector strategy, about 89 percent of the population has access to portable water in various forms. About 43 percent of the households have piped water in their homes. However, there are differences between rural and urban households. Among the urban households almost 60 percent are connected while it is only about 26 percent of households in the rural areas. Other popular sources of water are public pipes, and tanker trucks.

Table 5.2 **Water Supply, 2008**

	Urban	Rural	Total
Piped supplies into the household	59,5	25,7	42,9
Public standpipe	27,9	35,3	31,5
House Water tank	0,5	8,7	4,5
Public water tank	2,0	1,9	1,9
Borehole/protected dug/Furo	0,1	3,3	1,7
Spring		15,6	7,6
Water provided by tanker truck	5,1	6,3	5,7
Levada	0,0	0,8	0,4
Total	**95,1**	**97,6**	**96,4**

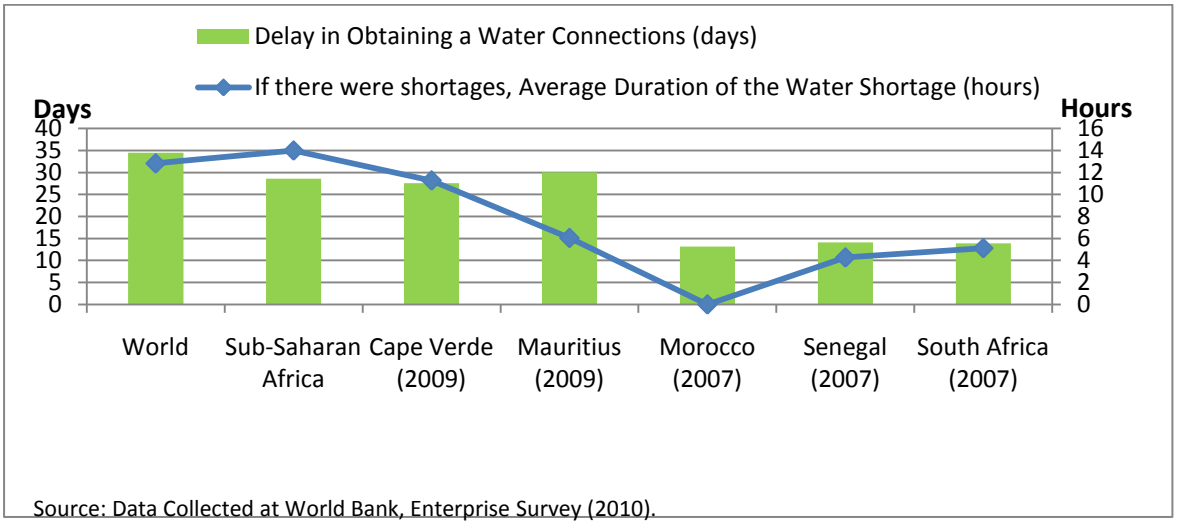
Data Source: Various Surveys[40]

[40] The date for the table were compiled from the following sources:
RGPH - 2000 - Receseamento Geral de População e Habitação de 2000 - Population and Housing National Census 2000
IDRF-2001/2002 - Inquérito as Despesas e Receitas Familiares - 2001/2002 - Household Survey 2001/2002
IDSR -2005 - Inquérito Demográfico de Saúde Reprodutiva 2005 - Demographic and Health Survey 2005
QUIBB - 2006 - Questionário Unificado de Indicadores Básicos de Bem Estar - Core Welfare Indicator Questionnaire - CWIQ 2006
QUIBB - 2007- Questionário Unificado de Indicadores Básicos de Bem Estar - Core Welfare Indicator Questionnaire - CWIQ 2007
Inquérito ao Emprego 2008 - Employement Survey 2008

On the production side, taking Praia as an example, Electra produces only about 7000 cubic meters of water per 24-hour cycle.[41] Yet, the planned capacity for Praia was to have reached 15000 cubic meters about three years ago in 2007. At present, in the capital city where data is more readily available, residents consume on average only about 30 liters of water per day. At the national level, the average daily consumption of portable water for households connected to the water network is around 50 liters per person, and 15 liters per person per day for users of fountains, ranging from 7 to 25 liters (PAGIRE 2010).

A key issue is the gap between demand and production. On average, less than 1000 cubic meters of portable water per capita per year is produced in Cape Verde. The result is chronic shortage of water and rationing. Compared with the comparator countries, Cape Verde performs better than only Mauritius in the delays in obtaining water connections, behind South Africa, Senegal and Morocco. On the average duration of water shortage, Cape Verde significantly underperforms compared to any of the comparators (Figure 5.32). In response, to limited water supply and long frequent outages, residents have learnt to do with little water, acquired storage facilities to store water for later use and when necessary to purchase water from tankers.

Figure 5.32



Source: Data Collected at World Bank, Enterprise Survey (2010).

Linked to the issue of shortage is cost. Households and firms pay high cost for water use. It is difficult to reduce price given that the main source of portable water is desalination. In the first instance the technology used is highly energy intensive and secondly it is almost 100 percent reliant on the use of imported oil. The prices as set by the regulatory agency for different sets of users are presented below (Table 5.3). Among the key conclusions are the high cost of water in Cape Verde and the fact that the poor tend to pay more for water for the first 10 cubic meters consumed. This is because the poor are less likely to be connected to the water network and to purchase their water from auto-tanks which is a more expensive source of water for the first 10 cubic meters.

[41] The information on the water situation in Praia was obtained in a discussion with the CEO of Electra, Mr. Antão Fortes, on 18 May 2010.

Table 5.3

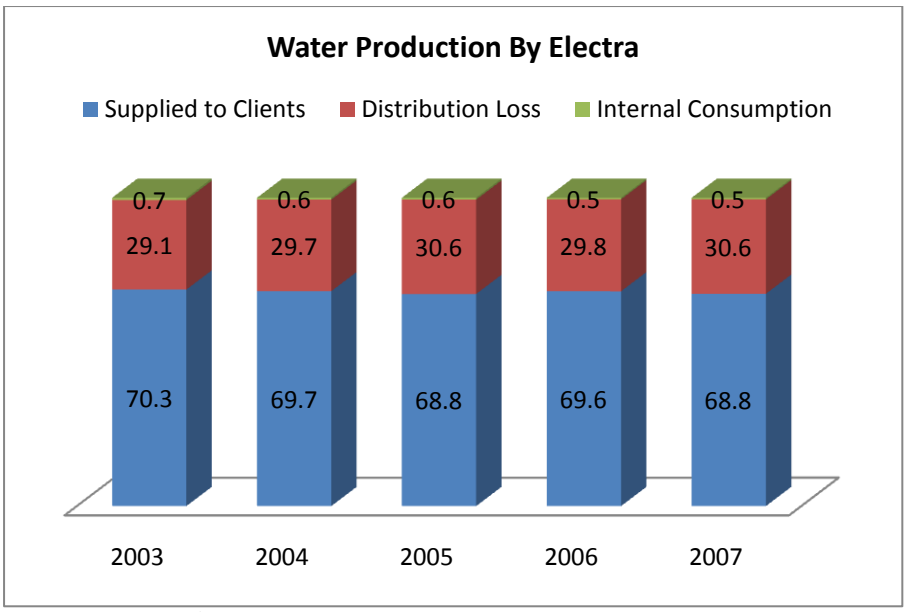
Water Tariffs (Cape Verdean Escudos)			
Users	**Base Tariff (T)**	**VAT (15%x20%T)**	**Tariff with VAT** *Esc/M3*
Domestic			
<= 6 m3	227$25	6$82	234$07
>6 e <= 10 m3	333$51	10$01	343$52
> 10 m3	443$84	13$32	457$15
Industry	390$50	11$71	402$21
Tourism	505$43	15$16	520$59
Social (non profits, hospitals, public fountains, etc)	251$45	7$54	259$00
Commerce and Services Public service, Embassies, Public Enterprises, Maritime and Navigation firms, Warehouse			
<= 20 m3	407$62	12$23	419$84
> 20 m3	475$35	14$26	489$61
Auto-Tanks I Hospitals, Public Fountains, non-profits	253$65	7$61	261$26
Auto-Tanks II Other Uses.	423$51	12$71	436$22

Source: Adapted from PAGIRE Volume I

Water resources supply and management have been a serious challenge at all levels, and not just in terms of supply availability and cost to households. For example, a high percentage of the water produced by Electra is lost due to an aged distribution network. As the chart below indicates, water loss ranged from about 29,1 percent to 30,6 percent between 2003 and 2007 (Figure 5.33). Current information provided by Electra is that loss is currently estimated at about 32 percent at the national level while for the city of Praia, the largest internal market, loss is estimated at about 40 percent.[42]

[42] Ibid, reference # 40.

Figure 5.33



Data Source: ARE[43]

The realities within the water sector are largely due to some key challenges which must be addressed if the sector is to be modernized and improved. The challenges include a limited and aging water production and distribution network, the reliance on old water desalination technologies which are energy intensive and the consequent high costs of water production. Coupled with these challenges are the inadequate institutional environment with its lack of clear roles and duplication, and weak managerial and regulatory capacity. Additionally, the lack of an up-to-date information system on water resources, the weak management and monitoring of both surface and subterraneous water, the inability to guarantee the quality of water all around the nation, and the weak capacity to monitor the necessity and forecast water demand present crucial challenges for the water sector in Cape Verde.

These are the key challenges which the new published water sector strategy aims to address. The proposed strategic agenda of the water sector focuses on the increasing water availability, improving knowledge and management of water resources, creating a favorable institutional environment for implementation of the water strategy, constructing and rehabilitating infrastructure, and improving communication, education and awareness about water (Table 5.4).

[43] Data obtained from ARE's website: http://www.are.cv/Downloads/Agua/Dados%20estatisticos%20-%20Agua.pdf

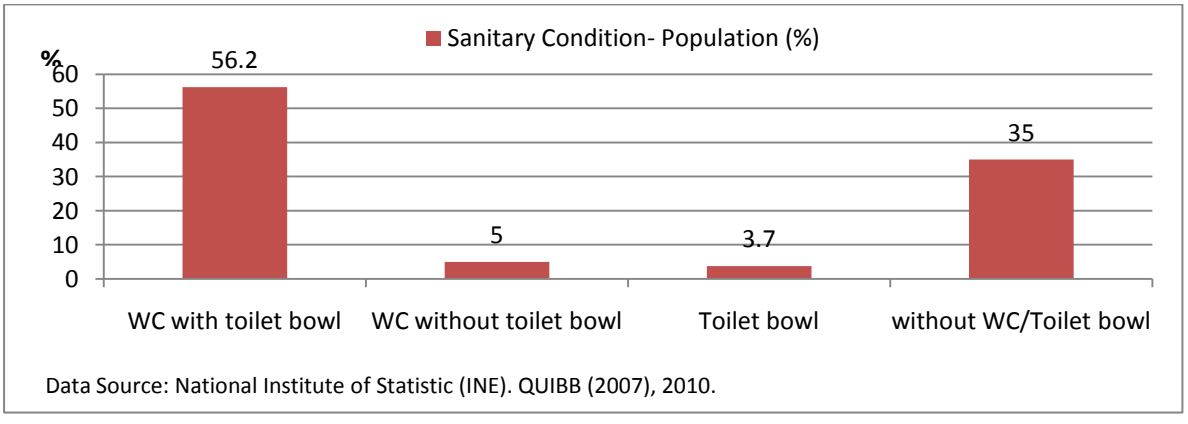
Table 5.4. Strategic Agenda for the Water Sector

Strategic Objectives	Proposed Programs
Increase water availability	Extraction of Surface Water; Ground water recharge; Desalination of sea Water; Reducing consumption.
Improve knowledge and management of water resources	Reinforcement of the water management services; Establishment and operation of an integrated information system on Water; Management of risks related to Water.
Create a favorable institutional environment for implementation of the water strategy	Legal and Institutional reform; Improving the participation of the actors and the civil society.
Construct and rehabilitate infrastructure	Construction and/or rehabilitation of infrastructure supply for Water and sanitation.
Improve communication, education and awareness about water	Promotion of education, communication and awareness related to the water issues.

Source: Adapted from PAGIRE Volume II

As indicated earlier the situation with sanitation is not better. The sanitation infrastructure in Cape Verde is inadequate and undersupplied (Figure 5.34). The World Bank estimates that only 43 percent of the population is covered by a sanitation infrastructure. In 2007, an estimated 35 percent of the population did not have basic sanitary conditions. Of this group, the majority, 53.3 percent, live in rural areas (Table 5.5).

Figure 5.34



Data Source: National Institute of Statistic (INE). QUIBB (2007), 2010.

Table 5.5 **Sanitary Condition by Region**

Sanitary Condition	Cape Verde (%)	Urban (%)	Rural (%)
WC with toilet bowl	56.2	68.3	38.2
WC without toilet bowl	5.0	4.1	6.4
Toilet bowl	3.7	4.8	2.0
without WC/Toilet bowl	35.0	22.7	53.3

Data Source: National Institute of Statistic (INE), QUIBB – 2007, 2010.

Waste water collection and treatment is a problem area. Coverage is low. According to the 2007 Core Welfare Indicator (QUIBB 2007), only about 26,5 percent of the population nationally have septic tanks and 14,3 percent are connected to the sewage system, for a total of 40.8%. In the urban areas, the connection rate is 57,4 percent while it is only 15, 9 percent in rural areas. In Praia, the capital city, only about 18 to 20 percent of the households are connected to the sewage network according to Electra.[44] Waste management is a task for the municipalities. This is carried out directly by local councils through autonomous services or municipal companies except in Praia where responsibility was given to Electra, under a concession contract.

With respect to solid waste, only 62,9 percent of households use an appropriate system for collection according to the result of the most recent QUIBB 2007. Of the 62,9 percent, 47, 7 percent use containers while 15,2 percent dump directly in collection vehicles. The remainders dispose their waste in various forms. 21,5 simply dispose directly in nature; 7,8 percent bury or burn; while 7,5 percent dispose somewhere around the house. The collected waste is disposed off at the final destination without treatment. Sal and the municipality of São Filipe both have new systems for waste treatment which are expected to be operational soon. The system consists of a landfill and an incinerator, respectively. In most cities, waste is deposited in open dumps or controlled landfills. Among the common problems for most of the municipalities are inadequate facilities for collection, accumulation of waste in containers which create poor hygienic conditions, and the lack of human resources with the training and skills for waste management.

The drainage system is also fragile. There are no clear policies and plans for drainage are not articulated within a comprehensive framework for urban planning. The result is that good rainy seasons always lead to floods which cause substantial material and property losses, particularly in Praia, Mindelo, Ribeira Brava and Tarrafal (São Nicolau), Ribeira Grande (Santo Antão), and Santa Maria (Sal Island).

A review of the sanitation sector was recently undertaken as part of the ongoing process to formulate a national policy on sanitation. The policy review process surfaced crucial problems facing the sector. Among these are the inadequate institutional and legal environment, weak human capacity, limited investment and financial sustainability.

The institutional and legal framework is a crucial challenge for the sector. There are simply too many laws and significant areas of overlap in the roles of central and local governments. The sector lacks

[44] From discussion with CEO of Electra, Mr. Antão Fortes, on 18 May 2010.

clearly demarcated responsibilities and duties in the areas of policy development, inter-sectoral coordination, regulation, monitoring and evaluation. Coupled with these is the weak institutional capacity for regulation and management. On several of the Islands with more than one municipality, for example, there is no coordination or collaboration leading to multiplicity of solutions and entities in the sector. The result is wastage of resources and inefficiencies due to duplication. Furthermore, under the Cape Verdean legal code it is compulsory for homes to be connected to the sanitation network in areas where it is available. This rule is, however, not enforced.

The problem is not helped by the weak human capacity in the sector. This relates to management capacity, including management system, compliance with standards and supervision, and poor collection. Another problem is the limited investment. The outcome of limited investment is inadequate infrastructure and inability to satisfy national requirements. Coupled with this is the issue of financial sustainability. Despite having regulations which are in line with user payments principle, compliance is not enforced by municipalities.

Additionally, the uncontrolled urbanization with increased internal migration of people seeking employment in and around the cities presents a challenge for the sector. It essentially complicates an already difficult situation and makes urban planning difficult. Also, because of a weak urban planning system, in some cases, it is simply a challenge to connect some homes to the sanitation network.

The fragility of the basic water and sanitation infrastructure has been areas of concerns since the 1990s. For obvious reasons, not the least of which is public health. Major investment will be required in upgrading the water and sanitation system for the nation. The alternative is to put at risk the country's bet on tourism as an engine for growth. The inadequate water system increases the factor costs of Cape Verde and limits its competitiveness as hotels have to invest in expensive water desalination systems to meet their needs. This is not efficient and costly. Also, there are implications for health. The weak sanitation system was a key factor in the 2009 Dengue Fever epidemic. The impact of the outbreak was huge, especially with respect to loss productivity due to absence from work and the strain placed on the public health system. The 2009 Dengue Fever outbreak had a limited impact on the tourism sector because it was quickly curtailed. The problem though is that it put at a risk the image of Cape Verde, especially with respect to one of its key selling points: lack of tropical diseases. A key factor in the spread of the outbreak was the sanitation conditions in the cities which allowed mosquitoes to thrive. Recent WHO data shows that water-related diarrhoeal diseases affect over 10 percent of children under 5 years of age in Cape Verde (Figure 5.35). Among the comparators, Cape Verde performs better than only Senegal and Morocco. Water-related diseases are partly the indirect costs of the sanitation problems in Cape Verde (Table 5.6).

Figure 5.35

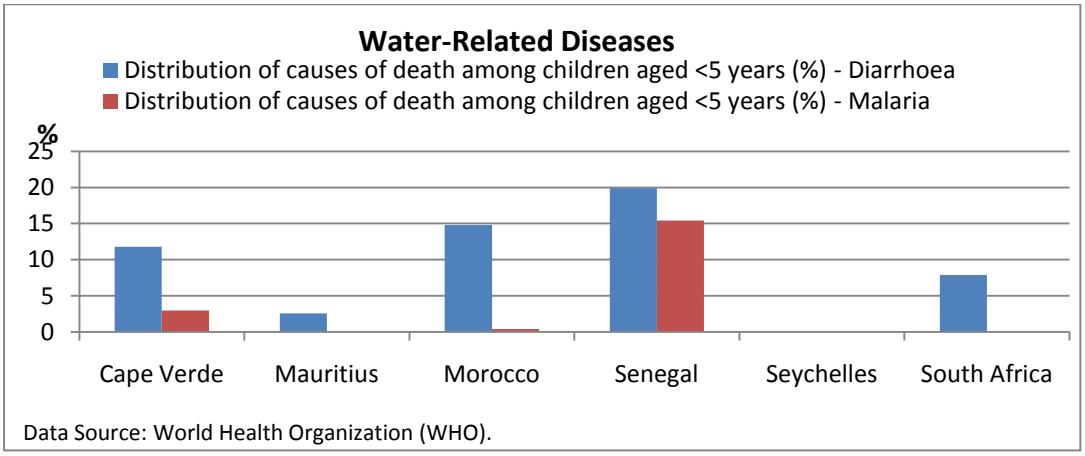


Table 5.6 **Cases of Water-Related Diseases from 1994 to 2006**

	Cholera	Typhoid	Diarrhoeal Diseases (<5 years of age)	Diarrhoeal Diseases (>5 years of age)	Malaria	Hepatitis
1994	86	90	14880	5898	2	311
1995	12995	40	18381	26969	107	208
1996	428	143	16155	7805	53	188
1997	2	240	15542	8644	4	205
1998	204	285	14914	7098	9	317
2000	0	0	14362	12844	128	253
2001	0	0	12942	9029	100	201
2002	0	0	11547	8240	11	200
2003	0	0	10485	8771	48	167
2004	0	0	11414	7810	32	161
2005	0	0	8741	6849	54	125
2006	0	0	13364	7059	62	145

Data Source: PAGIRE Volume 1.

Efforts have begun to redress the institutional challenges facing the sanitation sector. There is ongoing effort to formulate a national policy and strategy for the sanitation sector. A draft policy is under discussion which will attempt for the first time to create a unified national institutional framework for managing the sanitation sector. However, a lot of investment will be needed to bring up-to-date the sanitation infrastructure and upgrade the policy and institutional environment. Among the core elements laid out in the sanitation sector strategy are:

- Reform of policies: a focus on integrated management to clarify the institutional management model, and define a framework for regulation, inspection, and financial sustainability of the sector.
- Reform of legal framework: draft the Law on Sanitation which sets out guidelines for national policy, whilst protecting the environment and protecting public health. Also

planned is the revision of the legal framework for municipal public water supply, sanitation, and urban wastewater and municipal solid waste management.

