

Cape Verde

Putting New Life into Reform Policy, and then....

Yves Bourdet

Country Economic Report

2000:8

CAPE VERDE

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AND THEN ...

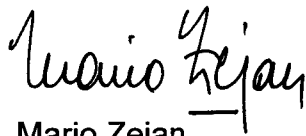
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This country economic report on Cape Verde is part of a series of annual studies, which are undertaken by the departments of economics of three Swedish universities in collaboration with the regional departments of Sida, under an agreement with the Secretariat for Policy and Socio-Economic Analysis. The purpose of these studies is to improve Sida's economic analysis and knowledge of the programme countries for Swedish development cooperation in order to enhance the effectiveness of programme as well as project support.

This report has been prepared by Yves Bourdet, Department of Economics and Institute for Economic Research, Lund University.



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ISBN 91-586-8998-2
ISSN 1404-031x

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CAPE VERDE

PUTTING NEW LIFE INTO REFORM POLICY, AND THEN...^{*}

1. Introduction

A decade ago Cape Verde embarked on a process of market-oriented economic reforms. The reforms, albeit limited in scope, were started at the end of the 1980s under the monopoly rule of the PAICV (*Partido Africano da Independencia de Cabo Verde*). They were widened and accelerated after the first multi-party legislative and presidential elections of 1991, with the victory of the MpD (*Movimento para Democracia*). In the mid-1990s, reform policy seemed to be at death's door with a clear worsening of the fiscal stance and an economic growth short of expectations.¹ Starting in 1997-1998, concomitant with a government reshuffle, the reform path was given a new lease of life and new measures were introduced to secure the withdrawal of the state from many areas of economic activity. This renewal of reform policy was accompanied by a much greater involvement of the multilateral donor community, in particular the IMF, the World Bank and the European Union.

The purpose of this paper is to examine the new life infused into reform policy since 1997-1998 and evaluate its economic outcome. A main aspect of the recent changes concerns the strengthening of the fiscal policy stance, which has direct as well as indirect effects (through its impact on economic growth) on employment and poverty. A secondary purpose is therefore to discuss the impact of this "second wave"

^{*} An earlier version of this paper benefited from constructive comments by Richard Bomboma, Dominique Lecompte, Carl-Erhard Lindahl, Júlio Morais, Inga Persson, Adão da Silva Rocha, José António Vaz Senedo and seminar participants in Praia and Stockholm. Thanks are also due to Luís Dupret and Isa Morais Rodrigues for valuable assistance during my stays in Praia in January and May 2000, and to all the officials and others in Cape Verde who devoted time to informing me about the economic and political situation. The author is also grateful to Laura and Dominique Lecompte for an unforgettable exploration into the badiu inner-land on the island of Santiago.

¹ On the first wave of economic reforms, see e.g. Bourdet (1998) and (1999).

of economic reforms on the employment and poverty situation. Cape Verde faces severe structural development constraints in the forms of poor location and high transaction costs, small domestic markets, poorly developed physical infrastructure and an inadequate stock of human capital, preventing the country from embarking on a process of self-sustaining rapid economic growth. A third purpose of the paper is to see to what extent the deepening of the reform process can contribute to lessening these constraints and secure long-term growth. A discussion of the articulation between reform policy and more strategic development issues is all the more important for Cape Verde for two main reasons. First, bilateral aid has decreased during the past few years and is expected to decrease further in the future. The main reason behind this tendency is the relatively high per capita income reached by the country today, some 1,200 US\$, which is above many donor countries' eligibility level for development assistance. Second, the stream of remittances from Cape Verdeans living abroad is likely to diminish in the future as a result of the significant diminution of emigration during the past two decades.²

The paper is structured in the following way. Chapter 2 surveys the structural reforms and their articulation with the strengthening of fiscal policy. Particular emphasis is placed on the period after 1997. Chapter 3 concentrates on the impact of reform policy on economic growth, with particular attention paid to the distribution of growth between sectors and islands. Chapter 4 examines the Achilles heel of the reform policy (and of the Cape Verdean economy), namely the (un)employment and poverty situation. Chapter 5 looks at reform policy from a more long-term strategic perspective and examines the prospects for the country to improve its trade performance and embark on a more self-sustaining growth path. In a concluding chapter, we briefly examine the dynamics of exit, voice and loyalty in Cape Verde and how these may affect the political sustainability of the reform process.

