Report Number : ICRR0020706

1. Project Data

Country
Cabo Verde

Practice Area(Lead)
Macro Economics & Fiscal Management

Programmatic DPL
Planned Operations: 2
Approved Operations: 2

Operation ID
P127411

Operation Name
CV-DPL 4-PRSC VIII

L/C/TF Number(s)
IDA-54180

Closing Date (Original)
31-Dec-2014

Total Financing (USD)
15,500,000.00

Bank Approval Date
22-Apr-2014

Closing Date (Actual)
31-Dec-2014

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	15,500,000.00	0.00
Revised Commitment	15,500,000.00	0.00
Actual	15,565,514.00	0.00

Prepared by	Reviewed by	ICR Review Coordinator	Group
Zeljko Bogetic	Robert Mark Lacey	Lourdes N. Pagaran	IEGEC (Unit 1)

Operation ID
P147015

Operation Name
CV-DPL 5-PRSC IX (P147015)

L/C/TF Number(s) IDA-54180,IDA-56810	**Closing Date (Original)** 31-Dec-2015	**Total Financing (USD)** 10,000,000.00
Bank Approval Date 16-Jun-2015	**Closing Date (Actual)** 31-Dec-2015	

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	10,000,000.00	0.00
Revised Commitment	10,000,000.00	0.00
Actual	10,138,680.00	0.00

2. Program Objectives and Policy Areas

a. Objectives

This series of Poverty Reduction Support Credits (PRSCs) has two program objectives, one under each policy area. The development objective under the first policy area is “ensuring macro-fiscal stability and improving the efficiency of public expenditures.”

The development objective under the second policy area is to “improve the provision of infrastructure services and investment climate, enhance labor force skills and the functioning of labor markets, and improve environmental protection.” (Program Document for the Eight PRCS Credit, March 27, 2014; section 4 The Proposed PRSC 8, paragraph 4.1).

The program development objectives were unchanged during the implementation of the series. Originally designed as a series of three operations, PRSC 8, 9 and 10, the series was truncated to the first two operations, PRSC 8 and 9, because several triggers for PRSC 10 were not fulfilled. The Bank decided in November 2015 to use the Program for Results (PforR) instrument to support the reform program in the state-owned enterprise sector that was previously envisaged under the PRSC 10.

b. Pillars/Policy Areas

There were two policy areas (or pillars): (i) Good Governance and Public Sector Efficiency and (ii) Competitiveness, Private Sector Development and Labor Productivity.

Under the first policy area—which supported the first objective of macro fiscal stability and efficiency of public expenditures—the reform program focused on five main reform activities: (i) domestic revenue mobilization, (ii) public financial management (PFM), (iii) state owned enterprises (SOE) oversight and service delivery quality, (iv) national investment system, and (iv) social protection. The first three policy reform activities aimed to help strengthen macro-fiscal stability, the first part of the first objective, while the other two were to help improve efficiency of public expenditures, especially in the areas of public investments and social safety net. Prior actions were focused on revenue mobilization (four prior actions including one on the budget law resulting in several tax policy measures, and one on the Tax Benefit code, which regulates the system of fiscal incentives). There were also two prior actions in the PFM area (including the legal establishment of the Single Treasury Account), and two prior actions addressing the contingent liabilities and financial statement audits of four large SOEs. There were no prior actions regarding national investment system and social protection reform.

Under the second policy area, four reform activities focused on (i) infrastructure management, (ii) investment climate, (ii) skills development and labor market, and (iv) environmental sustainability. Each reform activity corresponded to one element of the second objective to "improve the provision of infrastructure services and investment climate, enhance labor force skills and the functioning of labor markets, and improve environmental protection." Prior actions were concentrated in the first area targeting seven prior actions in support of select infrastructure SOE reforms and five in the four remaining areas, including two prior actions in the area of financial sector stability, which was added in PRSC 9.

c. Comments on Program Cost, Financing, and Dates

The total cost of the Program was SDR 17.3 million (US$25.5 million equivalent) - SDR10.1million (US$14.9 million equivalent) for PRSC 8 and SRD 7.2 million (US$10.6 million equivalent) for PRSC 9.

There were no co-financiers to the Bank financing program.

There was no IMF program.