- Reform of the institutional framework: creation of a National Sanitation body to coordinate the sector, and develop and monitor policy implementation.

5.3.6 Ground Transportation Infrastructure

Cape Verde's ground transportation infrastructure remains limited and it is 100 percent dependent on fossil fuels, all of which must be imported. This is in the backdrop of geographic fragmentation and difficult terrain on most of the islands that present serious engineering and financial challenges for the build-up and upkeep of road transportation infrastructure. As of 2005, Cape Verde has1625 km of roadways (Table 5.7). The great majority of the roadways in Cape Verde remain cobblestone at about 68 percent of the total. Only about 6 percent of the roadways are covered with asphalt.

Table 5.7 Roads in Cape Verde Island (Km)

Island	Asphalt	Bilayer/Bicouche	Parallel Cobbled Stone	Portuguese Cobbled Stone	Stone	Dirt	Total
Santo Antão	0	0	5	112	28	143	288
S.Vicente	9	0	12	26	7	1	55
S.Nicolau	0	0	15	69	15	15	114
Sal	54	12	0	0	0	0	66
Boavista	0	0	20	9	21	3	53
Maio	0	0	56	0	0	0	56
Santiago	38	0	216	26	187	246	713
Fogo	0	0	0	171	44	8	223
Brava	0	0	12	38	0	7	57
Total	**101**	**12**	**336**	**451**	**302**	**423**	**1625**
% of Total	6%	1%	21%	28%	19%	26%	

Less than ten percent of Cape Verde's road network is paved. In comparative terms, this gives Cape Verde an extremely low ratio of about 3 km of road per 1000 inhabitant, and a roadway density of 36 km per 100 sq. km of roads. These ratios are without considering the question of quality. Only 318 km, or 20 percent, of the roadways in Cape Verde is estimated to be in good condition (Table 5.8). The construction of good roads has been a key area of investment over the last decade, as a result of the growth of tourism and the need to facilitate access by farmers to markets. About 256,7 km of roadways was built between 2001 and 2009. Of this, cobbled stone represents about 5,77 percent (14,8 km) while 93,23 percent (241,9 km) was covered by asphalt.

Table 5.8 **Road Conditions in Cape Verde** (km)

Islands	Good	Reasonable	Poor
Santo Antão	33	24	231
S.Vicente	22	13	20
S.Nicolau	44	17	53
Sal	31	17	0
Boavista	7	7	39
Maio	25	15	16
Santiago	137	159	417
Fogo	17	72	134
Brava	2	20	35
Total	***318***	***344***	***945***
% of Total	***20%***	***21%***	***58%***

As we noted in the above section of geography, the difficult, mountainous terrain on the major islands signifies that the roadways infrastructure on these islands is limited. Thus, the opportunities for markets within individual islands are stunted. The island of Fogo, a key agricultural producer, has only one principal road, a beltway that rings the island primarily along the foot of the island, leaving villages and farms in the upper zones without easy and cost-efficient access to markets or services.

5.3.7 Air and Maritime Transportation

Cape Verde has ambitions to become a regional air and maritime transport hub, particular for air cargo and ships. Here it will have to compete with the much bigger Senegal. The air transportation sector has been experiencing rapid growth in the last decade, a growth that has been outpacing the supply of quality and adequate infrastructure. Air transportation infrastructure is relatively modern, internationally certified, and has been experiencing expansion in the last several years. The country now boasts of four international airports (Sal, Boa Vista, Mindelo, and Praia). The carrier fleet is relatively modern, and thus far enjoys a solid safety record. While Cape Verde scores well on the quantity and newness of the air transportation infrastructure, there is a question about the adequacy of the present infrastructure to meet future needs, especially the projections for tourism growth. Likewise, as noted earlier, inter-island transportation is characterized by high costs.

For example, the recently opened Praia international airport is already undergoing expansion construction. The international airport in Boa Vista, opened in 2008, is already being seen as inadequate for the traffic volume. The rapid and high growth of tourism in Boa Vista is putting pressure not only on the airport but also the maritime port, both of which will need substantial investment to expand and upgrade. The problem in the air transportation infrastructure is not limited to physical installation. A serious looming problem is qualified human resources, especially technicians and air traffic controllers. First, many of these professionals are nearing retirement within the next five years. Second, there is not plan or program in place to train and certify new professionals.

The maritime transport services play critical economic and social roles in Cape Verde. Inter-island maritime transport is crucial to upholding the nation's development agenda, given the challenges of fragmentation. The aim of government in recent years has been to make Cape Verde (especially the Island of Sao Vicente) an international platform for transshipment while at the national level efforts have focused on upgrading national port infrastructure to facilitate social cohesion and the development of integrated national market. Ease of movement of goods and people between the islands are essential to the project of building one national market and ensuring economic sustainability and high growth. Results so far show significant progress.

The number of containers (in tones) has been increasing over the years, from less than 100,000 in the 1990s to more than 500,000 in the 2000s, a variation of more than 1000 percent between the period 1995-2008. The same is true for the number of passengers arriving at the airports of Cape Verde, a variation of 160 percent between the periods 1995-2008 (Figures 5.35 & 5.36). The increase in the number of containers and passengers are the natural outgrowth of the tourism sector and it is what prompted the construction of new international airports in Cape Verde. Also the small scale transshipment tests point to the possibility of Cape Verde becoming a transshipment platform for the region.

Figure 5.35

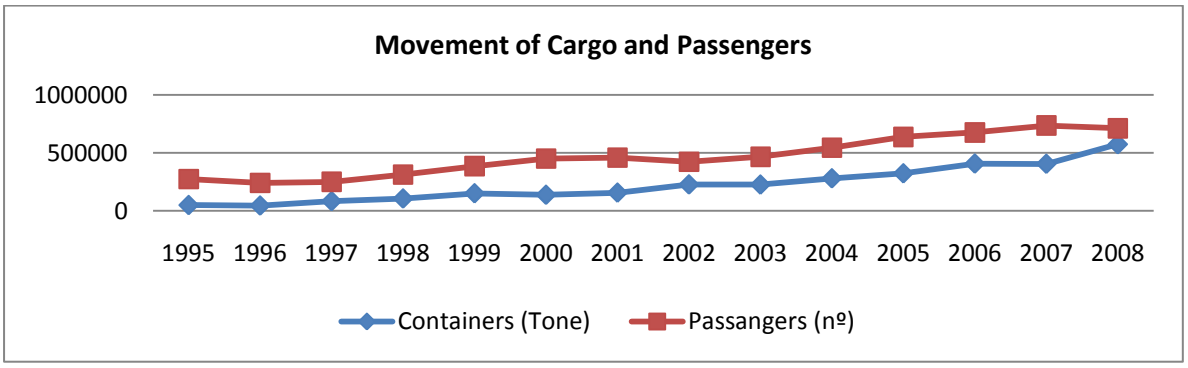
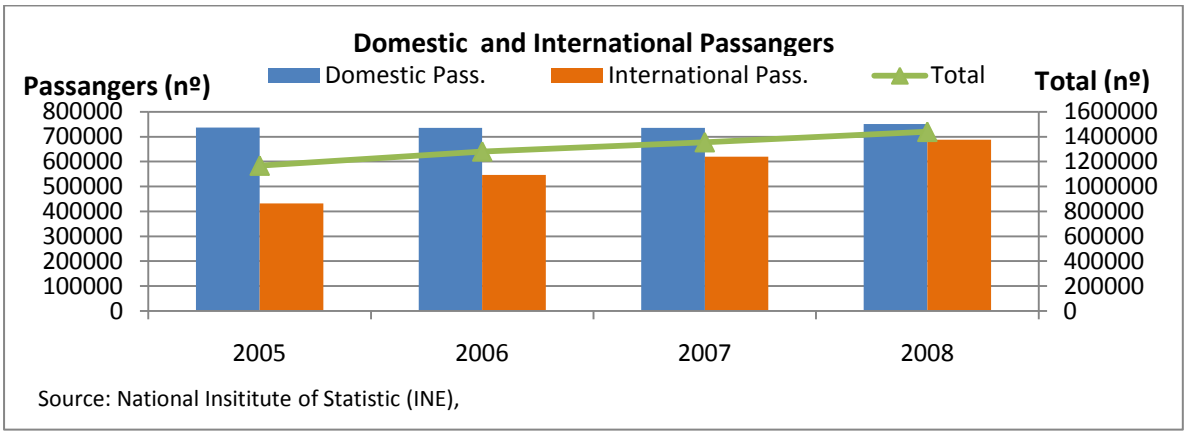


Figure 5.36



Source: National Insititute of Statistic (INE),

The rapid growth of maritime transport in Cape Verde over the years, according the 2008—2011 transport sector strategy, have highlighted the importance of transshipment for the development of Cape Verde while bringing to the fore some of the core challenges within the sector that must be

addressed, if the strategy to build a transshipment center and an integrated national market is to work. Among the weak points of the maritime transport sector identified by the sector strategy are:

- Insufficiencies in landing berths to allow for the approach of various types of ships used in national and international shipping;
- Limitations of the grounds for cargo displacement particularly containerized general cargo;
- Deficiencies in equipment to handle different types of cargo;
- Limitations due to operation of port infrastructures, namely at the level of unnecessary and complex port procedures which are burdensome and impacts on transport cost.[45]

These weaknesses affect both international container traffic in Praia (Santiago) and Porto Grande (Sao Vicente and also inter-island cargo traffic.
For an archipelago, maritime transportation infrastructure is the primary means to move people and goods and unify the domestic market. Its economic and social value is crucial. However, the maritime transportation infrastructure in Cape Verde continues to be plagued with a series of challenges beyond the weak points identified above and would require substantial investment despite recent efforts.

First, the passenger ferry and cargo ships are ageing and small. Frequent mechanical breakdowns often mean weeks of service interruptions, and all the multiplier effect this has on business, personal lives, resupply of goods, and shelf life of sensitive merchandise. Frequent breakdowns make interisland cargo and passenger transportation in Cape Verde is inefficient and unreliable. Key problems associated with the ageing fleet include the lack of appropriate transport facilities such as cold storage for agricultural products, high energy consumption, and the fact that many are ill adjusted to offer comfort to passengers or allow easy cargo handling.

Second, the ports infrastructure continues to be inadequate. With the substantial contribution of the first MCA Compact, a good deal of investment has been focused of the ports. Expansion work is currently underway for the port of Praia. Nevertheless, with the partial exception of the port of Mindelo, the ports of Cape Verde do not possess the adequate passenger and cargo infrastructure to offer efficient service. Even the port of Mindelo requires a substantial amount of investment to upgrade its infrastructure to be able to serve as an international platform for transshipment and cruise ships. Passenger terminals are yet to be built in ports like Praia and São Felipe.

Third, all the ports of Cape Verde will require substantial investment to build up and refit the necessary infrastructure for high-speed, roll-on, roll-off ferries and cargo transport. This is crucial given the new investment such as Fast Ferry which will bring a new generation ferry for inter island transport sector in Cape Verde. There is a need for investment to build the necessary support infrastructure so that the new ferries are able to operate efficiently.

Fourth, the sector is plague with weak logistics and very limited or non-existing inter-modal planning. [46] It makes matters worse that there are no modal articulation, making it difficult to

[45] Ministry of Infrastructure, Tranpsort and Sea. Strategic Plan for Transport 2008—2011. Praia, Government of Cape Verde.

transfer from one transport mode to another. An example is the lack of coordination in scheduling among transportation providers which complicates the problems of service reliability. Another example is the lack of intermodal facilities to optimize transport chain and minimize disruptions, be it the development of value-added activities in the ports' area or the absence of good logistics such as not having good and secure vehicle parking areas at ports, dully equipped facilities for goods transfer or good access.

These challenges highlight the key weaknesses facing maritime transport sector in Cape Verde. The weaknesses and high costs of inter-island transportation effectively undermine a functioning internal market because of the inability to move goods and people from one island to another with ease and at low cost.

The maritime and inter island services are all provided by private firms since 1997, when government decided to close the state-owned firm, Arca Verde, and sold its assets. However, there are a few islands where the demand is quite limited and in which government has had to step in to ensure minimum income for operators in order to guarantee service. While all operate under a free market system, a few links are subsidized to attract operators due to limited demand and others with bigger demand are not. There are other differences in the maritime transport among the islands.

Cape Verde Islands is naturally divided into two groups: Barlavento and Sortavento. For example, the link between Santo Antão and São Vicente is the best serviced. There are competing firms offering regularly scheduled services between the two islands. One key challenge is ensuring regular services between the agricultural islands such as São Nicolau, Santo Antão and Fogo with the main national market which is Santiago and the tourist market which is mostly in Sal and Boa Vista. In fact, the link between the two islands where tourism is concentrated to the other islands and between each other is very limited.

The limited service linking producers in the more agricultural islands to the main markets is a critical problem. It makes it difficult to transport farm outputs timely. And, in many cases, the transport problems from unreliability to lack of temperature controlled facilities have hindered growth and poverty alleviation in Cape Verde. Beyond the transport of farm outputs, the very limited maritime transport links between the Boa Vista and Sal with the other islands limits the growth opportunities and benefits of tourism for the national economy. Maio, for example, has huge potential for tourism. But it is very isolated despite its closeness to Santiago and Boa Vista. Similarly, Brava is close to Fogo but quite isolated from the national market.

The key to ensuring sustainable high level growth and deep reduction in poverty will depend partly on exploiting the tourism potential of the other islands. This will require infinitely improving the current inter island maritime transport and making it easy for tourists to move between islands and to transport goods between the islands. The unique tourism products that Cape Verde can offer are the variety of experiences that tourists can enjoy on the various islands. But to exploit the various

[46] Ministry of Infrastructure, Tranpsort and Sea. Strategic Plan for Transport 2008—2011. Praia, Government of Cape Verde

experiences afforded by the uniqueness of each island will require ability to get from one to the other timely, efficiently and cheaply.

Tourism, as such, will provide the main potential growth in demand for inter island transport over time. This is especially true if tourism continues to grow as it has done in the last decade and half. It will particularly require strong inter island transport links between the tourism oriented islands and the others. Currently, these are Sal and Boa Vista. But tourism is also likely to take off in Maio in a significant way in the near future. These "tourism islands' will require regular maritime transport service with each other and with the other islands. Linked to tourism will be the movement of goods and nationals between islands. One key growth sector is the transport of locally produced goods such as food items to where the markets are located.

Thus, transport is critical to building a unified domestic market and addressing the challenges of transportation in the archipelago will allow Cape Verde to overcome one of its biggest bottlenecks to growth. As it is now, transport, especially maritime transportation, in Cape Verde is unreliable, expensive and insufficient to meet even current needs.

5.3.8 Telecommunications Infrastructure

A country's telecommunications infrastructure is a central pillar of a knowledge economy and economic competitiveness. At first glance, the telecommunications infrastructure does not appear to be a critical constraint to growth. For a small island economy, and compared to mainland countries, the telecommunications infrastructure is fairly modern and sophisticated. The government information technology infrastructure, for example, is a model for other developing countries. While we judge the telecommunications as not constituting a binding constraint to growth, it does represent a drag on growth and competitiveness of Cape Verde. The main problems of the telecommunications sector in Cape Verde, all interrelated are: lack of competition, high costs, and low access.

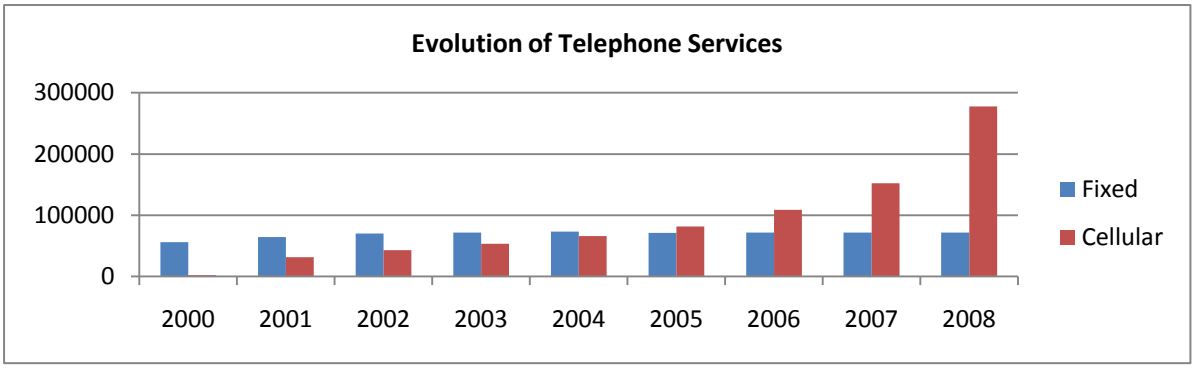
The telecommunications sector was initially a monopoly, with state ownership of Cabo Verde Telecom. The company was privatized in the 1990s, but the effect was to transfer monopoly status to private hands. Given Cape Verde's micro scale, limited market and the high start-up investment costs associated with the sector, economies like Cape Verde will always face a low ceiling in terms of the market competitiveness of the sector. By 2005, the sector was liberalized further to allow a new entrant. Technically, the sector can no longer be characterized as a monopoly. In practice, the market is dominated by a single firm, CV Telecom.

The telecommunications infrastructure in Cape Verde comprises more than 72,000 fixed telephone installed in 2008, for a penetration rate of over 14 per 100 inhabitants.[47] Fixed line installation has remained fairly flat over the past decade, especially after 2002. With liberalization of the sector in

[47] Data from the national telecommunications regulatory agency, Agência Nacional das Comunicações (ANAC), 2010. Nearly 94 percent of the installed fixed phones are analogue. The number of fixed lines is likely to have remained flat, despite the enormous increase in cellular service, because the dominant internet service provider, CV Telecom, requires fixed line connections for ADSL service.

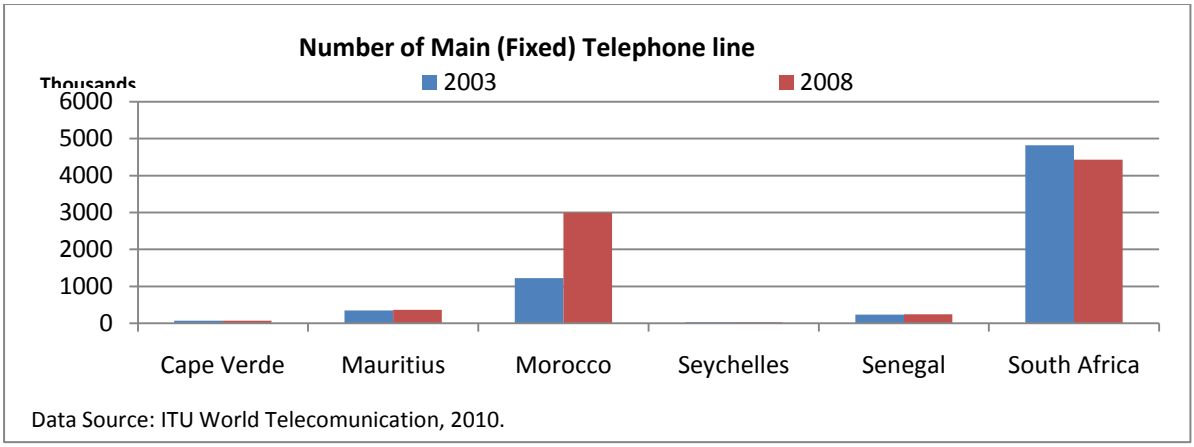
cellular and internet services, Cape Verde has been experiencing a massive growth of cellular subscribers. In 2008, there were an estimated 278,000 subscribers, for a penetration rate of over 55 percent. The following figure shows the evolution of telephone services (Figure 5.37).

Figure 5.37



In the area of telecommunications infrastructure, Cape Verde compares only modestly in the group of comparator countries selected. In relation to the number of fixed telephone, Cape Verde compares less favorably to the comparator countries (Figure 5.38).

Figure 5.38



Data Source: ITU World Telecomunication, 2010.