² Cape Verde still belongs to the group of Least Developed Countries (LDCs) in spite of a gross domestic product per capita above the threshold used to determine the list of LDCs. It is the economic vulnerability of the country, in particular its high dependency on emigrant remittances and foreign aid (together some 40 percent of GDP) that motivates this special treatment. The UNCTAD secretariat undertook a vulnerability profile study in December 1999 (CNUCED (2000)), which resulted in the Economic and Social Council of the UNCTAD proposing that Cape Verde remains in the group of LDCs until 2003, when a new vulnerability study will be prepared.

2. Deepening Structural Reforms and Strengthening Fiscal Policy

The economic reforms introduced in the early 1990s can be grouped under three main headings: 1) microeconomic measures whose aim is to improve the allocation of production resources and to spur economic growth. These first kinds of measures include the removal of price controls, the privatisation (or, if not viable, the liquidation) of a large number of state-owned enterprises (32 enterprises between 1994 and 1997), the strengthening of property rights in agriculture, the promotion of foreign direct investments, the revision of the Labour Code to increase labour market flexibility, and the modernisation of business legislation. 2) a market-oriented macroeconomic stance with the separation of fiscal and monetary policies (through the creation of a two-tier banking system) so as to give public policy the tools necessary for the conduct of stabilisation policy. 3) integration of the Cape Verdean economy into the world economy through the removal of quantitative restrictions on imports, the simplification and lowering of import tariffs, and the introduction of various export promotion measures, like the setting up of export-processing zones in Mindelho and Praia. These third kinds of measures also include a comprehensive tax reform whose aim is to broaden the tax base, improve the efficiency of the tax system and secure a level of tax revenue compatible with the development objectives of the government, as well as a nominal exchange rate peg (first to a currency basket and after July 1998 to the Portuguese escudo and indirectly to the euro), in order to build up anti-inflationary credibility.³

The outcome of the first wave of reforms, that is the reforms introduced during the first half of the 1990s, was mixed.⁴ This was the case both for growth and internal balance. Between 1991 and 1996, the growth of GDP attained some 4 percent on

³ Another important reason behind the adoption of a nominal exchange rate peg is the desire to secure the value and the stream of emigrants' remittances that correspond to some 20 percent of GDP. The actual stream of remittances is presumably larger than this figure, many of them entering the country by underground channels. A proof of this was given during the 1996-1998 period, when street traders only charged a negligible premium for foreign exchange in spite of the considerable, unmet (in the best cases delayed) applications for foreign currencies in the formal banking system. On this episode, see Olters (1999).

⁴ For a more complete evaluation based on the statistics available at that time, see Bourdet (1998).

average.⁵ This may look appreciable but in fact most of the growth could be ascribed to a significant increase of international assistance and an expansive fiscal policy. Public investments grew rapidly, in particular between 1993 and 1997. The fiscal deficit amounted to no less than 16 percent of GDP in 1993-1997 and as a result public debt increased fourfold, measured in terms of GDP, during the same period. An unsustainable fiscal deficit and a quasi-explosive increase in the domestic public debt were the dominant macroeconomic ills in the mid-1990s. In addition, the rate of unemployment remained considerable, some 38 percent according to the 1996 Labour Force Survey, and about one fourth of the active population according to the official figure of the Ministry of Finance, covering mainly the urban labour market.

Getting a new lease of life!

The mixed results of the first wave of reforms were the main factor behind the reorientation of economic policy that took place in 1997-1998. This reorientation was accompanied by a cabinet reshuffle in May 1998 and the nomination of António Gualberto do Rosário to the post of Vice Prime Minister. António Gualberto do Rosário can be regarded as the main architect of the new life put into reform policy. His decisive role in the design and implementation of economic policy, as in today's political life in Cape Verde, may be further strengthened in the future by the announced political retreat of the current Prime Minister, Carlos Veiga, after the legislative elections to be held in early 2001. Another important feature of the reorientation of economic policy concerns the large role played by multilateral organisations, in particular the IMF. The first wave of reforms in the early 1990s was home-grown and had been designed and implemented with limited input from the donor community. The loss of control over fiscal policy in the mid-1990s was the main factor behind the involvement of the IMF in the conduct of economic policy in

⁵ The figures for the GDP growth rates were revised upward in connection with the calculation of the national accounts in 1998. The revision reflects mainly new economic activities that were not taken into account (or only imperfectly taken into account) in the previous calculations. For the period between 1991 and 1996, the revision means that real GDP growth averaged some 5 percent instead of 4 percent. The new figures were not known when the government re-orientated its reform policy in 1997 and we therefore have kept the previous figures when examining the factors behind the reorientation in the main text.