PRSC 8 was approved on April 22, 2014 and closed on its original closing date December 31, 2014.
PRSC 9 was approved on June 16, 2016 and closed on its original closing date December 31, 2015.

3. Relevance of Objectives & Design

a. Relevance of Objectives

The objectives were substantially relevant to the country conditions and to government and Bank's strategy, and remained relevant at closure. Both objectives were also well aligned with the government's Growth and Poverty Reduction strategy, especially its governance pillar. They were also closely aligned with the Bank's CPS 2015-17 of which the series was the key financing instrument.

Improved debt sustainability, targeted by the first objective, has been and remains a long standing problem. Total public debt (at 103 percent of GDP in 2014) was on an unsustainable trajectory before the approval of the series because of the sizeable public investment led fiscal expansion and much lower-than expected growth performance. Therefore, the program aimed to reverse public debt dynamics with fiscal measures mostly on the revenue side. In the event, despite some fiscal consolidation, lower-then-envisaged economic growth, continued public investments and onlending to SOEs, and exchange rate depreciation resulted in public debt increasing to over 129 percent of GDP in 2016-17. Hence debt sustainability remains highly relevant.

The second objective aimed at improving the investment climate and skills and labor market functioning needed to strengthen the enabling environment for robust growth. In each of these areas, country performance was lacking. Improvements, coupled with fiscal consolidation, sought to restore macroeconomic stability and more robust growth in the future.

Rating

Substantial

b. Relevance of Design

The series' objectives were broadly clear and linked with the corresponding policy areas. The policy framework was also based on considerable Bank analytical work underpinning both operations. However, the macro-fiscal framework, as elaborated below, raises question about realism, internal consistency and sustainability of the program objectives. Also, design was overly complex, especially with respect to the second objective, with multiple reform areas and a total of 28 indicators. Some of the indicators were very weakly related to the objectives (e.g., on the banks' non-performing loans and labor markets). Objectives could have been more explicitly articulated with stronger linkages to a simpler, clearer and more outcome oriented results frameworks.

Regarding the first objective, measures on the revenue side and the single treasury account are relevant to the fiscal content. However, the fiscal program, as noted above, raises questions of realism and internal consistency, as well as of the appropriate mix of fiscal measures. For example, the design of the fiscal program emphasizes revenue mobilization but without clear measures to support rationalization of current public expenditure. This choice is not explained nor justified. It also raises the question of the sustainability of the macro-fiscal program -- revenue based fiscal stabilizations have often been unsuccessful because they tended to be associated with deteriorating, not improving, control of public expenditures.

The second objective is also broadly related to the policy measures supported by the series, but the theory of change is insufficiently explicit. It does not provide clear reasons for the choice or prioritization of measures. Greater selectivity and prioritization among the measures would have made for a simpler, more strategic and implementable design. Quality of prior actions also raises some questions as they are mostly of the upstream legislative and administrative decision variety. While they are important in some key areas (e.g., Budget Law, Tax Benefit Code), they do not necessarily result in implementation and results.

The range and complexity of the proposed measures were likely to place heavy demands on a small state with limited institutional capacity. Given the gravity of the public debt dynamics, a credible program focusing on macro-fiscal stabilization while addressing a few, critical structural bottlenecks holding back growth would have made for a more streamlined and credible design. Moreover, program design does not provide a sufficient sense of whether exogenous factors and unintended (positive and negative) effects were important and to what extent they would affect outcomes.

The macroeconomic policy framework was unrealistic and inconsistent. In 2014, the Authorities were seeking to reverse Cabo Verde's lackluster growth, fiscal imbalance and adverse debt dynamics through consolidation. Growth was projected to average 3.5% in the 2014-17 period, much higher than during 2011-13. This was to be led by domestic demand. However, the fiscal deficit was simultaneously to drop from 8.7% to 4.8% of GDP. This was to be achieved mainly through higher taxes, though cuts in expenditure were sought as well. The demand-led growth projection and fiscal contraction were, therefore, inconsistent. Moreover, domestic credit expansion was constrained by elevated interest rates and a high percentage of non-performing loans. The external environment was difficult; devaluation was ruled out by the fixed exchange rate to the euro, and little increase was expected in foreign direct investments. In the absence of an IMF program, judgment regarding the adequacy of the macro-fiscal framework rested with the Bank. Despite the Bank team's reservations about the realism and consistency of the projections, they were, nevertheless, adopted.