In terms of the *per 1*00 Inhabitants index, Cape Verde has the third highest index for the years 2003 and 2008. However, there was a little decrease in this index during the period 2003-2008 (Table 5.4; Figures 5.39 & 5.40).

Table 5.4**: Number of Main (Fixed) Telephone *per* 100 Inhabitants.**

Country	2003	2008	Variations (%)
Cape Verde	15,51	14,41	-7,09
Mauritius	28,29	28,48	0,67
Morocco	4,09	9,46	131,30
Seychelles	25,77	26,63	3,34
Senegal	2,14	1,95	-8,88
South Africa	10,29	8,91	-13,41

Data Source: ITU, World Telecommunication, 2010.

Figure 5.39

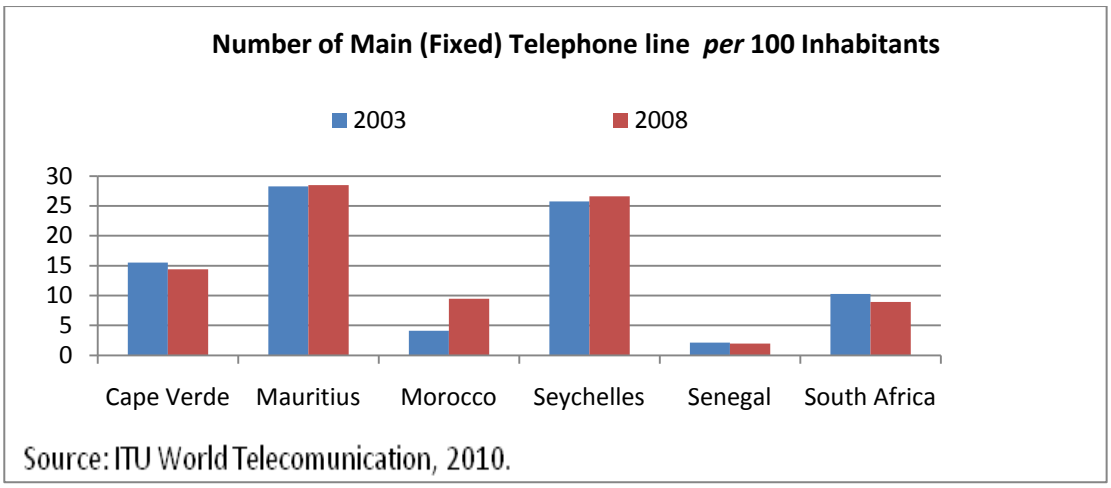
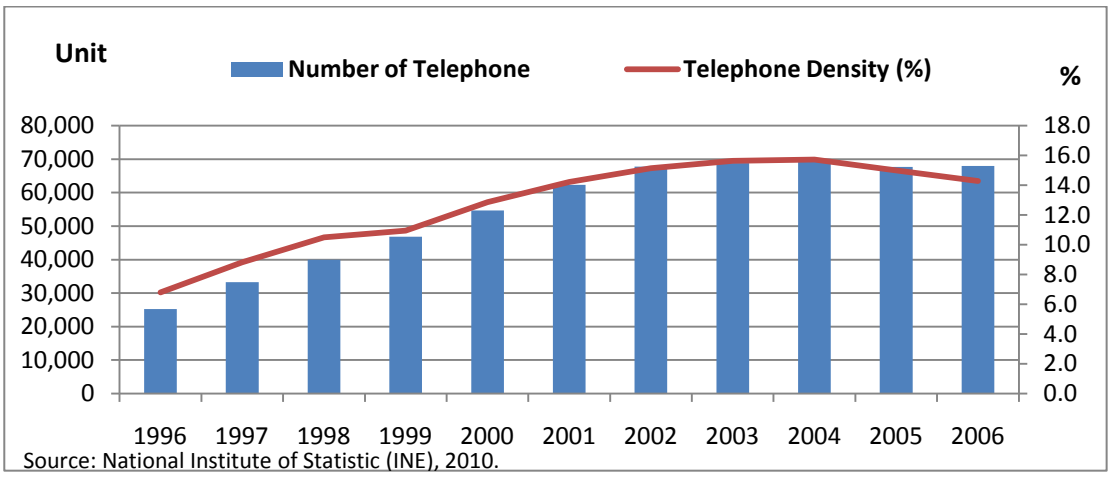
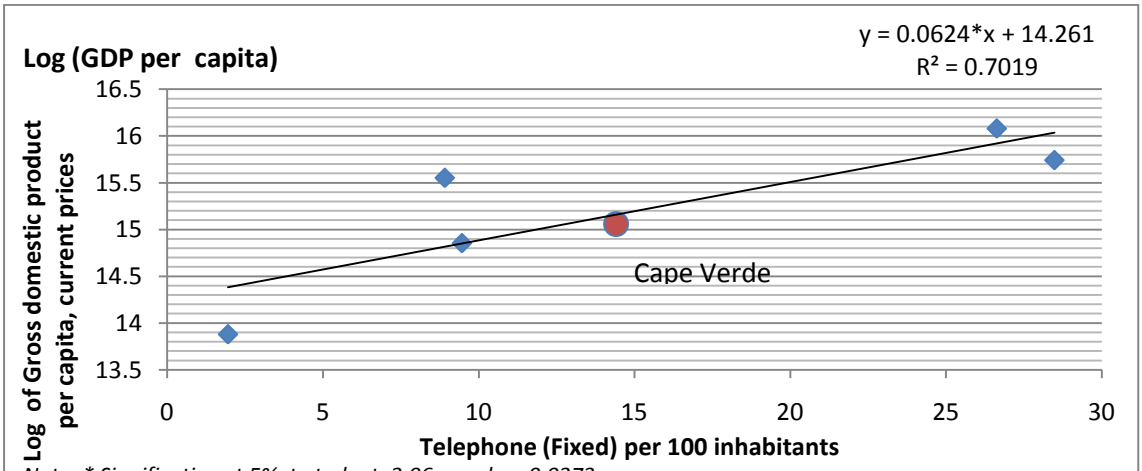


Figure 5.40



A cross country regression on the log of GDP per capita and number of telephone line per 100 inhabitants show a quite positive relationship. Cape Verde is slightly below the regression line (Figure 5.41).

Figure 5.41 **Telephone (fixed) per 100 inhabitants versus Log of GDP Per capita (current price, USD).**

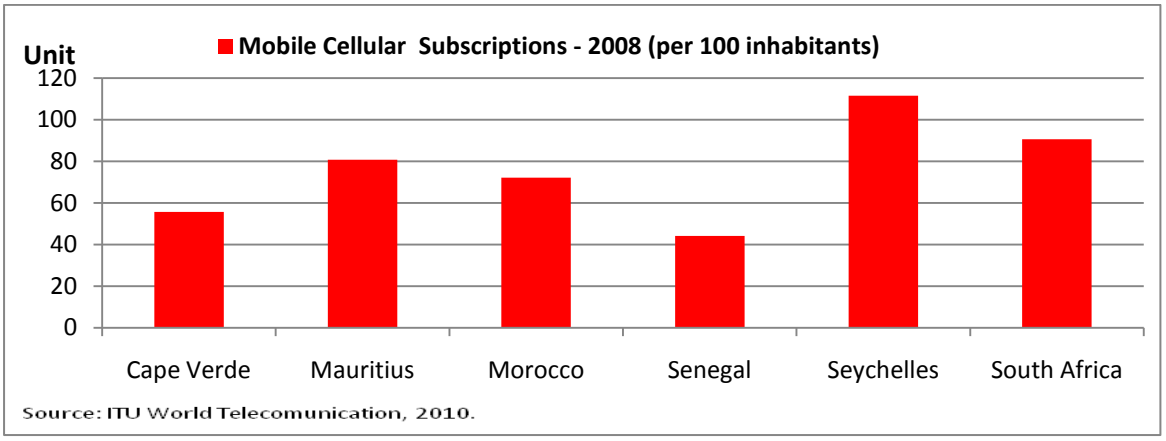


*Note: * Significative at 5%, t-student: 3.06, p-value: 0.0373.*
Data Source: World Bank, 2009.

Cape Verde has one of the lower indexes, just 55.6, of cellular phone subscribers *per* 100 inhabitants. Compared with Seychelles, we see that the latter has double this number (111,5 *per* 100 inhabitants). Despite rapid growth in cellular penetration, Cape Verde still ranks low in comparison. In terms of subscriptions per 100 inhabitants, it is only slightly better than Senegal (Figure 5.42).

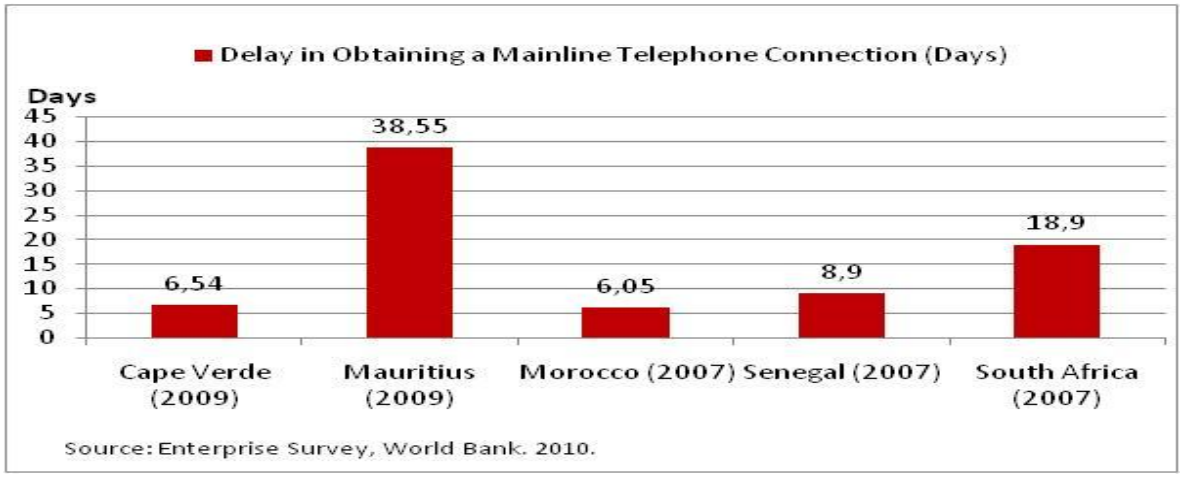
Despite an increasing number of users, the cost of telecommunication in Cape Verde remains high. Thus, the quasi-monopoly social cost and drag on the competitiveness of firms. The cost of an international phone call via cellular service is roughly $1.28 USD per minute, while the cost of a local cell to cell call is 42.7 cents USD.[48] Internet usage rates are even higher. Not counting the sign-up costs that include monthly subscription and equipment rental, users are charged for megabytes used beyond the allotted monthly limit.

Figure 5.42



Cost and access factors notwithstanding, Cape Verde has good overall telecommunications infrastructure quality and reliability – even if this infrastructure is unevenly distributed among the islands. In some specific services, Cape Verde's telecommunications infrastructure performs well. On the number of days required for a mainline telephone connection, Cape Verde out-performs all the comparator countries except for Morocco which has a slight advantage (Figure 5.43).

Figure 5.43



[48] Author's own calculations based on reported tariff rates to ANAC and US dollar exchange rate of 81.8 escudos as of mid-April 2010.

With respect to Internet, the country had less than 15,000 subscribers in 2008. A noteworthy jump in subscriptions is noticeable from 2007 to 2008, due primarily to the introduction of mobile internet GPRS. As expected, the great majority of subscribers (46% of all ADSL users) are residents of the capital city, whose only access option remains CV Telecom. The following chart and tables present the number of internet user *per* 100 inhabitants (Figure 5.44; Tables 5.9 & 5.10).

Figure 5.44

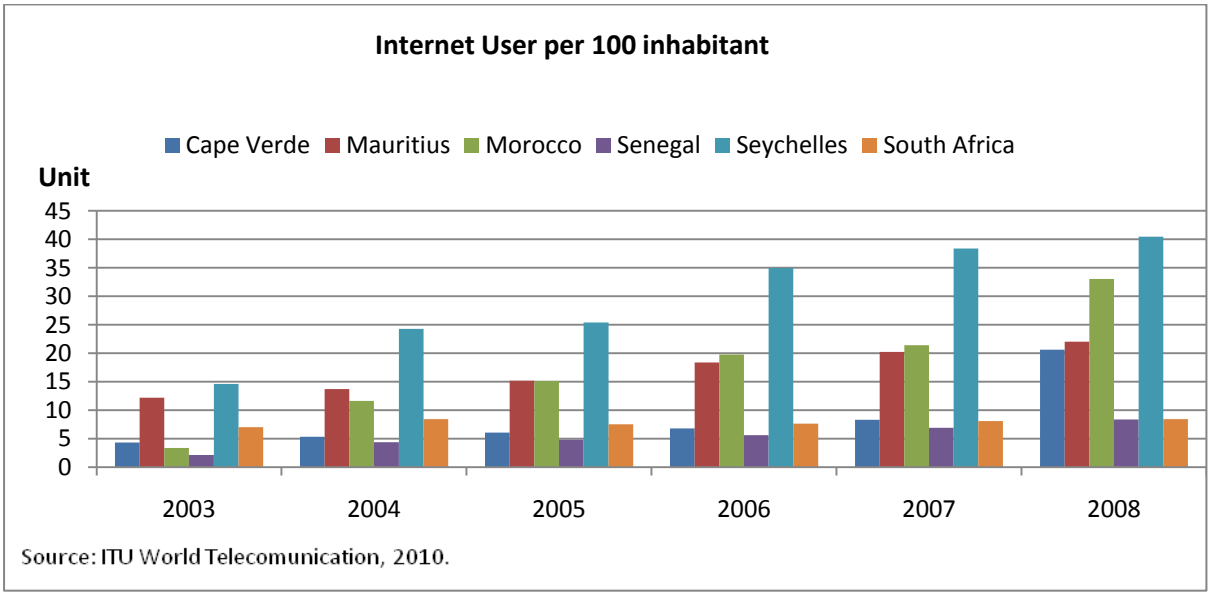


Table 5.9 **Internet Subscribers per 100 Inhabitants**

	2003	2004	2005	2006	2007	2008	Variation: 2003-2008
Cape Verde	1.08	1.20	1.37	1.54	1.49	1.85	71,30
Mauritius	4.98	6.45	10.27	11.37	13.06	15.59	213,05
Morocco	0.20	0.38	0.86	1.30	1.55	1.55	675,00
Senegal	0.14	0.18	0.18	0.26	0.33	0.39	178,57
Seychelles	3.42	4.02	4.69	6.01	6.95	6.75	97,37
South Africa	6.70	7.51	7.51	7.51	7.51	7.51	12,09

Data Source: ITU World Communications, 2010.

Table 5.10 **Internet Users Per 100 Inhabitants**

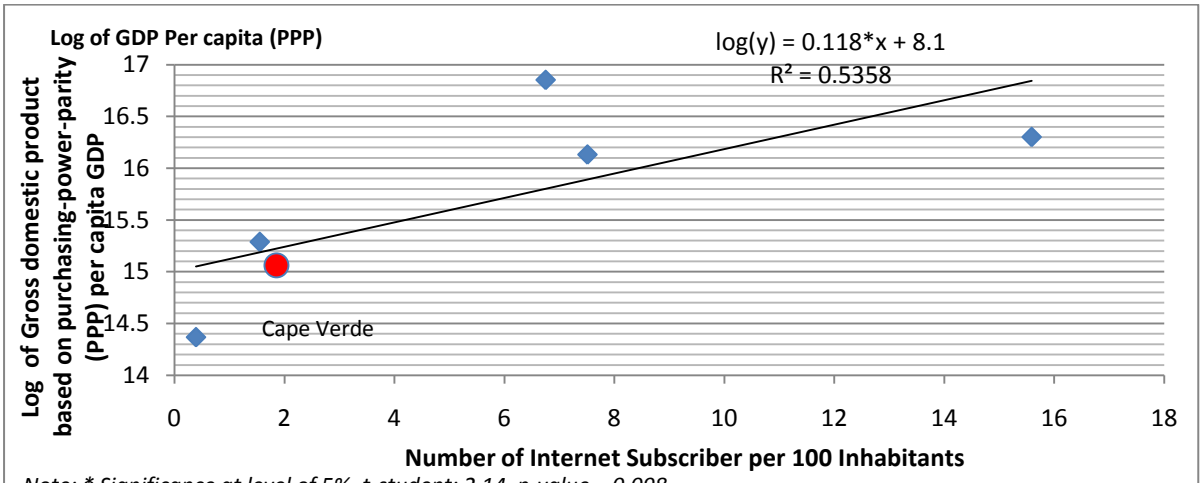
Countries	2003	2004	2005	2006	2007	2008
Cape Verde	4.32	5.32	6.07	6.81	8.28	20.61
Mauritius	12.19	13.69	15.17	18.38	20.22	22.03
Morocco	3.35	11.61	15.08	19.77	21.4	33.04
Senegal	2.1	4.39	4.79	5.61	6.89	8.35
Seychelles	14.59	24.27	25.41	34.95	38.38	40.44
South Africa	7.01	8.43	7.49	7.61	8.07	8.43

Data Source: ITU World Communications, 2010.

The chart and tables show that all the countries have experienced an increasing number of internet subscribers. However, there is a big difference among the countries. Cape Verde has a serious limitation in this regard, positioned in fourth place among the comparators in internet subscriber *per* 100 inhabitants for the years 2003 (1,08) and 2008 (1,85), although this represented an increase of 71,3 percent over the period. Compared to Morocco, we see that the index has increased 675 percent for the period. Senegal, Seychelles, and Mauritius also show big improvement in this index, 178.5 percent, 97,37 percent and 213 percent, respectively. Cape Verde continues to perform well in comparison to Senegal and South Africa.

Overall, a critical chokepoint in the telecommunications infrastructure remains internet access, which is greatly restricted as a result of high cost, lack of competition, and high technology costs in the small island economy. A cross country analysis on the relationship between the number of internet subscribers and the PPP GDP (per capita) indicate a positive relationship and Cape Verde is at the low end and below the regression line (Figure 5.45).

Figure 5.45 **Number of Internet subscriber per 100 inhabitants vs Log of PPP GDP Per capita, USD**



*Note: * Significance at level of 5%, t-student: 2.14, p-value = 0.098.*

5.3.9 Infrastructure Summary

In summary, Governments in Cape Verde since 1975 have devoted a high priority to infrastructure development. The country's peculiar geographic characteristics, on top of the usual costs of insularity, have presented policymakers with daunting engineering and financial challenges.

On the sectors reviewed, although the cost of telecommunication remains a problem, it is not a binding constraint. There will be a need to address the monopolistic aspects of the market and ensure more competitiveness. A key element of any change will be upgrading the capacity to regulate the sector, ensuring transparent management of the national infrastructure and providing equal access to all operators.

Transport, especially inter-island maritime transportation continues to present a binding constraint for growth given its limiting factor on the movements of goods and people between islands. It is costly and unreliable. It also hinders the ability of farmers to get their goods to market and is a bottleneck to ensuring that all the islands benefit from the tourism sector. It will be important to put in place the necessary infrastructure which will attract and make it easier for the private sector to invest in inter-island transportation.

Energy and water are linked and remain a biding constraint for Cape Verde. The main issues have to do with high costs, inadequacy and unreliability of the network which leads to long duration power cuts, the high costs in productivity losses and value added of power inadequacies for firms, the high technical and non-technical losses in the electricity production and distribution, and the weakness of the institutional framework from policy making and regulation to the management of the main power company, Electra, which is now state-owned. All these contribute to making energy a binding constraint. In addition to the negative impact on firms, the unreliability of electricity is not a pull factor for FDI and this might hinder growth, employment and poverty reduction.

The mix of solutions must include the planned shift towards renewable energy, reduction in the external dependency, upgrade of the networks and managerial capacity, substantially reducing technical and non-technical losses and costs, interconnection of networks (central production units), investing in sustainable energy solutions for remote communities, and reform of the sector, including re-privatization of the energy company and reorganization of the sector.

Sanitation also remains a problem. The sector is quite underdeveloped in Cape Verde and facing significant institutional issues. Inadequate sanitation network and systems continue to lead to property loss as a result of flooding, provide fertile ground for the spread of epidemics such as the 2009 Dengue Fever outbreak and have direct and indirect costs in terms of water-related diseases and productivity losses as workers miss work due to illnesses. Similar outbreaks of epidemics could have significant negative impact on the growth of the tourism sector and economic performance.

5.4 Is it innovation?

Experience has shown that what a nation exports matter. Countries that have experienced the most rapid growth are the ones that have gradually shifted their export structures over time from low-

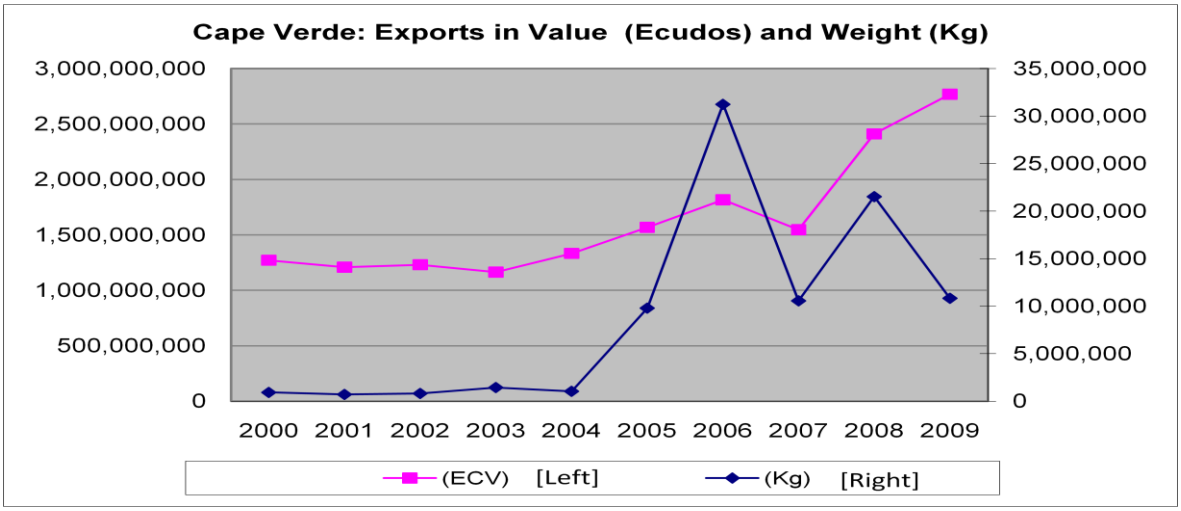
technology, low-skill, and largely labor-intensive products to high-technology and high-skill products. The examples of Japan after World War II, the South Korea, Taiwan, Singapore, and Hong Kong in the 1980s and that of China come to mind. They and many other nations such as Malaysia, Vietnam and India have all demonstrated the importance of moving up the value chain despite the received trade theory. As Lall (2000) argues, export structures, being path-dependent and difficult to change, have implications for growth and development.[49] Low technology products tend to grow the slowest and technology intensive products the fastest. The result has been that export success in an ever globalizing world has become quite important for economic performance. In fact, there is a high correlation between success in exporting technology intensive products and GDP.

5.4.1 Evolution of Exports

In the search for whether or not innovation is a binding constraint to growth, it will be important to look at the evolution of the exports and other factors that point to innovative activities such as the registration of patents and inventions, and performance in adopting innovations. We have already discussed above the low penetration and high access costs of internet connectivity as well as the weakness of the technological and scientific infrastructure necessary for a national innovation system.

Although Cape Verde is a high trade intensive nation as shown in Section 2, it is, persistently running a trade deficit. Its economy is narrow and exports have been quite limited. The value of exports has been on the rise since 2000 except for declines in 2003 and 2007 (Figure 5.46). Successive governments of Cape Verde have been cognizant of the need to expand the productive base of the economy and expand its capacity to exports. A key strategy by the government was the establishment of the industrial zones such as the one in Mindelo, São Vicente to provide facilities for light industries. It also put in place various incentives to encourage the FDI focused on light industry sector.

Figure 5.46

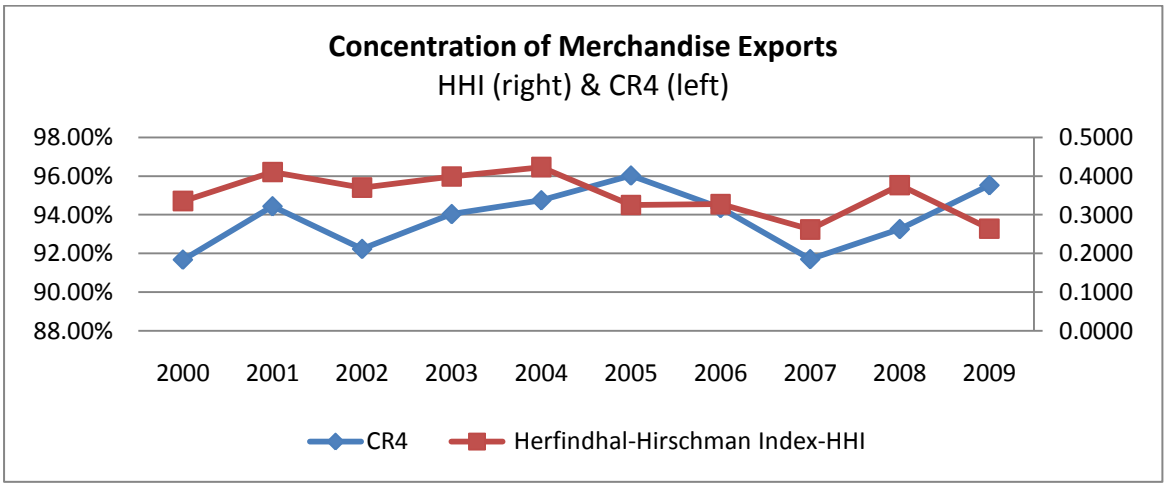


Source: Cape Verde Customs

[49] Sanjaya Lall (2000). The Technological Structure and Performance of Developing Country: Manufactured Exports, 1985-1998. *Oxford development studies*, 28(3), 337-69.

Is Cape Verde diversifying its products and/or moving up the technology ladder? We focus on the merchandise export data to attempt to answer this question. What is clear is that the efforts to build a light industrial manufacturing has yielded some gains but not significant enough to alter the trade balance or the composition of exports of Cape Verde. Trade deficit continues while the concentration of exports in a few products has not been altered nor the low technology content. We calculated the percentage share of the top four export products in the total merchandise exports (CR4). We also calculated the Herfindhal-Hirschman Index (HHI). Both measure the degree of concentration. The range for the HHI is 0 to 100 while that of CR4 is 0 to 1. A nation's exports are diversified the closer the two measurements are to zero. Higher levels mean high concentration. For Cape Verde, we did the calculations from 2000 to 2009 (Figure 5.47). The CR4 was never less than 91 percent. That is the top four products accounted for at least 91 percent of the merchandise exports between 2000 and 2009. The HHI fluctuated between 0,26 and 0,4231 over the same period. The result of the two calculations is an indication that Cape Verde did not diversify its exports over the last decade.

Figure 5.47



Data Source: Cape Verde Customs

5.4.2 Cape Verde's Export Basket

We then review the list of export products (Table 5.511). What is clear from the list is the limited amount of merchandise products that Cape Verde exports. The list shows that the export basket for Cape Verde in 2009 is slightly larger than that of 2000. The list of goods increased from 17 to 20 during the period. The limited export list is not surprising because of the limitations posed by geography and smallness of the economy.

In addition, the changes in the composition of the export product list over the same period were quite limited (Table 5.12). Sixty percent of the top ten goods in 2000 made it into the 2009 top-ten list, although not necessarily in the same order. The product categories in 2000 that did not made it to 2009 include footwear, electronic components, coffee, and bottled wine. The new goods that made it to the top-ten in 2009 include food preparations, wood works, wooden furniture and molasses.

Table 5.11 **Merchandise Exports**

2000			Rank	2009		
Products	**Value**	**% Share**		**Products**	**Value**	**% Share**
Parts of footwear	582.977.755	0,458541493	1	Fish	929.562.515	0,3357645
Clothing	434.468.125	0,341731157	2	Fish, fresh and chilled	890.617.164	0,3216971
Footwear	89.725.763	0,070573851	3	Clothing	517.243.108	0,1868318
Fish, fresh and chilled	58.402.058	0,045936173	4	Parts of footwear	307.280.843	0,110992
Fresh and frozen lobsters	29.400.072	0,023124644	5	Spirits and liqueurs	60.816.370	0,0219673
Electronic components	28.113.272	0,02211251	6	Lobsters	34.330.171	0,0124003
Fish	13.674.844	0,010755957	7	Food preparations n.e.c.	11.033.667	0,0039854
Spirits and liqueurs	13.084.052	0,010291269	8	Woodworks n.e.c.,	4.402.986	0,0015904
Coffee	8.700.068	0,006843044	9	Wooden furniture	2.348.430	0,0008483
Bottled wine	4.912.875	0,003864225	10	Molasses	2.082.997	0,0007524
Medicines	2.160.000	0,001698949	11	Coffee	2.067.525	0,0007468
Skins and hides	2.066.598	0,001625484	12	Soft drinks	2.027.774	0,0007324
Dyes	1.605.140	0,001262524	13	Footwear	1.372.358	0,0004957
Chemicals (amides)	1.301.300	0,001023538	14	Fins	1.262.121	0,0004559
Biscuits and crackers	629.253	0,000494939	15	Oilseeds	575.820	0,000208
Flour crustaceans	119.288	9,3826E-05	16	Dyestuffs	492.888	0,000178
Prepared food n / e	33.587	2,64179E-05	17	Mineral water	313.594	0,0001133
			18	Chamois	287.000	0,0001037
			19	Medicines	213.304	7,705E-05
			20	Paints	165.060	5,962E-05
Total	**1.271.374.050**			**Total**	**2.768.495.695**	

Data Source: Cape Verde Customs; Value is in Cape Verdean Escudos

Table 5.12 **Top Ten Exports**

2000	Rank	2009
Parts of footwear	1	Fish
Clothing	2	Fish, fresh and chilled
Footwear	3	Clothing
Fish, fresh and chilled	4	Parts of footwear
Fresh and frozen lobsters	5	Spirits and liqueurs
Electronic components	6	Lobsters
Fish	7	Food preparations n.e.c.
Spirits and liqueurs	8	Works n.e.c., wood
Coffee	9	Wooden furniture
Bottled wine	10	Molasses

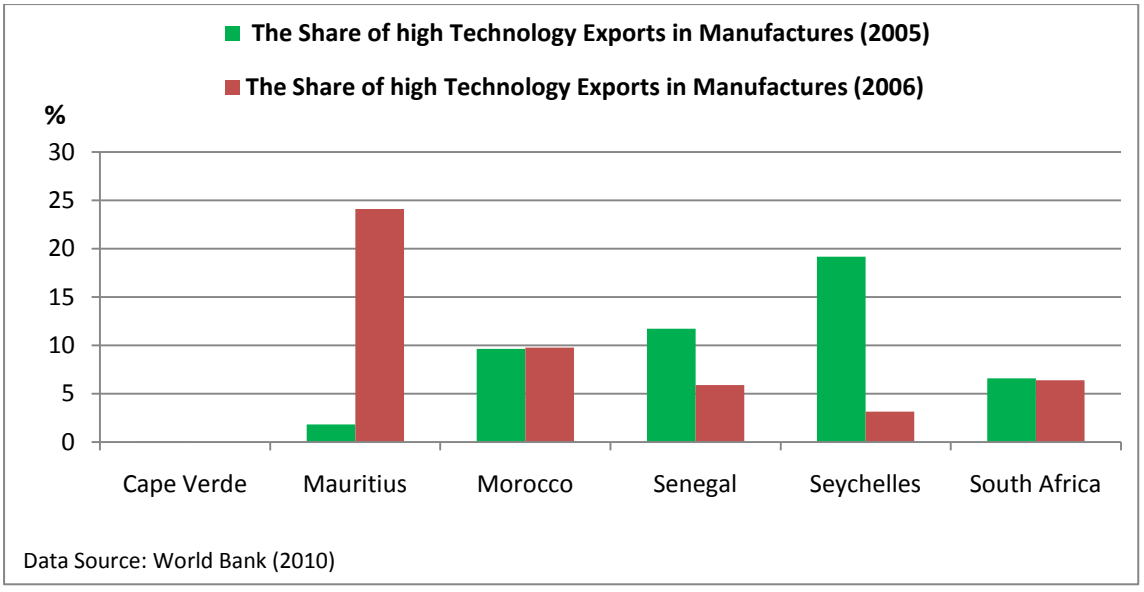
Data Source: Cape Verde Customs

5.4.3 Export Sophistication

Does this signal discovery of new products and increasing sophistication? Cape Verde is not a resource rich country; the closest to natural resources that it does have is fisheries and it is the first two on the top-ten list in 2009.[50] Among the top-ten list in 2000, three products can be categorized as low technology goods. They include parts of footwear, footwear, and clothing, while in 2009 the low technology products included clothing, parts of footwear, wood works and wooden furniture. Going down the list of products in 2000, there are two medium technology products (dyes and chemicals) and two high technology products (medicines and electronic components). In 2009, dyestuffs and medicines remain on the list while electronic components dropped off completely. What is new on the list of exports include soft drinks, molasses, oilseeds, wooden furniture, wood works n.e.c., food preparations, mineral water, chamois and paints. Among the new products only paints represent a move up the technological ladder. However, paints represent the smallest share of Cape Verde's merchandise exports. The rest are either a continuation of the low technology or natural resource based manufactures.

There have been some shifts in the composition of merchandise exports between 2000 and 2009. But based on the foregoing review however the changes do not necessarily signify a shift in the technology intensity of Cape Verdean exports. Although we do not have the data to calculate the export sophistication index, using World Bank data we calculated the share of high technology exports in manufactures in 2005 and 2006 (Figure 5.48)[51]. For Cape Verde, the share of high technology in manufactures was quite low in 2005 and did not register any in 2006. Cape Verde's performance cannot be compared to any of the comparators. We also undertook a cross country analysis using GDP per capita (PPP) and the share of high technology exports in manufactures (Figure 5.49). We can reasonably conclude that Cape Verdean exports do not show increasing sophistication.

Figure 5.48

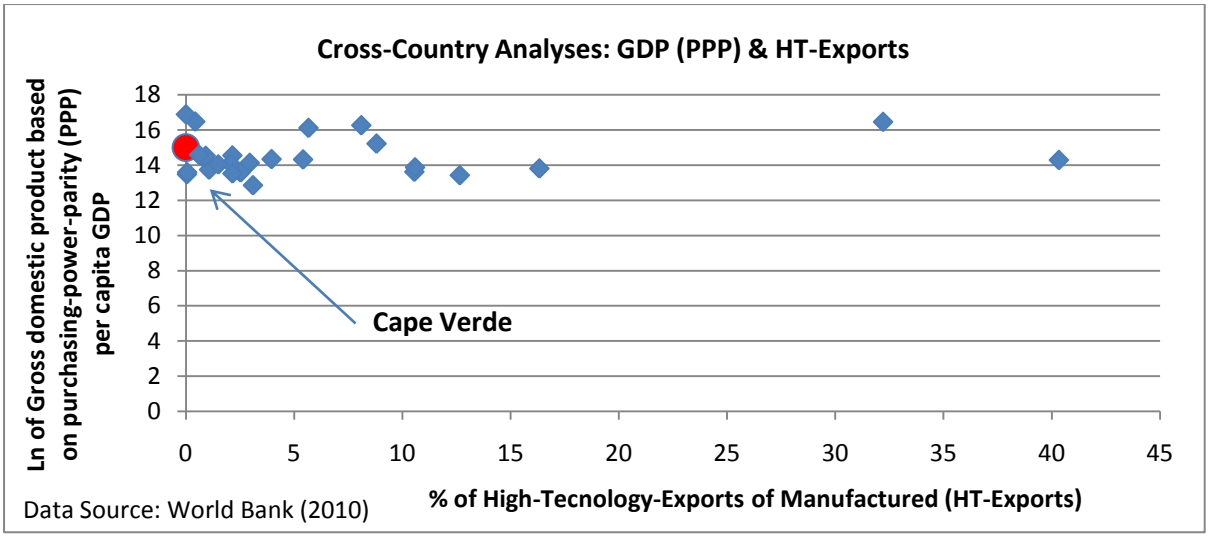


Data Source: World Bank (2010)

[50] Fish products were probably not the first two in 2000 because it was the year that the EU placed an embargo on fish imports from Cape Verde.

[51] World Bank (2010). World Development Indicators. The World Bank. Washington, DC

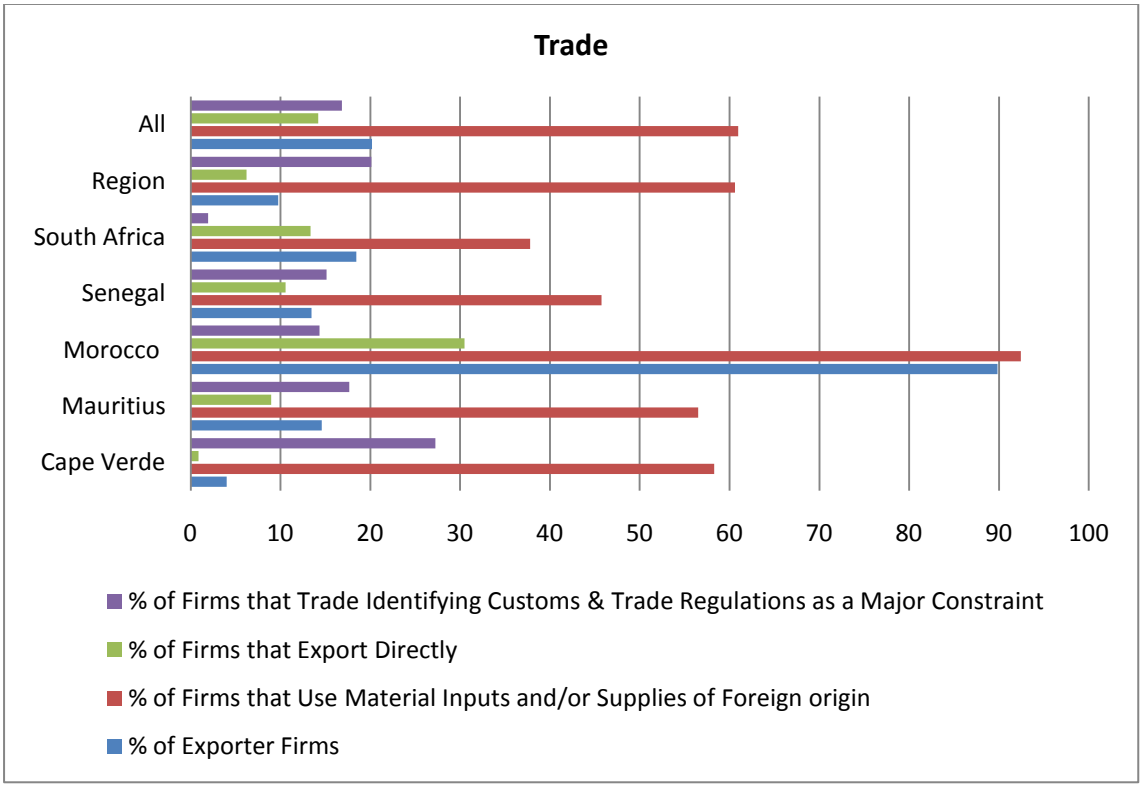
Figure 5.49



Data Source: World Bank (2010)

The limited range of Cape Verdean exports can be explained by the narrowness of the economy and the limited amount of firms that are engaged in exports. Based on the Enterprise Survey figures, only about 4,02 percent of Cape Verdean firms are engaged in exports, either directly or indirectly. This compares unfavorably to the benchmark countries. For example, 89,8 percent of Moroccan firms are engaged in exports while 18,43 percent of South African companies do. Among the comparator countries, Mauritius has the more similar economy given the dominance of services and the importance of tourism. Mauritius, however, has 14,5 percent of its firms exporting. This may be due to the success of its firms in textiles. The percentage of firms exporting in Cape Verde is also less than the average in the SSA region and for all countries (Figure 5.50).