Rating
Modest

4. Achievement of Objectives (Efficacy)

Objective 1

Objective

Ensuring macro-fiscal stability and improving the efficiency of public expenditures

Rationale

Despite attainments in some reform activities and targets, there is not enough evidence that the first objective of ensuring macro-fiscal stability and improving efficiency of public expenditure was achieved. There was modest progress on tax policy reform, which, together with short-term technical assistance from the IMF on tax administration, resulted in improvements in the revenue-to-GDP ratio and better, centralized control of fiscal incentives and budgetary expenditures through the single treasury account.

However, large, foreign financed public investments and on-lending to SOEs continued to contribute to the escalation of public debt. Moreover, there was no progress in two activities that aimed to contribute to the efficiency of public expenditures: national investment system (which would have helped improve the quality of public investments) and social protection (which was dropped). National investment system reform aimed to improve the quality of the choice of public investments and strengthen the link between macro-fiscal management and the budget's contribution to national investments and growth.

Overall, the objective of ensuring macro-fiscal stability was not achieved. Total public debt deteriorated from 103% of GDP in 2014 to an estimated 129.1% in 2016 (contrary to the projected 109%), despite some reduction in the fiscal deficit. The main reasons were a large growth underperformance, deflation, the exchange rate effect due to the appreciation of the US dollar, and inadequate expenditure measures, especially loss of control of externally financed public investments (IMF Article IV consultation, November 2016).

Rating

Modest

Objective 2

Objective

Improve the provision of infrastructure services and investment climate, enhance labor force skills and the functioning of labor markets, and improve environmental protection

Rationale

The achievement of the second objective was mostly negligible, with only limited advances in one area - environmental protection. There was no tangible progress in key areas of difficult structural reforms aiming for improvements in external trade, public-private partnerships, and reduced SOE losses, especially the state airline company. Under PRSC9, policy reforms and associated metrics in labor markets were dropped with the explanation that the CPS did not feature Bank support in labor markets (IMF, Article IV consultation, November 2016). In the areas of skill enhancement, there was measurable progress in the activities, but they were mostly upstream outputs showing no evidence of greater skills that could lead to improved job opportunities and higher incomes.

Regarding environmental protection, 45 geographic areas with defined boundaries were legally defined and published (against a baseline of 3 and a target of 40). Although the scale is significant, this was an interim output measure towards actual improvement in environmental protection. There is, as yet, no evidence of effective enforcement supported by the program. .

Rating
Negligible

5. Outcome

Objectives were substantially relevant to the country conditions and the government's and the Bank's strategy, and remained relevant at closing. Regarding design, the series' objectives were broadly clear and linked with the corresponding policy areas but linkages with the rest of the results framework, especially those supporting the second objective could have been clearer and better prioritized. Some of the actions and targets were weakly related to the objectives. There are questions regarding realism, internal consistency and sustainability in the macro-fiscal framework. The design was too complex with 28 indicators, related to the second objective, which featured multiple reform areas. In effect, the series aimed to achieve too many outcomes in too many areas in a short period of time. Efficacy was modest with regard to the first objective, and negligible for the second, where there was no tangible progress in key reforms (for example, state-owned enterprises).

a. Outcome Rating
Unsatisfactory

6. Rationale for Risk to Development Outcome Rating

Risks to development outcomes are deemed significant. For example, risks to the achievements on macro-fiscal stability and efficiency of public expenditures at the time of evaluation cannot be underestimated. With total public debt estimated close at to 130 percent of GDP in 2016, this small, vulnerable economy is, de facto, in a debt distress situation, and further, major fiscal consolidation is necessary to reverse adverse debt dynamics after three years of deflation and weak growth. This will be extremely difficult. While the IMF Article IV consultation, November 2016 outlines a scenario of such significant further consolidation it is only one scenario, backed neither by a formal IMF program nor a firm set of measures.