Figure 5.50



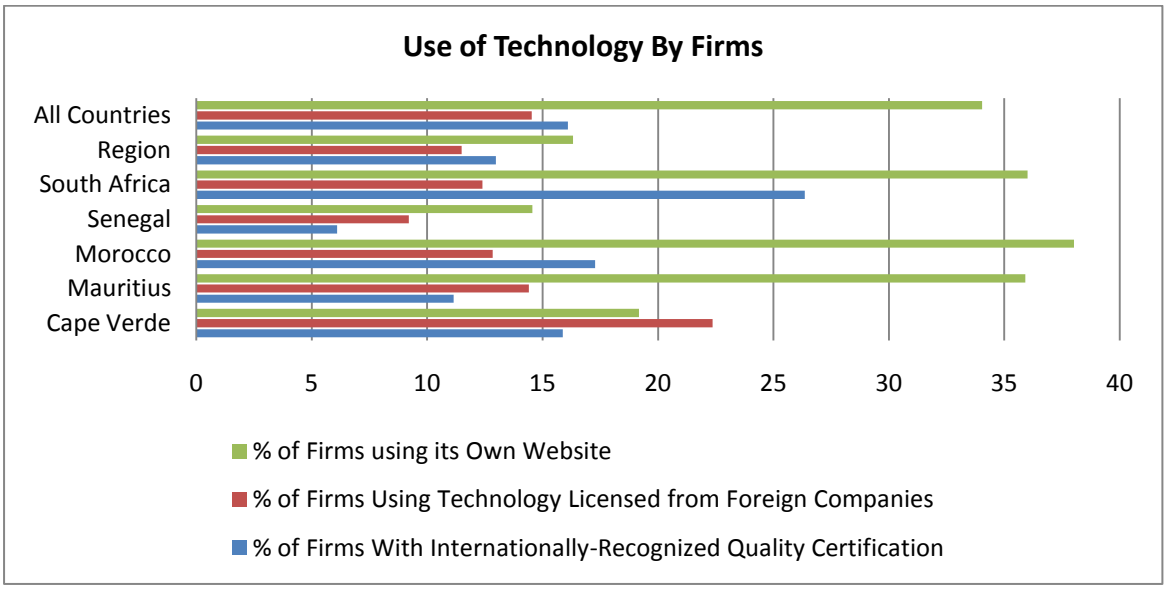
Data Source: Enterprise Surveys

5.4.4 Technology Adoption

It is possible that the high export concentration and the lack of increasing sophistication in Cape Verdean exports may be due to the lack of technology adoption. It will be difficult to expect Cape Verdean firms to export increasing sophisticated products if they are not adopting technology. We review the results of the Enterprise Survey. For example, on firm using its own of website, Cape Verde at 19,17 percent performs only better than Senegal (14,56 percent) among the comparators. Similarly, Cape Verdean firms performs better than the region (16,31 percent). On the percentage of firms with internationally-recognized quality certification, Cape Verde is right in the middle, higher than Senegal and Mauritius while lower than South Africa and Morocco. A higher percentage of Cape Verdean firms (22,36 percent) are using technology licensed from foreign companies than any of the comparators or the region or all countries.

These survey results however do not offer any conclusive evidence that Cape Verdean firms are averse to technology use. They show that on website use for example that Cape Verde is behind the leader but has higher adoption rate than the region. At the same time, its position is right in the middle when it comes to percentage of firms adopting internationally-recognized certification while a leader in terms of using foreign-licensed technology (Figure 5.51).

Figure 5.51



Data Source: Enterprise Surveys

5.4.5 Explaining the Cape Verdean Situation

Moving from low technology products to technology intensive products is not automatic nor is it guaranteed. The strategies used to achieve competitiveness have differed greatly between countries. However, moving up the value chain in terms of producing ever higher technology intensive products requires, no matter what strategy a country adopts, the mastery of learning and innovation. Increasingly those that are successful see an increase in the number of export products and the rise in the sophistication of their export products.

Cape Verde has made major strides in growing its economy over the years. But on the question of exporting increasingly sophisticated products or services, it is a laggard. For sustained growth and poverty reduction, Cape Verde must be able to expand its exports and move up the technology scale. This is particularly important given the importance of export competitiveness for nations and Cape Verde's graduation from the list of LDCs.

Cape Verde is now in transition, working on moving towards a more entrepreneurial economy with emphasis on innovation. This however will require highly qualified knowledge workers, professionals and entrepreneurs. These, at present, are missing elements in the Cape Verdean armory. The capacity to process knowledge, innovate and produce increasingly sophisticated export products is highly dependent on the level of human capital. As noted in the section on human capital earlier, the Cape Verdean economy is more and more challenged by the lack of skilled labor. The transition from aid and remittances-based development to innovation-driven economy requires a different set of skills, which are in short supply in Cape Verde at this time. In addition to the shortage of skills from vocational, professional to specialized skills, there is a mismatch between supply of skills and market needs.

Compounding the situation is the quality of high education in Cape Verde. About 10 years ago, there were no universities in Cape Verde. By 2010, Cape Verde has nine universities. Among the nine, one is public while the rest are private. Presently, the university system is not equipped to undertake innovation oriented research and development. There is no national research council or fund to promote and support research and innovation activities. Most faculties in the universities are part time without the necessary training to be academics or professors. Faculties are not engaged in the types of development that is necessary to produce the graduates that will be the knowledge workers of tomorrow. Laboratories are limited. Libraries are not adequate. Physical infrastructure and teaching facilities are inadequate. Well trained faculty with PhDs is in very short supply. It is particularly challenging for professions in the sciences, technology, and engineering. A key element of the problem is the weak national capacity to manage and regulate tertiary education sector in Cape Verde. It is a new sector and the least to emerge is a system for planning, managing and regulating the sector. Additionally, there are no resources set aside or plans to develop the academics for the universities.

The lack of a robust system of accreditation and quality control makes it difficult for consumers to know which is which among the universities in Cape Verde. There are no rating agencies for universities or any market information which may help in the evaluation of universities. Additionally, there are no systems for professional bodies to regulate professions such as medicine, law, accounting, and others like it is in advanced economies such as the United States. Professional bodies do not exist in most instances. And, in cases where they do, they have no rigorous process of admitting practitioners.

From the labor market perspective, market information is limited and not systematically produced on market demand. For example, the department of education undertakes only a partial review of market needs. Importantly, survey of firms on current and future employee needs to inform national manpower planning and individual education decision is underdeveloped.
These problems affect not only university education but also vocational training. The system for vocational training lacks coordination and is not linked with the agenda for economic transformation

which is focused on building Cape Verde as an international platform for services. The development of the transformation sectors will require highly skilled professionals and current educational system will need to be retooled.

The road to increasing export sophistication for Cape Verde depends highly on the ability of the nation to build the necessary human capital. It is only through training of the knowledge workers and professionals. Success however will depend on the nation's ability to provide the necessary public goods, including accreditation, quality control, market information, faculty development, and the physical and technological infrastructure that are necessary for tertiary (vocational and university) education in Cape Verde.

5.4.6 Innovation Summary

In summary, use of technology is important and could be a harbinger of propensity to innovate. However, the crucial result must be increasing innovativeness. On this, a critical judge is the nature of the nation's export basket. Increasing exports sophistication is associated with higher incomes and with lower poverty rates on average. The reality in Cape Verde is that its export basket is limited and concentrated in a few low technology or resource-based manufacture such as fisheries. However, the problem is not concentration; it is the lack of upward mobility in the technology ladder.

Somehow Cape Verde has not been able to break out to producing technology-embodied products with some exception such as clothing, footwear, paints and medicines. However, these are still produced and exported in very low quantities. Two explanations can be offered. First, the lack of inputs (no primary resources, high costs of inputs, and limited labor pool) and smallness of the market militate against large investment in manufacturing. Secondly, Cape Verde over the years, despite building a reasonably sound macro and micro economic environment has not been able to build the ecosystem that is needed for innovation. One key limitation here, as identified above, is the human capital. Cape Verde's skills base is weak and is a crucial constraint to building a more innovative and entrepreneurial economy.

University institutions are relatively new to the country while vocational training is limited and the institutional infrastructure for tertiary education has been limited. Applied technical, scientific and engineering research is not common. Venture or risk capital is almost nonexistent. Linkage between university and private sector does not exist. Without an ecosystem –anchored on high skilled knowledge workers and skilled professionals—which could support innovation it is highly unlikely that Cape Verde could have produced and export increasingly technology intensive products in any significant quantity.

These realities make it difficult for Cape Verde to move up the high technology product ladder. Innovation is a binding constraint. But as countries such as Japan have demonstrated, innovation is critical for growth for resource-poor island nations such as Cape Verde. It is only through innovation that such nations can overcome the challenges posed by the lack of resources. But for this to happen in Cape Verde, the necessary human capital must be developed.

6

Is it Low Appropriability?

We now turn to risks in the search for binding constraints to growth in Cape Verde. The diagnosis focuses on two potential sources of constraints: macro and micro risks. We take these sources in turn.

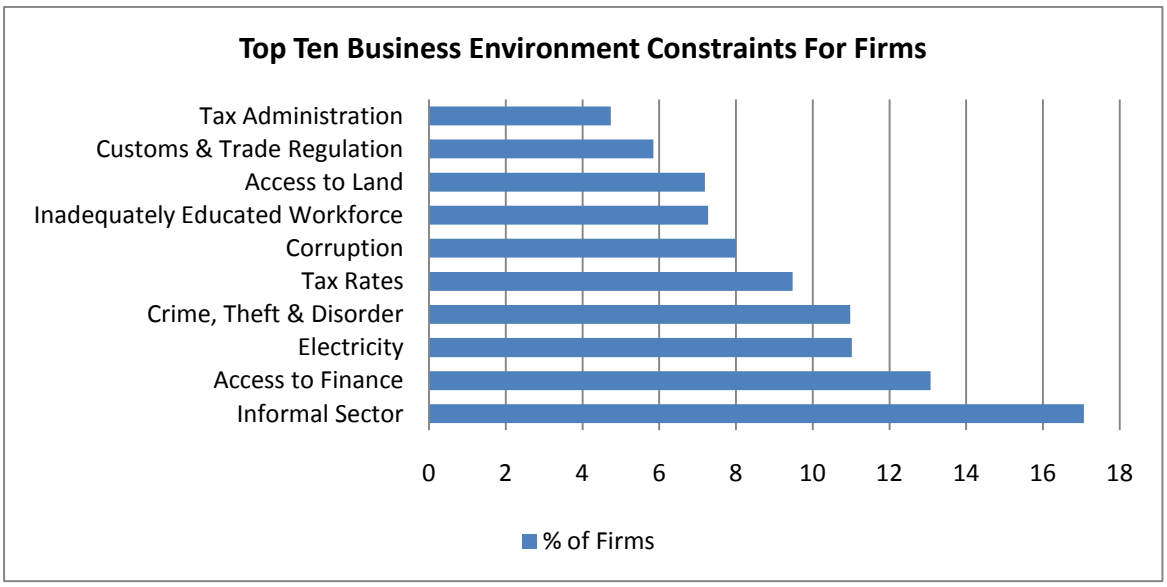
6.1 Is it Macro Risks?

The macroeconomic environment has a crucial role to play in ensuring and maintaining long term competitiveness and growth. Without it, competitiveness and growth will be harmed and long term development cannot take place. Macroeconomic stability works through confidence; it allows firms and other economic agents to make investment decisions. Maintaining stability requires keeping a lid on inflation, managing deficits and ensuring that the currency is not overvalued. Without a stable macroeconomic environment, inflation is likely to run out of control. Consequently, economic agents will be unable to make informed decisions. For a country such as Cape Verde maintaining macroeconomic stability is even more important, as a country that is heavily dependent on external resource flows. The only way to facilitate the flow of resources is to ensure a credible and stable macroeconomic environment.

6.1.1 Business Concerns

The survey of Cape Verdean businesses shows that a large percentage of firms are not concerned about the business environment (Figure 6.1). The top three concerns are the informal sector, access to finance and electricity. Among the top concerns only one breaks the 15 percent barrier. That is, about 17 percent of firms are concerned about the informal sector in Cape Verde.

Figure 6.1

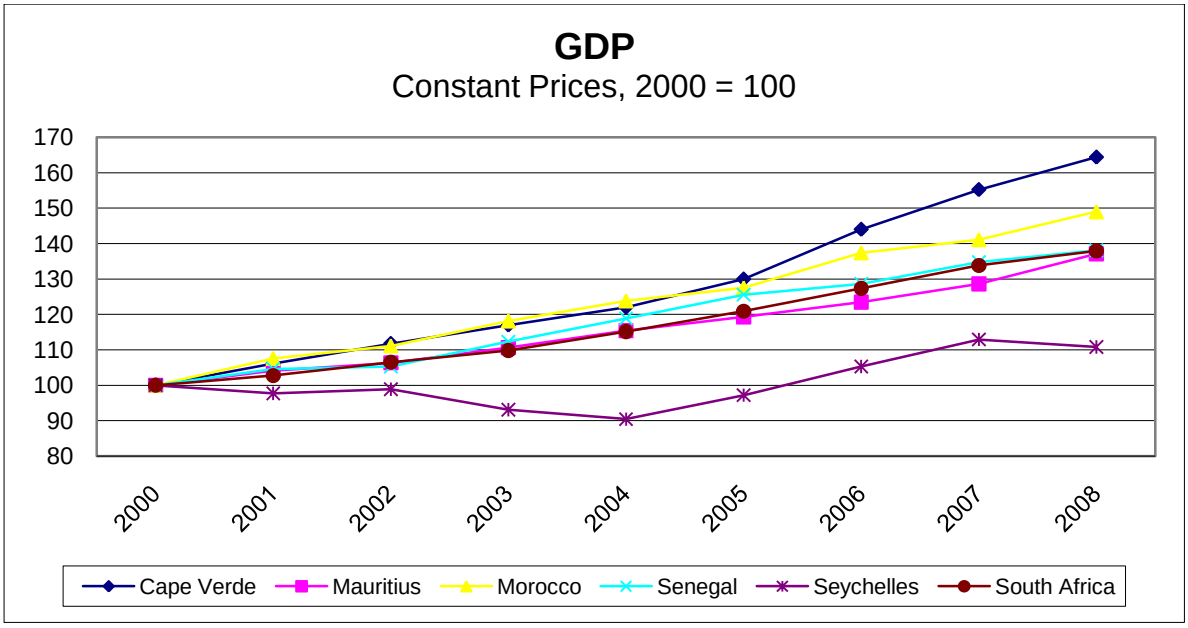


Data Source: Enterprise Survey

6.1.2 The Macro Economy

As demonstrated in Section 1, the Cape Verdean economy has experienced substantial growth over the years. Between 1999 and 2007, GDP growth averaged 7,18 percent. Taking 2000 as a base year, Cape Verde performed well relatively to the benchmark countries over the proceeding eight years (Figure 6.2).

Figure 6.2

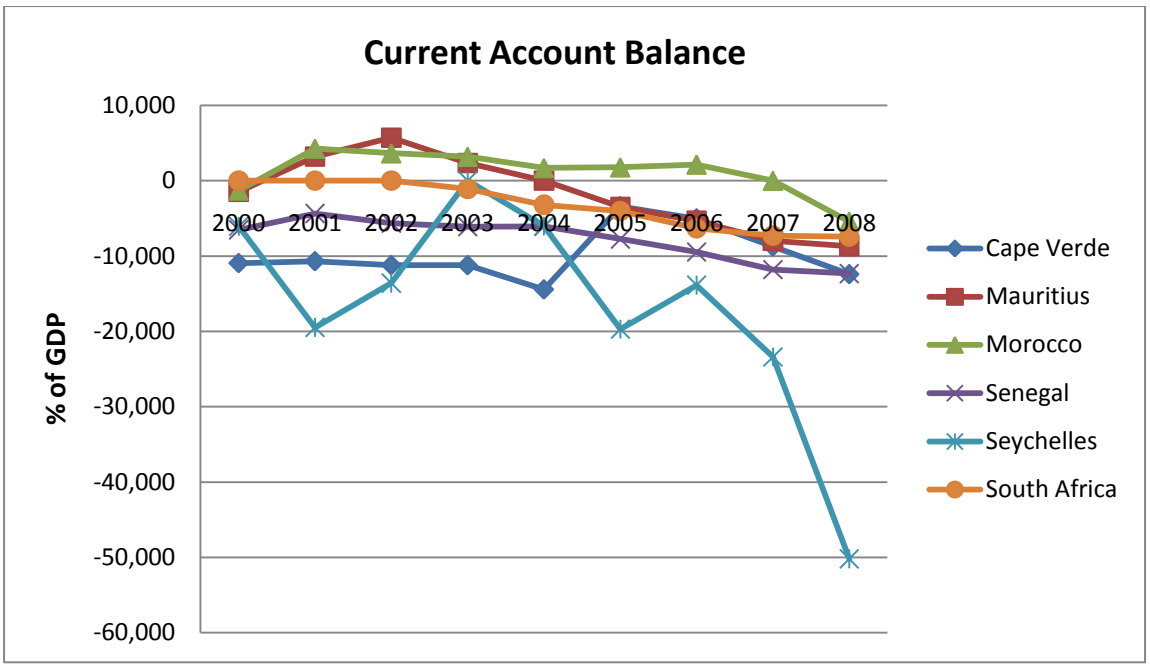


Data Source: IMF

The global crisis has not spared Cape Verde. It has had effects on some major sources of external financing and slowed investments in the key sector, tourism. The government put in place countercyclical measures to ease the effects of the global crisis. Among the measures implemented were the reduction of the tax rate for households and firms, enactment and implementation of a major public investment program, and increased social transfers to vulnerable families. The government's response has been timely and has stimulated demand and investment. The projected economic growth rate by the IMF for Cape Verde despite the negative impact of the global crisis is 3.5% for 2009 and 4% for 2010.

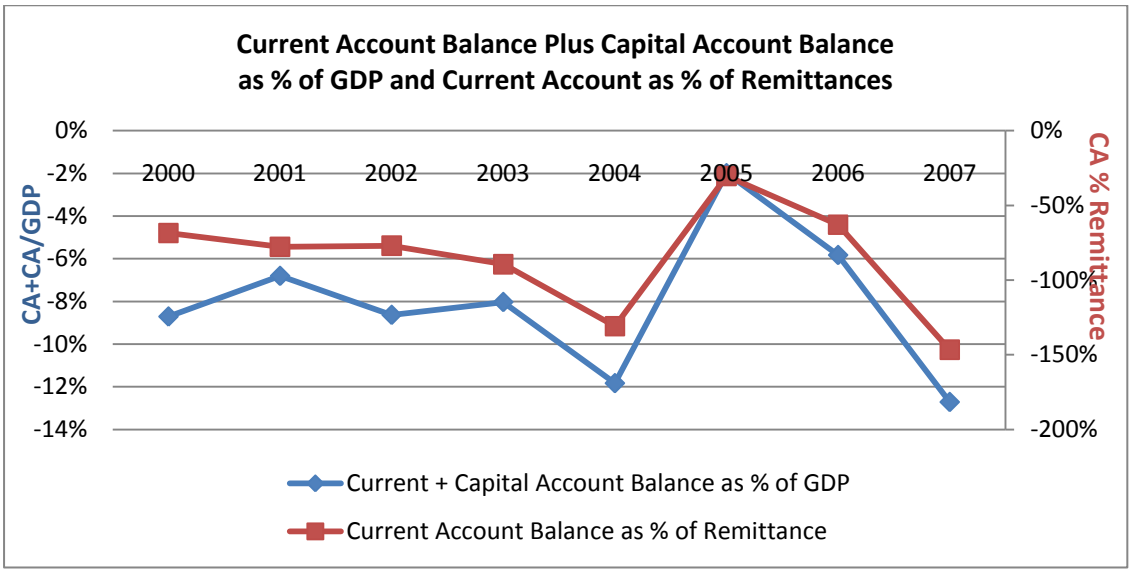
The downside of the measures is the deterioration of the public finance. The deficit rose from 1.2% of GDP in 2008 to about 9% in 2009. The current account situation also worsened (Figures 6.3 & 6.4). This has generated concerns in some quarters. It is not only Cape Verde is faced with a worsened current account balance. The comparator countries have witnessed the same deterioration in the current account balance. For Cape Verde, however, the deterioration should not be a major concern. The overall debt to GDP ratio is on the decline and government has met the objective of reducing domestic debt to less than 20% of GDP, two years earlier than expected. Importantly, the increased debt is to fund a major investment program in infrastructure which could improve Cape Verde's long-term competitiveness and broaden the productive base of the economy.

Figure 6.3



Data Source: IMF

Figure 6.4



Data Source: BCV

A major strength of Cape Verde is its judicious fiscal and monetary policies in face of the global developments. The monetary policy has consolidated the independence of the Bank of Cape Verde, the central bank. It is pragmatic and necessary to sustain the peg of the Cape Verdean Escudo (CVE) to the Euro, and to attract emigrant savings. There are also key structural reforms. One of this is the system for the Integrated Government Budgetary and Financial Information Management (SIGOF) which provides for enhanced transparency and accountability in public finance management in Cape Verde. The government is also working to meet the requirements to better integrate into the regional and global economy. An example is the formulation and implementation of action plans focused on tax and customs reforms in light of Cape Verde's membership of the World Trade Organization (WTO).

The government has thus been able to manage to control inflation (Figure 6.5). Cape Verde compares well the benchmark countries (Figure 6.6). The spikes in inflation, in recent years, have been due, in large part, to the volatility in energy and food prices. Record global surge in the prices of oil and food were witnessed in 2007-2008. Cape Verde imports most of its energy and food. Specifically, it is highly dependent on imported oil to generate about 90 percent of its power needs and to produce most of the water it needs through desalinization.[52] However, Cape Verde has managed to minimize the effects of the global volatility in prices. Data also indicate a very low correlation between changes in consumer price index (CPI) and the broad monetary measure, M2 (Figure 6.7).

Figure 6.5

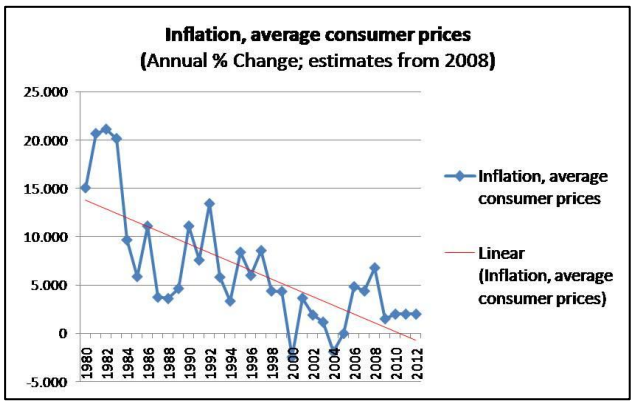
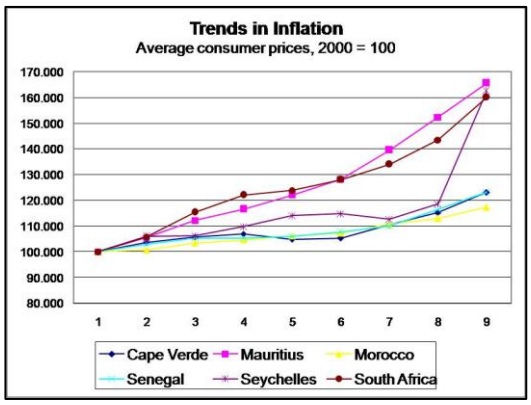
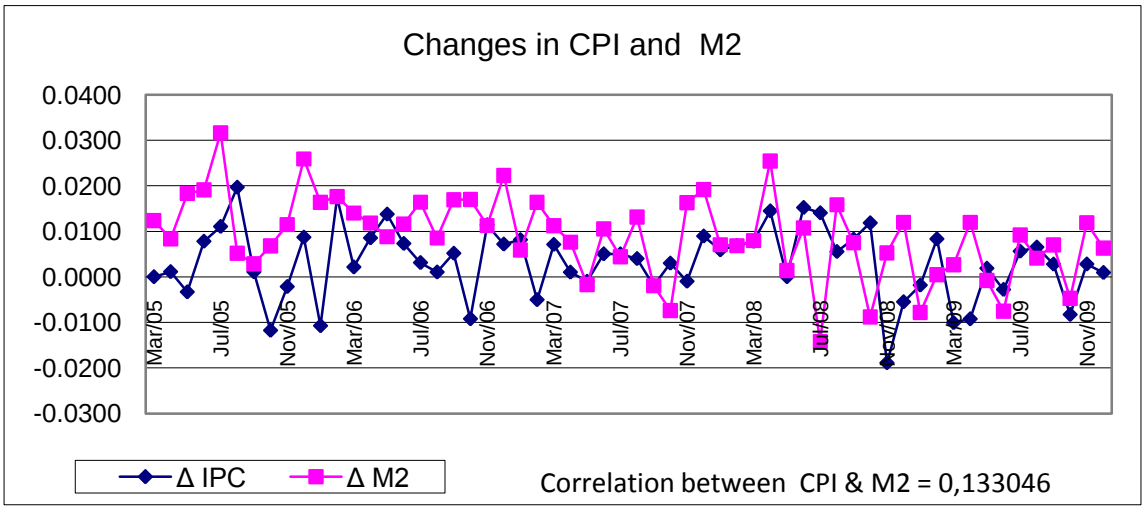


Figure 6.6



Data Source: IMF

Figure 6.7



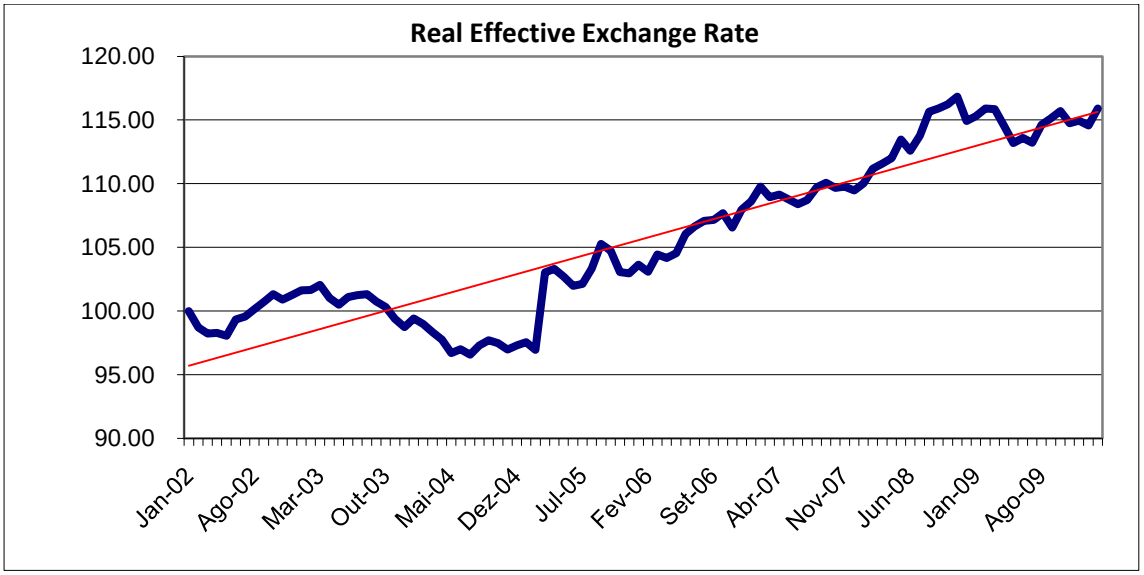
Data Source: IMF

[52] The dependency on imported oil should begin to decline from 2011 as ongoing renewable energy projects come on stream. The national energy policy adopted in 2008 (http://www.governo.cv/documents/politica_energetica.pdf) set as an objective the generation of 50 percent of the energy needs from renewable sources by 2020.

The expectation is for continued stable and low inflation. Cape Verde has been able to weather the recent global economic downturns. As concluded by OECD (2009), "Despite pressures stemming from the volatility of international food and fuel prices over the past year, the country has managed to sustain high growth without falling prey to strong inflation. This is due in part to the Cape Verdean escudo's peg to the euro but also to the dismantling of wage indexation. Inflation was a moderate 6.7 per cent in 2008, and is expected to fall in 2009 and again in 2010."

The expectation of a moderate inflation is due in part to the prospect for a good harvest. Rainfall in 2009 was very good and outputs are expected to increase. There are two likely effects: lower food prices and lower food imports. This will contribute to an improvement in the trade balance. Unfortunately, the policy choices in the short term are limited as the Bank of Cape Verde only has the ability to follow a limited independent monetary policy given the currency peg to the Euro.[53] Cape Verde's real effective exchange rate has been on an upward trend since February 2005, with a decline in early 2009 before rising again (Figure 6.8). The currency peg has its benefits and costs. But what is important is that Cape Verde has been able to largely build a credible policy regime.

Figure 6.8



Data Source: IMF

The key challenge which Cape Verde must face is addressing the core limitations which geography poses for the economy, and which limits its ability to compete in the global marketplace.

6.1.3 Macro Risks Summary

In summary, macro risks are not binding constraints to growth for Cape Verde. Yes, it will be important to continue to build on the reforms and to maintain macroeconomic stability. Cape Verde has passed all the policy support instrument (PSI) reviews of the International Monetary Fund (IMF)

[53] Marcio Ronci (2009), "Navigating the 'Impossible Trinity' – Monetary Management under the Exchange Rate Peg in Cape Verde," IMF Working Paper. Washington: International Monetary Fund.

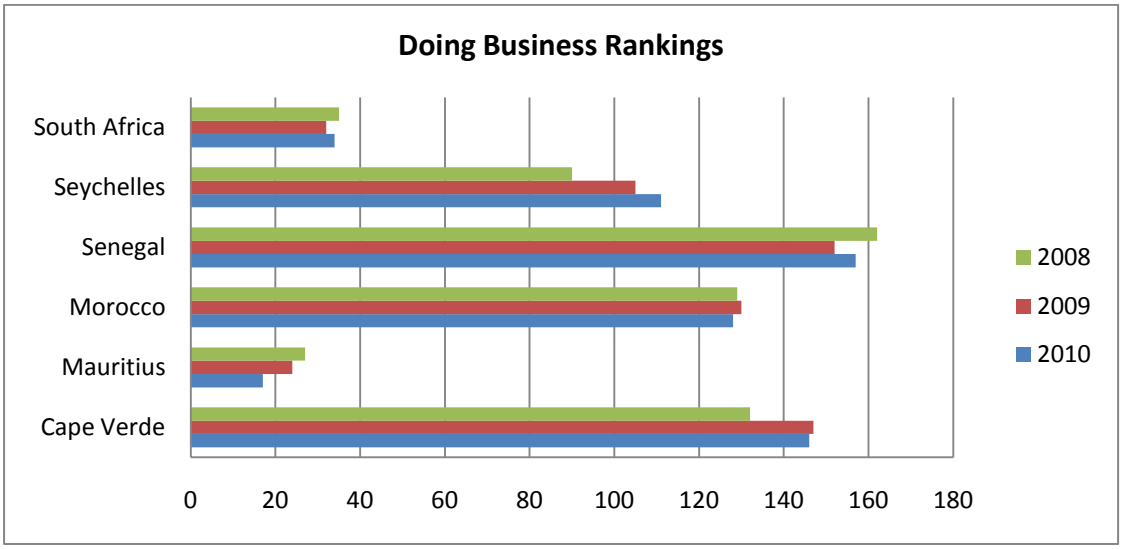
to-date. In fact, in IMF's recent report towards the end of 2009, it concluded that Cape Verde's "Prudent macroeconomic policies in recent years created sizeable buffers in the form of increased international reserves and low domestic debt. … The government public investment program is appropriately aimed at eliminating major infrastructure bottlenecks and so increasing the economy's long-term potential growth. Monetary management aiming at stabilizing capital flows continues to be broadly appropriate. The exchange rate peg continues to serve Cape Verde well as an anchor for financial stability. Steady progress is also being made in the implementation of structural reforms in particular to improve public debt and financial management and strengthen the financial system."[54]

6.2 Is It Micro Risks?

6.2.1 Doing Business Rankings

Cape Verde ranks 146th out of the 183 economies included in the 2010's doing business report (Figure 6.9).[55] Within the Sub-Saharan Africa (SSA) region Cape Verde's ranking is 20th out of 46 countries. A priori, Cape Verde is expected to rank better, whether among SSA countries only or in the world rankings. The government realizes this and has established a task force to lead the effort to reform where it is necessary to ensure that business constraints are lifted. The government also contends that the ranking does not reflect some ongoing reforms.

Figure 6.9



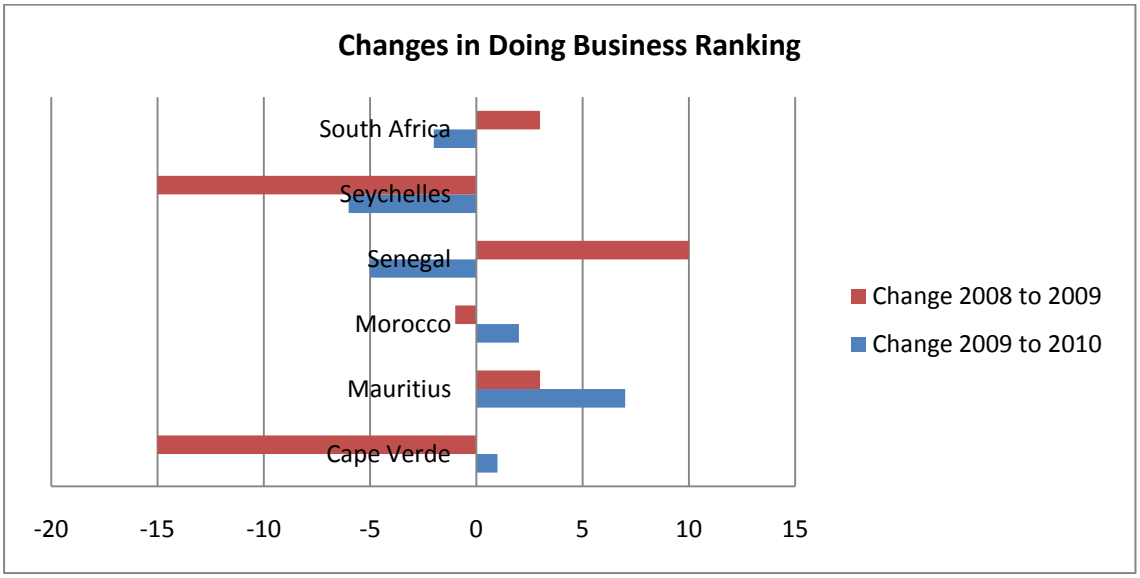
Data Source: Doing Business

Compared to previous years, Cape Verde has not followed a straight trajectory. Between 2008 and 2009, Cape Verde's position (or ease of doing business) according to the report deteriorated. Its rank actually decline by 15 positions during the period. However, it had a marginal improvement between 2009 and 2010; it improved its ranking by one position. Among the comparator countries only Senegal performed worse on the ranking that Cape Verde consistently through the three years. Mauritius and South Africa performed significantly much better in the overall rankings, while

[54] IMF 6th PSI Report, October 2009.
[55] Doing business report data obtained from http://www.doingbusiness.org/

Morocco is only did slightly better than Cape Verde. Seychelles follows Mauritius and South Africa. A focus on the changes over the three year period shows that between 2008 and 2009, South Africa, Senegal, Mauritius improved their overall positions while Seychelles, Morocco and Cape Verde declined in the rankings. Between 2009 and 2010, South Africa, Seychelles and Senegal positions deteriorated. Only Seychelles' position deteriorated in both periods. Cape Verde and Morocco managed to improve slightly (1 and 2 positions respectively) while Mauritius improved its position by seven (Figure 6.10).

Figure 6.10



Data Source: Doing Business

6.2.2 Explaining the Rankings

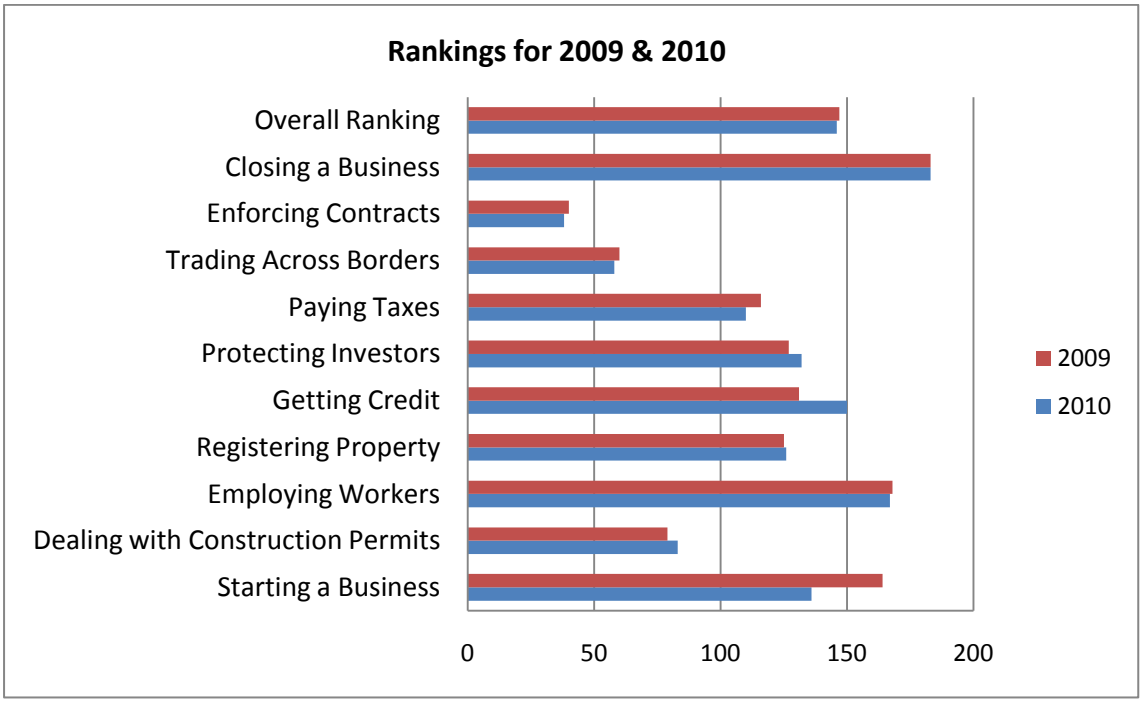
What accounts for Cape Verde's position? This will require an examination of the performance of Cape Verde in the ten factors which constitute the basket from which the overall ranking is computed. We look at the rankings in 2009 and 2010 and calculate the changes in position between 2009 and 2010 (Figures 6.11 & 6.12).

Two factors weigh Cape Verde's ranking down significantly. They are: closing a business and employing workers. The corporate or entrepreneurial culture is relatively young in Cape Verde. Regulation on closing firms can be burdensome especially for SMEs. Many entrepreneurs therefore simply do not take the trouble to legally close firms. The result is that Cape Verde is ranked 183rd out of 183 economies in closing a business, but it is because the data point is zero. Employing workers is also another factor in which Cape Verde ranks quite low. This is in part due to inflexible labor law despite recent reforms.

The next set of factors are getting credit, protecting investors, registering property, starting a business, and paying taxes. Cape Verde performs better in these variables compared to the first two. But the rankings are still low. Among these variables, Cape Verde witnessed improvements in starting a business and paying taxes. It deteriorated in getting credit, and protecting investors. Registering property witnessed slight change, from 125th to 126th position among the 183 countries.