In the absence of balance of payments or direct fiscal support from outside, there is a high risk that further fiscal consolidation will not materialize and that a full blown macro-fiscal crisis will ensue. In the investment climate area, reform has been slow and there is considerable risk from poor SOE financial results and further contingent liabilities to the budget. In the area of environmental protection where good progress was achieved in defining legal boundaries of protected areas, enforcement and actual improvement remain in question. As a result, there is significant risk that improved environmental protection (part of the second objective) will not be achieved.
These risks are somewhat mitigated by the advent of a new Administration in 2016, which has indicated a willingness to tackle some of the country's more serious fiscal and structural issues.

a. Risk to Development Outcome Rating

Substantial

7. Assessment of Bank Performance

a. Quality-at-Entry

The series aimed to address relevant strategic concerns, such as the need for fiscal consolidation and progress in a number of structural reform areas. The policy framework was based on considerable Bank analytical work, which underpinned both operations (ICR, tables 2-1, and 2-b). However, design was too complex and too ambitious, especially with regard to the structural policy agenda supporting the second objective. There was a lack of focus and clear priority among the large number of reform areas and targets. The macro-fiscal framework was internally inconsistent and over-optimistic.

While monitoring indicators had largely clear baselines and targets, there were deficiencies in M&E design, including excessive focus on legislative prior actions and not enough on implementation, as well as weak links in the results chain and the relevance and quality of some target indicators (e.g., roads in good condition).

Risks were underestimated (Program Document, PRSC8, p. 32-33): risks to the growth projections were considered moderate and those to the macro-fiscal framework low. In the event, both materialized to a significant extent with the growth path significantly below that projected and the macro-fiscal framework not delivering the desired debt dynamics.
Implementation and reporting arrangements for the program were led by the National Planning Committee and Ministry of Finance. It is unclear from the documentation whether this dual

implementation and reporting affected the outcomes (Program Document PRSC8, p.31).

Quality-at-Entry Rating

Moderately Unsatisfactory

b. Quality of supervision

The Bank maintained supervision and dialogue beyond the completion of the prior actions. It developed and maintained collaborative and participatory dialogue with the Authorities and the wider Budget Support Group, which it chaired. Although, according to the Program Documents, it was intended to organize two supervision missions each year, only one Implementation Status Report was filed for PRSC 9 (and none for PRSC 8). The Bank monitored the implementation of the prior actions and triggers, including those for the third operation, which was eventually cancelled. Prior actions for both operations were implemented although with delays.

The second operation (PRSC 9) was prepared broadly as planned. One trigger was dropped (with the associated target) on the social protection measure because it was not part of the CPS (ICR, p. x); it was also weakly linked with the PDOs. As six out of eleven triggers for PRSC 10 were not met (Table 5, ICR, p. 18), the Bank decided to terminate the series The Bank does not have an office in Cabo Verde. As a result, the Bank team relied on consultants to support missions and carry out the liaison function and this arrangement is reported by the task team to have functioned well.

Quality of Supervision Rating

Moderately Satisfactory

Overall Bank Performance Rating

Moderately Unsatisfactory

8. Assessment of Borrower Performance

a. Government Performance

Ex ante, the frank dialogue and ambitious reform program, reflected in the program documents, suggested strong ownership and commitment. Progress was made in tax policy, where the Authorities received advice from the IMF, as well as on several legislative reforms. However, follow up and implementation on many structural measures was lacking, reflected in the low level of achievement of the program's development objectives. For example, implementation of the actions on the national investment system, key to the quality of public investments and growth environment, did not go forward. The ICR notes that major SOE performance issues and associated fiscal risks remain to be addressed. There is insufficient control of public expenditures, where little progress was made in enhancing efficiency. That these fundamental issues are still unresolved, and that public debt reached critical levels four years after the launch of the series, suggests insufficient ownership and commitment.

Government Performance Rating

Unsatisfactory

b. Implementing Agency Performance

The implementing agency was the Ministry of Finance on behalf of the Government. Dialogue appears to have been frank. However, little effort was made to address the complexity and rigidity of the M & E framework. This hampered the identification and monitoring of priority areas where a substantial impact on policy reform could have been expected. There is no information available in the documentation on the adequacy of the Ministry's staffing.