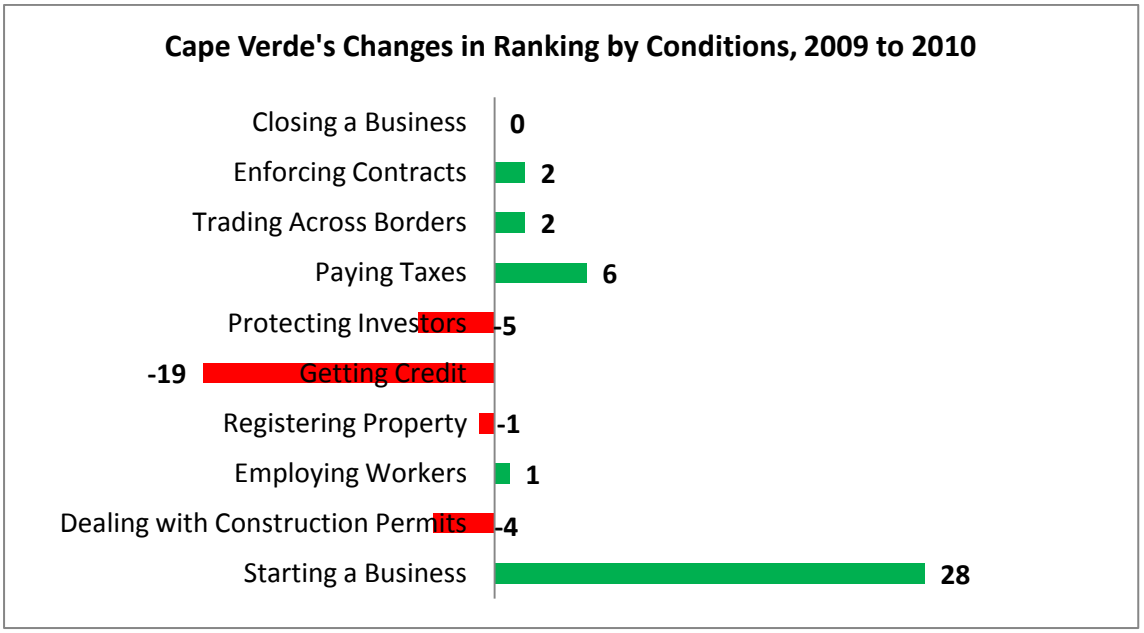
Cape Verde's best performance are in enforcing contracts, trading across borders, and dealing with construction permits. Cape Verde's position deteriorated slightly in dealing with construction permits while improving slightly in the other two factors.

Figure 6.11



Data Source: Doing Business

Figure 6.12



Data Source: Doing Business

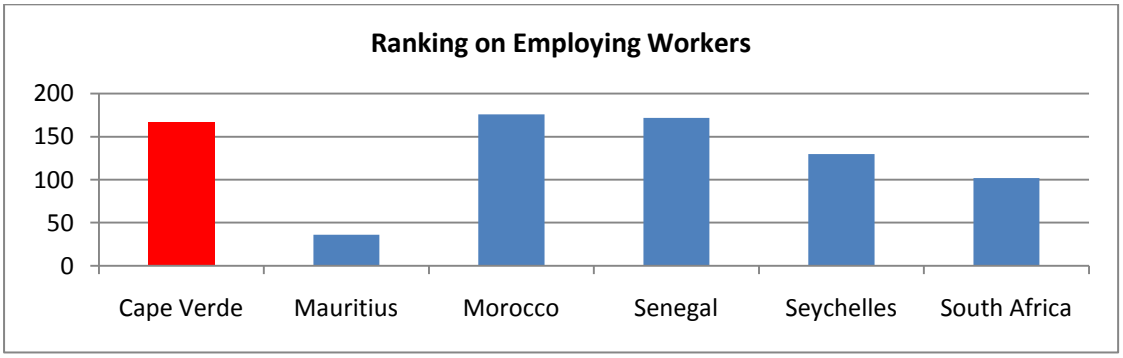
Thus, between 2009 and 2010, Cape Verde made improvements in five conditions, deteriorated in four while remaining in the same spot in one. The most gain is in starting a business where it moved up in ranking by 28 positions and deteriorated the most in getting credit where it dropped by 19 positions. This highlights the fact that getting credit remains a constraint for the Cape Verdean

private sector despite the high financial intermediation in the economy as shown earlier. Key problems areas where Cape Verde ranks close to the bottom and without much of a movement include employing workers and closing a business. We now look at some of the conditions.

6.2.3 Employing workers

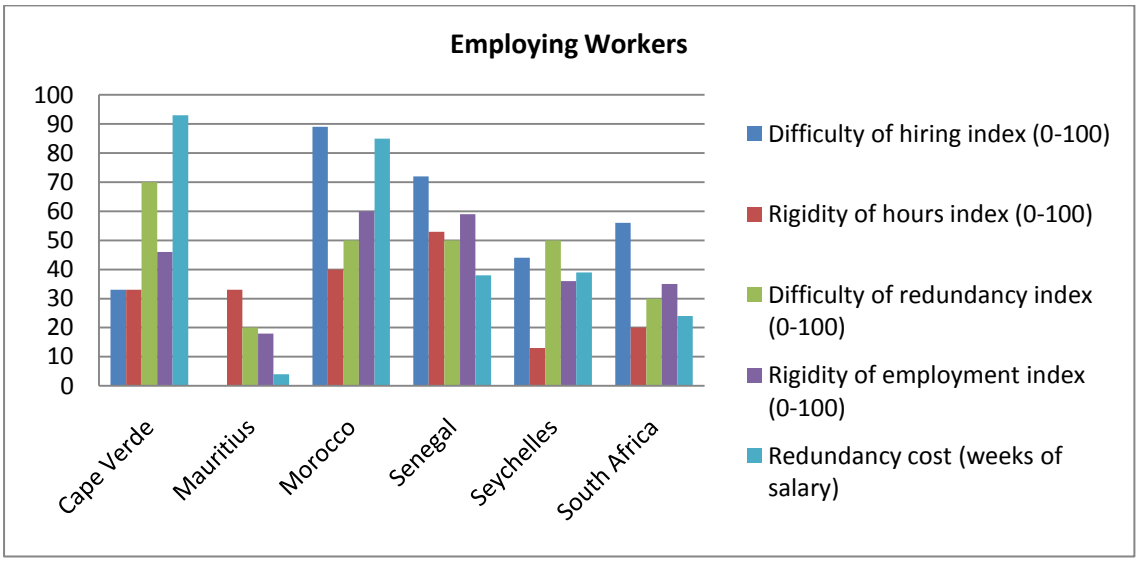
On employing workers Cape Verde made a minor improvement between 2009 and 2010. But at 167th position in this factor, Cape Verde is far below the list of the best performers. Within the group of comparators, Cape Verde only performed better than Morocco and Senegal. It substantially trails the leader, Mauritius, while it is 65 and 37 places behind South Africa and Seychelles, respectively (Figure 6.13). A key culprit is the cost of redundancy (Figure 6.14).

Figure 6.13



Data Source: Doing Business

Figure 6.14



Data Source: Doing Business

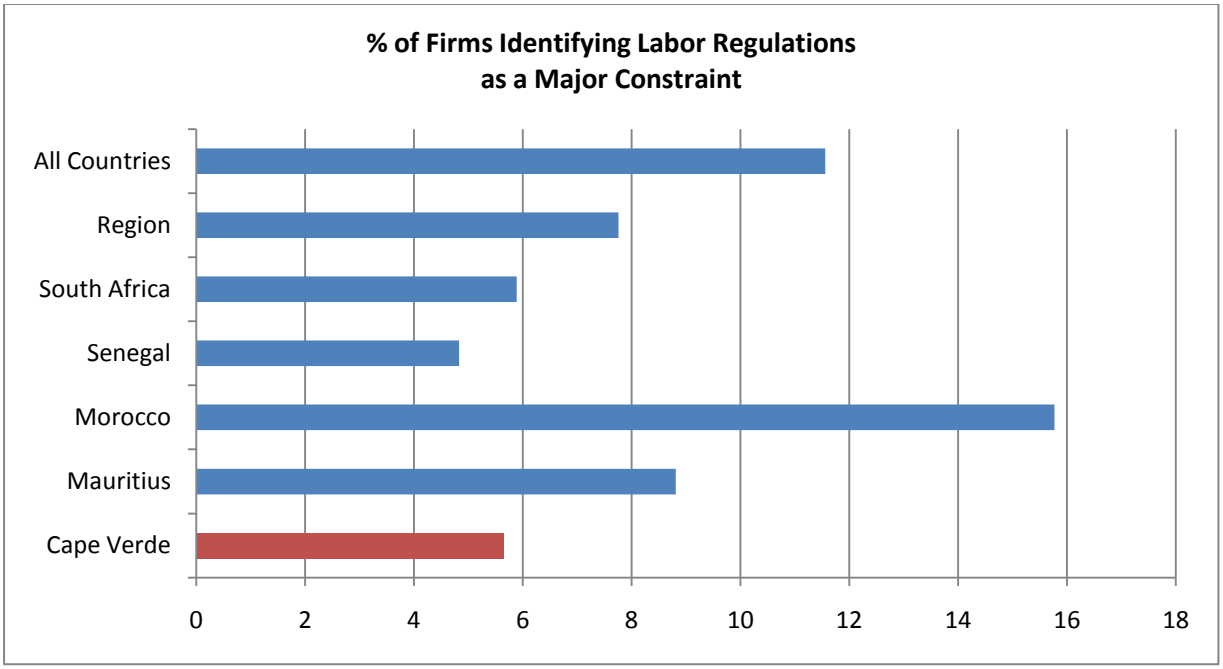
Cape Verde underperformed the comparators substantially with respect to the difficulty of redundancy and the cost of redundancy. The main problem for Cape Verde is the legal regulation which makes it difficult to dismiss employees. The process can be long and can be costly, with a slow justice system which seems to almost always side with employees in such disputes. It limits firm's

ability to make economic decisions and control costs, with implications for the bottom line and competitiveness.

A labor law was passed in 2008 to improve the situation. It did introduce flexibilities such as non-indexing of wages to inflation and the possibilities of changing labor contract. But its provision which limit the use of fixed-term contracts introduced another kind of rigidity. Rigidities of the labor market including economic barriers to lay-offs persist. The average cost to a business of dismissing a worker is equivalent to 93 weeks of wages (AfDB, 2009).

The result is that firms are excessively cautious with recruitment and hinders the nation's capacity to generate growth. A review of Enterprise Survey result shows that only 5,66 percent of firms identified labor regulations as a major constraint well below the benchmark countries except for Senegal (Figure 6.15). However, this does not nullify the high costs of redundancy in Cape Verde.

Figure 6.15



Data Source: Enterprise Survey

6.2.4 Corruption

The perception that Cape Verde is a well governed is well deserved. In fact, its political and institutional achievements, as documented by Freedom House, the Mo Ibrahim Governance Index, Transparency International, AfroBarometer and other measures is quite impressive (Tables 6.1 & 6.2). In the Mo Ibrahim Index of Good Governance in Africa launched in November 2009, Cape Verde was ranked second, with Mauritius coming first. Similarly, it was ranked third in 2006 and second in 2007. On the issue of good governance, Cape Verde consistently outperforms the comparator countries except Mauritius and Seychelles.

Table 6.1 Cape Verde Rankings

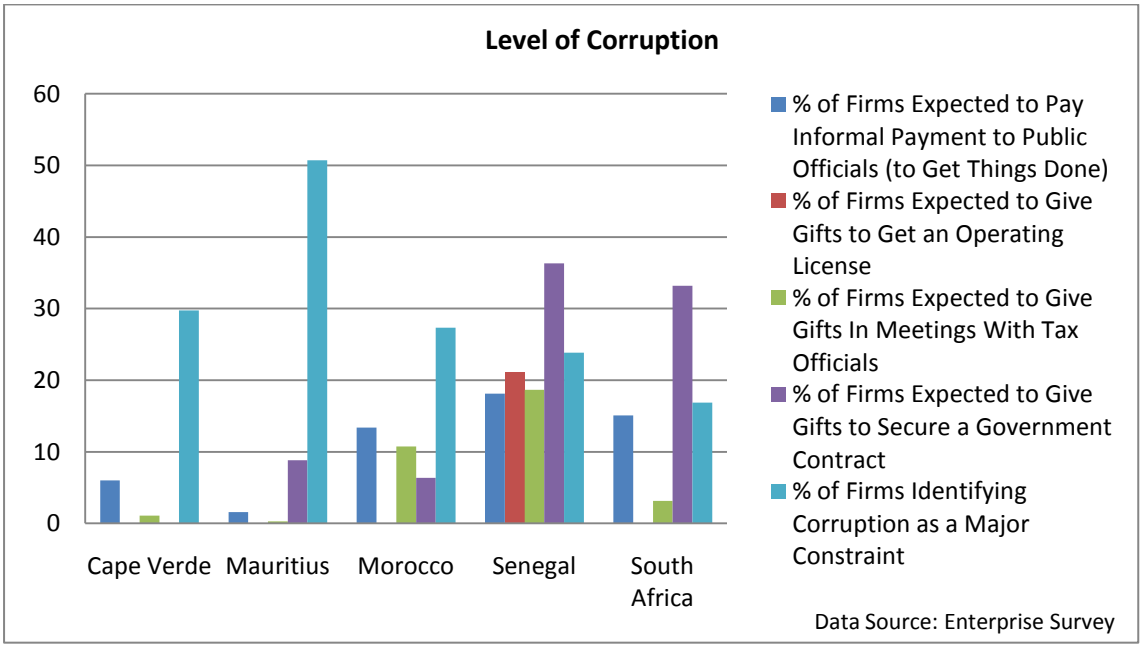
Rankings	Index
# 2 in Africa	2009 Mo Ibrahim`s Foundation: **Good Governance Index**
# 34 in world	EIU; **2008 Democracy Index**
Among 8 most free countries in SAA	Freedom House: **2009 Freedom Index**
# 7 in Africa	Heritage Foundation: **Economic freedom Index**

Table 6.2 Mo Ibrahim`s Foundation: **Good Governance Index**

Country	Rank 2006	Rank 2007	Score
Mauritius	1	1	82.8
Cape Verde	3	2	78
Seyshelles	2	3	77.1
Bottswana	4	4	73.6
South Africa	5	5	69.4
Namibia	6	6	68.8
Ghana	8	7	66
Tunisia	7	8	65.8
Lesotho	9	9	61.2
Sao Tome & Principe	10	10	60.2

An important element of good governance in Cape Verde is the low levels of corruption in addition to its strong democracy and respect for rule of law and human rights. On the issue of corruption, Cape Verde competes well with the comparator countries. Only about 6 percent of the firms surveyed expected to make informal payments to public officials to get things done while zero percent expected to give gifts to obtain operating license or to secure government contract (Figure 6.16).

Figure 6.16

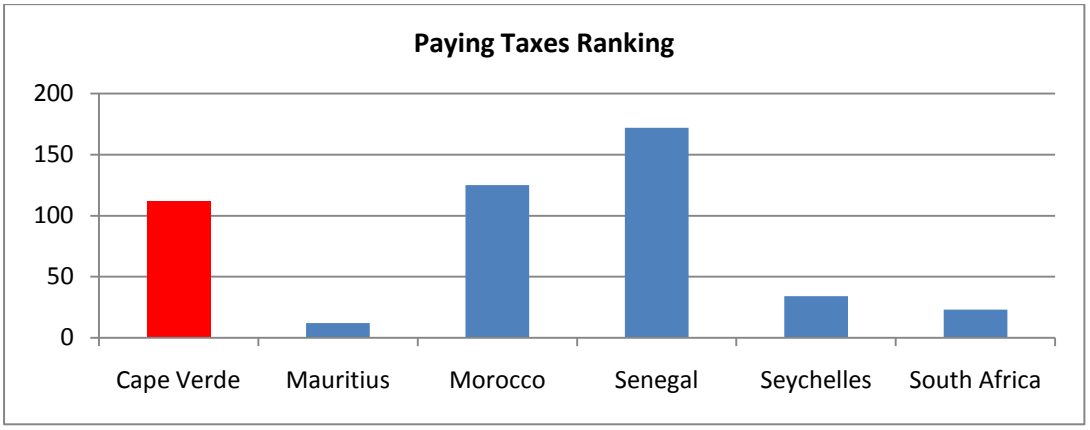


The procurement reforms and public finance management system which the government has undertaken has been crucial. The area of concern has been the customs but there are efforts to automate and reform the clearance process, which will reduce the opportunities for corruption.

6.2.5 Paying Taxes

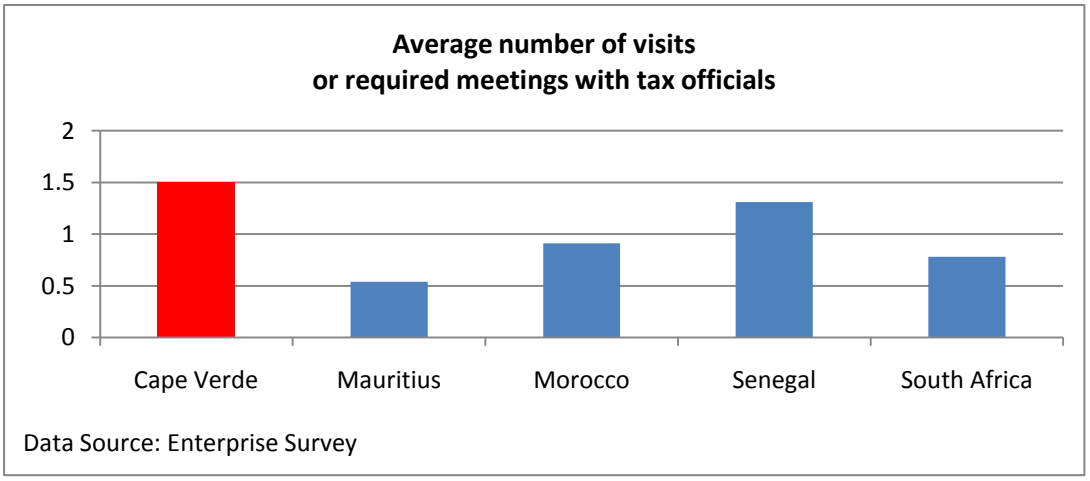
At 112th position, Cape Verde ranks only better than Senegal and Morocco among the benchmark countries in paying taxes in the doing business report (Figure 6.17). Cape Verde's performance is the lowest among the comparators when it comes to the administrative costs, as measured by the average number of visits or required meetings with tax officials (Figure 6.18).

Figure 6.17



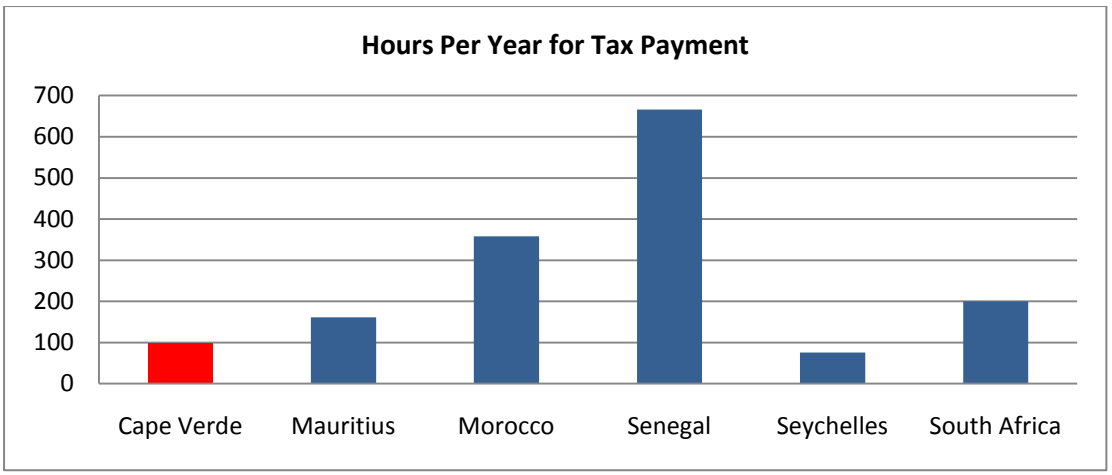
Data Source: Doing Business

Figure 6.18



On the numbers of hours spent per year in tax preparation, which may relate to the complexity of tax regulation or bureaucracy, Cape Verde scores better than all the comparator countries (Figure 6.19) except for Seychelles. However, this may also be partly due to the fact that the average Cape Verdean firm is probably smaller than say the average firms in the benchmark countries.