Implementing Agency Performance Rating

Moderately Unsatisfactory

Overall Borrower Performance Rating

Unsatisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

M & E design was too complex with 28 indicators, reportedly relying on the broader M&E framework of the Budget Support Group. But the sheer range of indicators diluted the government's attention and focus and contributed to limited achievement. The choice of indicators was better on the fiscal revenue side but the macro-fiscal framework and M & E lacked focus on public debt, described in the Program Documents as a critical issue. Without explicit indicators on the debt side and with large infrastructure investments, public debt continued on an unsustainable trajectory four years since the launch of the series. On the structural reform side, indicators were too many and too ambitious for the time frame of the Series. Eleven triggers were designed for the third operation in the series, which also appears excessive.

b. M&E Implementation

M & E data were collected and generally reported on, except for three indicators, which were dropped.

c. M&E Utilization

Some key M & E data, especially on the fiscal side were routinely used by the government and the Bank in policy dialogue, policy monitoring and analysis, and the assessment of progress in respective policy areas (e.g., revenue-to-GDP ratio, fiscal deficit as percent of GDP, total financing including on-lending to SOE as percent of GDP, non-performing loans as percent of total loans). They were also monitored by the Budget

Support Group and informed the other donors.

M&E Quality Rating

Modest

10. Other Issues

a. Environmental and Social Effects

By aiming to strengthen macro stability and environment for growth, the Series was expected to positively contribute to poverty reduction. In the event, growth acceleration did not materialize and, therefore, significant poverty reduction has likely not taken place, although the documents do not make it possible to ascertain what happened to poverty during the life of the Series.

Measures focused on improving environmental protection by establishing legal boundaries for environmental protection in at least 30 areas were expected to have positive impact. In the event, while the legal boundaries were established, enforcement was lacking.

b. Fiduciary Compliance

The Program Documents for both operations report that the public financial management systems were adequate. Budget laws were published in a timely manner, and there was regular fiscal reporting. There were, however, some deficiencies in the areas of audits and legislative oversight. The ICR does not discuss fiduciary compliance.

c. Unintended impacts (Positive or Negative)

The growth trajectory turned out substantially lower than envisaged, reflecting weaker external and domestic demand. This, and the exchange rate impact on public debt as a result of the strengthening of the US dollar, has negatively affected the public debt-to-GDP path. ICR also notes “large infrastructure investments” (ICR, p. 22) as a contributing factor.

Implementation of structural reforms was slow, likely reflecting capacity and political constraints.

d. Other

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11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Moderately Unsatisfactory	Unsatisfactory	Achievements under the first objective are rated modest, and those under the second objective negligible.
Risk to Development Outcome	Modest	Substantial	Macro-fiscal and public debt situation at evaluation is much worse than envisaged. Structural reforms especially in the SOE sector did not advance sufficiently to reduce fiscal risks. Growth environment is much weaker than earlier anticipated. These risks are somewhat mitigated by the advent of a new Administration in 2016, which has indicated willingness to address the country's structural and fiscal constraints.
Bank Performance	Moderately Unsatisfactory	Moderately Unsatisfactory	---
Borrower Performance	Moderately Unsatisfactory	Unsatisfactory	Implementation was lacking across a wide range of reform activities, suggesting weak ownership and commitment. Achievement was unsatisfactory, notwithstanding some achievements in the areas of tax reform mobilization, treasury account, and environmental protection
Quality of ICR		Substantial	Substantial

Note
When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

The ICR appropriately draws the lesson that in countries with low capacity, design of budget support operations must be realistic, selective and focused on a limited number of areas of high impact, taking into account the time horizon for the reform implementation. Excessive ambition can affect implementation.

IEG adds three further lessons:
First, the results framework as an operational tool is weakened unless they show clear links from objectives to reform areas, prior actions and target indicators. Absent such clear articulation of linkages, it is very difficult to attribute the Bank supported activities to the program objectives and measure and assess their contribution. Second, the relevance and criticality of prior actions may be diminished if they consist only or largely of legislative actions and not measures that demonstrate enforcement and a strong will to implement reforms. Third, in the absence of an IMF program during a Bank's budget support series, the Bank would be well advised to consider public debt related monitoring and target indicators to help achieve macro-fiscal stability.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

ICR quality was adequate on the coverage of main elements of self-assessment. It is, overall, candid and it clearly describes relevant issues in the operation's design and the achievements of its targets.
More discussion on the extent to which the operation achieved its objectives- beyond the specific targets in the results framework would have been welcome, as would have been more detailed analysis of the evolution of factors behind the escalation of public debt, public investments, and on the quality of policy dialogue and ownership. Many of the seven lessons are specific to this program with only limited wider applicability. Discussion of environmental and social risks and fiduciary compliance is sparse.

a. Quality of ICR Rating

Substantial