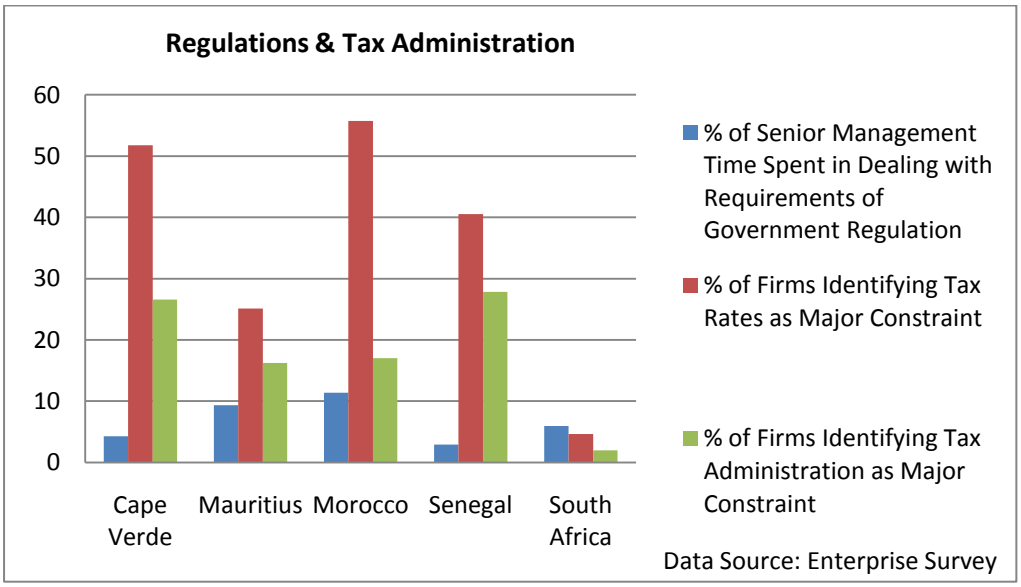
Figure 6.19



Data Source: Doing Business

Similarly, Cape Verde is in second place to Senegal on the percentage of time spent by senior management on dealing with government regulation. On the percentage of firms identifying tax administration as major constraint, Cape Verde is far behind the leader, South Africa, and only slightly better than Senegal, the last among the benchmark countries. 51,79 percent of Cape Verdean firms see the tax rate as a major constraint. On this, Cape Verde lags behind the benchmark countries except Morocco at 55,74 percent (Figure 6.20).

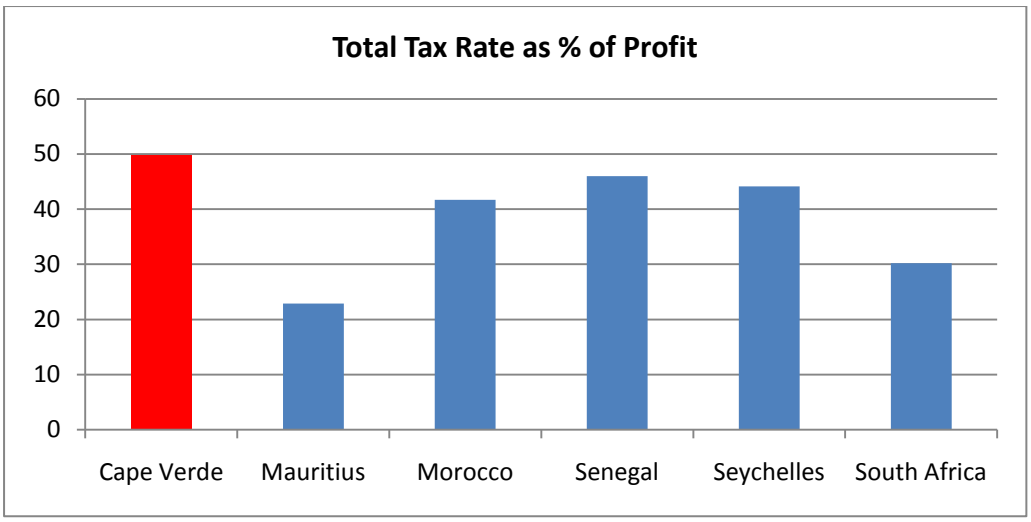
Figure 6.20



Source: Enterprise Surveys

On the share of profit that goes to paying taxes, Cape Verdean firms report 49,7 percent, the highest in the group, while for Mauritius, the lowest in the group, it is 22,9 percent (Figure 6.21).

Figure 6.21

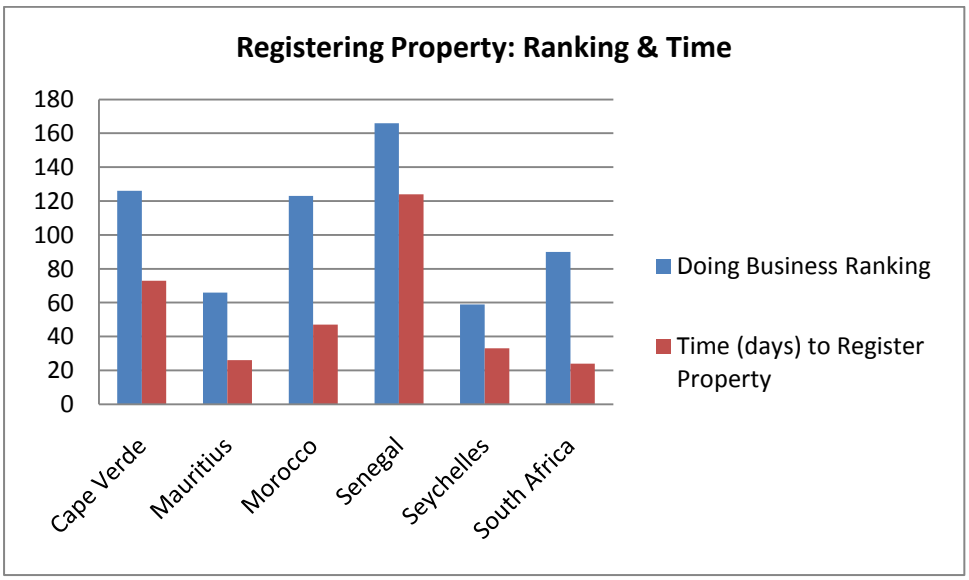


Data Source: Doing Business

6.2.6 Property Registration

Additionally, Cape Verde performs better than only Senegal among the comparators when it comes to overall ranking and in the time in days it takes to register a property (Figure 6.22).

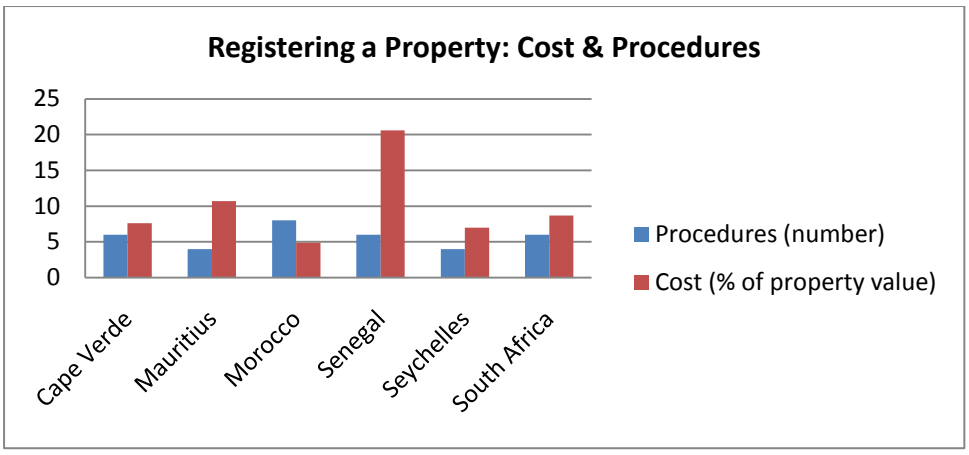
Figure 6.22



Data Source: Doing Business

On the cost of property registration, Morocco takes the lead at 4.9 percent of the property while Seychelles (7 percent) is slightly ahead of Cape Verde (7,6 percent). On the number of procedures, Cape Verde ties with Senegal and South Africa at 6 while Mauritius is the lead at 4 and Morocco in the last place at 8 procedures (Figure 6.23).

Figure 6.23



Data Source: Doing Business

Governments are dependent on tax revenue. Cape Verde is no exception. With a narrow economy, however, its tax base is quite limited. Efforts to ensure a more competitive economy and to promote investments have led to reforms in the tax system. Among the most important were the introduction of the VAT in 2004, the reduction in tax rate and efforts to reduce the administrative burden of paying taxes. The top tax rate was reduced from 45 percent to 35 percent in the 2009 budget. The corporate tax rate was lowered first from 35 percent to 25 percent and it was furthered lowered in the 2009 budget to 25 percent. Also, firms now have the possibility of filing and paying their taxes online. The reduction in corporate tax rate and online filings which will increase over time may not have been captured in the last doing business survey. This should over time reduce the administrative constraint, reduce costs of tax administration, and diminish the tax burden on enterprises.

6.2.6 Micro Risks Summary

Cape Verde will fare reasonably well if compared to ECOWAS countries on the business environment. However, when compared to the best performers in Africa the results are mixed. Cape is not consistently the worst performer among the benchmark countries but it is also far from been the best performer. Joining the league of the best performers is however a necessity if Cape Verde is to achieve its agenda for transformation.

Successfully becoming an international hub for high value added services will require an open business friendly environment. This is partly why Cape Verde pushed to conclude negotiation and joined the WTO in 2008. It is why Cape Verde entered into a special partnership with the European Union to ensure institutional upgrading and both technical and normative convergence with EU standards and norms.

Beyond these, Cape Verde has launched a series of reform programs. The tax rates have been reduced in the last budget. A task force on doing business has been created to coordinate government efforts to build a friendlier environment for business and enhance the nation's competitiveness. Among ongoing program is the business lifecycle project. The project is under

implementation with the financial support of the Investment Climate Facility. The aim is to extend the business in a day program of the Casa do Cidadão (Citizen's House) throughout the lifecycle of a business and extend to all islands. This will facilitate significant improvements in the procedures and significantly reduce, for example, the time it takes to obtain licensing and close a business. Online filing of taxes which has now been introduced should also reduce the administrative costs with respect to filing and paying taxes significantly. Expectations are that Cape Verde will perform much better in the next rounds of doing business as these reforms are completed.

In summary, we therefore conclude, taking into account the relative performance of Cape Verde compared to benchmark countries and the ongoing reforms, that micro risks is not a binding constraint.

7
Conclusion

Cape Verde is a country in transformation. It is no longer considered a least developed country, but there is no guarantee that it will be able to sustain its recent high growth performance and to compete in the new global economy. The record on Cape Verde's development performance must be appreciated in the context of the unique characteristics of the country in the global system. Development policy has evolved in the context of severe structural constraints and irreducible limitations. Despite these structural challenges, since independence Cape Verde has recorded significant achievements ranging from stable democracy, good governance, exemplary human development indicators, to rapid expansion in per capita incomes.

This study on constraints to growth examined the potential impediments to growth in order to identify the binding constraints to high growth and poverty alleviation in Cape Verde. Among the binding constraints identified are energy, transport, and geography. The study also identified some factors such as human capital and finance which are assessed as constraints. Although these constraints are not binding at this stage, if not addressed, however, they will become binding constraints to growth, poverty alleviation, and the transformation agenda in Cape Verde.

In finance, for example, Cape Verde shows high level of financial intermediation. Similarly, Cape Verde compares well in human capital levels in terms of literacy and levels of enrollments. But SMEs are handicapped by lack of access to finance, while the major obstacle for the large size firms in Cape Verde is inadequately educated workforce. Both factors have links with innovation, an area where Cape Verde underperforms when looking at the export composition which is highly concentrated and does not show increasing sophistication.

This analysis on the constraints to growth in Cape Verde must able be examined in the context of the quality of its recent growth performance, the many challenges the country faces going forward as well as the country´s own ambitious vision of where it wants to go. The analysis in this study does not capture some of these challenges and emerging forces that will shape the country´s future, but they are no less real. The analysis, for example, shows that problems remain despite recent high growth. One price of success means that it can no longer rely on external aid. More importantly, the country´s Agenda for Transformation will require new skills and new capacities. The new global economy, in which success or failure increasingly depends on the quality of a country's institutions and the creativity and entrepreneurial energy of its people, requires that Cape Verde create a much higher capacity to compete globally.

Ensuring sustained growth, poverty alleviation and transformation in Cape Verde will require addressing these binding constraints to growth. It will require a mix of policy reforms and investments to upgrade the nation's capacity and capabilities, including human, infrastructure and the institutional frameworks.

Annex
Report of the First Consultative Forum

1. Introduction

The process of engaging the public in formulating Cape Verde's proposal for a second compact with the Millennium Challenge Corporation (MCC) under the Millennium Challenge Accounts program began in earnest on 2 February 2010 when the first consultative forum was held at the Hotel Praia Mar. The forum brought together key stakeholders including experts, the representatives from private sector and civil society, and key policy makers in the public sector.[56] The objectives of the first consultative forum were to:

- Launch the consultative forum
- Begin the process of engaging stakeholders and experts
- Build consensus on process for developing the proposal for the 2nd compact
- Begin the process of developing the compact proposal

Beyond the need to inform the public and build a consensus on the process for preparing the second compact, the forum was meant to start answering the core analytical question of the first phase of the compact development: "what are the constraints to economic growth and poverty alleviation?"

The remainder of this report covers the organization of the forum, the methodology utilized and a summary of the outputs from the dialogue.

2. Organization and Methodology

The forum was a one day event. The agenda[57] included an opening session which was led by the Minister of Finance, H. E. Cristina Duarte. The Minister opened the forum and led the discussion during the opening session. A speech was also made by the Representative of the MCC in Cape Verde, Mr. Stahis Panagides, during the opening session.

Following the opening, a series of presentations were made by members of the National Task Force. These presentations allowed the National Task Force to introduce the Millennium Challenge Account, the first compact and its programs, the process recommended by the Millennium Challenge Account for developing compacts, the tasks to be performed and the method to be used in answering the key question before the forum. A dialogue session was then held with the participants on the various elements of the MCA program, the second compact and the role of the Consultative Forum.

[56] The list of the members of the consultative forum is in Annex 1. Those who participated in the first forum are indicated with OK.
[57] The agenda for the forum is in Annex 2.

Thereafter, the forum members were divided into four groups. Two groups were tasked with providing answers to what the constraints to growth are in Cape Verde while the remaining two groups focused on finding answers to the constraints to poverty alleviation. The process utilized by groups included electing a facilitator to facilitate dialogue, allowing individual members of the group time to reflect silently and to write their ideas on paper. This was followed by listing all ideas generated on flip charts, open group discussion to combine, edit and improve the ideas, finalizing the list, and then setting some form of priorities. The last session included presentations of the reports by the four groups and a dialogue on the outcomes in plenary.

3. The outputs of the consultative forum

The forum was designed to facilitate consensus on the compact development process. It is, as such, partly educational and was meant to ensure that there is an understanding as to how the MCC expects compacts to be developed. This outcome was particularly desirable given the high expectations which the qualification of Cape Verde for a second compact had generated around the nation and interests among various groups/stakeholders in submitting proposals for funding under the MCA program. At such, a key objective of the task force was to inform and to ensure that the public have a good understanding of the process that will be followed in developing the second compact.

Coupled with the need to have a broad understanding of the process, is the importance attached to engagement and ownership. The design of the forum took these into account and it was why the first forum was not simply informational. It was designed also to engage the stakeholders in a dialogue around the core question "what are the constraints to growth and poverty alleviation" which forms the core of the first phase of the compact development process. The participants at the forum were engaged to try to provide answers to this core question. The findings were to serve as inputs for the work to be undertaken by the constraints analysis group which has now been established.

The deliberations did yield quite significant number of ideas on the constraints to growth and poverty alleviation. Interestingly, the outcomes of the groups were quite similar in terms of the ideas generated on the constraints to growth and poverty. Below is a summary of the key elements that came from the groups and the follow up discussion in the plenary.[58]

Low levels of human capacity: Human resource is seen as a key element of the constraints to growth and poverty reduction. The skills level is seen as weak whether in the rural areas for farming or in ensuring that the core sectors of the transformation agenda are developed. Closely linked with this is the quality of high education, the mismatch between the supply (training) and demand for skills by employers which is a major hindrance for the private sector. Additionally, the lack of entrepreneurial education is seen as a problem. The lack of skills is also linked to the weak capacity of the economy to innovate, the slowness to expand the productive base of the nation, and the slow decision making in the public administration.

[58] The reports of the groups are in Annex 3.

Weak institutional capacity: A key agenda of the government today is state reform. However, institutional weaknesses persist and its effects can be seen in several areas according to the participants of the forum. It manifests itself in policy gaps, archaic regulatory processes and requirements which make Cape Verde score quite low in doing business rankings, and the lack of capacity to manage water resources with direct implications for watershed management and agricultural productivity and outputs. Institutional weakness also manifests itself in a judicial process which in Cape Verde is notorious for its slowness, and the increasing crime rate as national ability to curtail the rising drug-related and petty crimes seems to be severely challenged. Crime for instance has significant implications for tourism which is the key sector of the economy.

Infrastructure: There has been major progress in recent years in infrastructure development. Despite progress, a lot remains to be done. This is partly due to the insularity and fragmentation of national markets into nine islands. It leads to the need to duplicate infrastructure, increases the cost of production, and makes it difficult to build an integrated national market. Sanitation was mentioned as key area where there is a need for emphasis given its implications for health (poverty) and tourism. Another is energy which is costly and unreliable. The cost and unreliability of transport, especially in maritime transportation, has significant implications. Similarly, the cost of telecommunication is also recognized as a key problem. These factors lead to high costs of inputs with significant implications for competitiveness and growth.

Access to and cost of finance: A key element of the weakness of Cape Verdean private sector is the access to finance. In recent years, interest rates have reduced. But the financial market is still rather limited. The number of banking institutions have increased but the market is dominated by about three banks, with the main bank having more than 50% of the market share. Additionally, there are very limited financial products and financing options for the private sector. For most private sector firms, the ability to come up with the necessary collateral is limited while opportunity to access risk capital is almost non-existent. The financial institutions however indicate that the challenge is the lack of bankable projects by the private sector given that most are awash in liquidity. It is quite clear that weak capacity (human resources) has a critical role to play in the issue of access to finance on both the side of the banks and that of firms. A critical element will be for financial institutions to be more creative in assisting their clients and to offer more innovative products. Participants in the forum also noted the need for support to the private sector in terms of capacity building and programs to assist entrepreneurs.

Weak social capital and support systems: One example which highlighted by the participants as a clear success story in Cape Verde over the last decade is the transformation of the wine industry based in Fogo. The growth has been spectacular. But this has not spread to the other agricultural production such as cheese, grogue/aguardente, etc. Many believe that the growth in the wine industry has been due in large part to changed institutional arrangement. The industry moved towards cooperative arrangement which brought many growers together to cooperate and collaborate in the production, marketing and distribution of Fogo wine. The switch allowed for advantages of scale and quality improvements. The forum made a case for the need to support existing associations and new ones in others sectors to effectively work together and to duplicate the success with Fogo wine in other sectors and in the various islands. Such program should aim to provide capacity/skills building, and support to expand production, enhance management and distribution, improve quality and facilitate certification through provision of extension services.

Natural Causes: The geography and environment present critical constraints to growth and poverty alleviation. Insularity, limited rainfall, fragmentation of national markets, limited land for agriculture, lack of natural resources and small size of national market. These factors are limiting and in many circumstances increase costs, hinder growth and poverty alleviation. But these are factors that will always be around and the challenge is to develop and implement appropriate response to minimize their impacts. For example, in the agricultural sector, efforts to increase water capturing, improve watershed management, build institutional capacity to support the sector, enhance adoption of innovative methods and tools, facilitate access to finance, and ensure improve quality and access to markets. Another sector is energy where dependency on fossil fuels and the additional transportation cost makes energy costly in Cape Verde.

4. Concluding Remarks

The consultative forum is made up of the stakeholders from every core sector of Cape Verdean society and was established in the framework of the preparation of the second MCA compact proposal.

The forum provides a critical way to engage Cape Verdeans in the development of the second compact to ensure country ownership in the formulation and implementation. The first forum, in this respect, was very useful and several are planned for the future. The forum allowed the National Task Force to outline the process for developing the proposal for the second compact and to build a consensus on the approach.

The first forum also allowed the stakeholders to begin the process of undertaking the constraints analysis. The robust debate in groups and plenary let to consensus around key ideas: low levels of human capacity, weak institutional capacity, infrastructure, access to and cost of finance, weak social capital and support systems, and natural causes as outlined in the previous section.

This is the beginning of the process and the ideas generated during the first forum will serve as inputs to the analytical work which is to be undertaken as part of identifying, characterizing and prioritizing the binding constraints to growth and poverty alleviation in Cape Verde within the framework proposed by the MCC for compact development. The next major step in engaging the public are a series of focus groups with experts and following the focus groups will be the presentation of the draft constrains analysis to the consultative forum for review and comments.