Cape Verde. This involvement took the form of an IMF adjustment operation that was first proposed in 1997 but only began to be implemented in 1998.⁶ Other multinational organisations that have increased their engagement in the design of economic policy are the World Bank and the European Union. On the other hand, recent years have seen a disengagement of some bilateral donors, with the notable exception of Portugal, the former colonial power, and Luxembourg.

The new life put into reform policy since 1997 consists in a greater integration of the various components with a pivotal role attributed to a new instrument, the Trust Fund. (We speak of a new instrument in the sense that it did not belong to the first wave of reforms.) The main objective of the Trust Fund is to contribute to restoring macroeconomic balance by gradually reducing the burden of domestic public debt on public finance. Two decades will be necessary to pay off the entire domestic public debt.⁷ The construction of the Trust Fund rests on the acceleration of structural reforms, in particular accelerated privatisation of state-owned enterprises, and on improved confidence of the donor community in the reform policy. This is so because the financing of the Trust Fund comes from two main sources: the proceeds from the privatisation of state-owned enterprises (US\$ 80 million) and multilateral and bilateral assistance (US\$ 100 million mainly in the form of grants).⁸

Thus the acceleration of the privatisation process after 1997 was necessary to build up the domestic component of the Trust Fund. This acceleration, combined with other structural and stabilisation measures, was also necessary for the multilateral and

⁶ The arrangement with the IMF contains a stand-by credit of about US\$ 2.8 million. Initially the stand-by arrangement covered the period between February 1998 and April 1999. It was, however, extended, first to the end of 1999 (concomitantly with an increase of 40 percent in the size of the stand-by credit) and then to March 15, 2000.

⁷ The capital invested in the Trust Fund has been converted into certificates (TCMF: *Títulos Consolidados de Mobilização Financeira*). These are held by the commercial banks and other financial institutions, instead of the public domestic debt instruments, and are remunerated from the Trust Fund's revenue. The TCMF are to be bought back by the government in parallel with the improvement of the fiscal situation.

⁸ Only 90 percent of the revenue of the Trust Fund is used to service the domestic public debt. 5 percent is used to remunerate the Portuguese Central Bank for its management services. The remaining 5 percent is used to finance a special emergency fund (FEED: *Fundo Especial de Estabilização e Desenvolvimento*) that can be mobilised in cases of droughts or other natural disasters. This last aspect was particularly important for the support of some donors to the Trust Fund. The FEED was first mobilised in 1999 to finance a public work programme aimed at alleviating the impact on poverty of the drought in 1998.

bilateral donors to engage financially in the building up of the fund. The main foreign contributors are the World Bank, the European Union, Portugal, the African Development Bank, Switzerland and Austria. The financing of the donor community was still short of expectations in mid-1999 with some US\$ 26 million lacking to reach the planned US\$ 100 million. Two reasons explained this outcome. A first reason was that some bilateral donors expected by the Cape Verdean government to participate at the outset did not come forth. A second reason was the recurrent delay noticed by bilateral donors in the transfer of the privatisation receipts to the Trust Fund.⁹ Two events have, however, improved the prospects for the Trust Fund to be fully capitalised by the end of 2000. Two new countries, Holland and Sweden, have decided to contribute to the Trust Fund in 2000, with some US\$ 2.3 and 1.7 million, respectively. In addition, because of the depreciation of the Cape Verdean escudo vis-à-vis the US dollar, the funds required for the financing of the Trust Fund are now US\$ 160 million instead of US\$ 180 million, as planned at the outset.

Ambitious and politically controversial privatisation programme

A critical aspect in the deepening of reform policy concerns the accelerated programme of privatisation of the majority of the remaining state-owned enterprises. Some 45 percent of the Trust Fund is to be financed by the sale of state-owned enterprises. Privatisation is therefore decisive for the operation of reducing the domestic public debt and for the support of the donor community. It is also necessary to relax the constraint on fiscal policy. The accelerated privatisation programme is being carried out in close co-operation with the World Bank.

The second wave of privatisation was approved by the National Assembly in 1997 but only began to be implemented in 1998. It is not expected to be completed before 2002, but most of the enterprises concerned are to be privatised in 1999 and 2000. This second wave concerns no fewer than 27 companies in the industry and

⁹ In 1999, the delay could, to some extent, be ascribed to the fact that the government preferred to use some privatisation proceeds to finance the FEED (see footnote 7) instead of depositing them in the Trust Fund. In January 2000, privatisation receipts deposited in the Trust Fund amounted to US\$ 37.5 million, that is about half of the planned domestic contribution.

services sectors, including utilities.¹⁰ Only three enterprises, in the food (pasta and flour milling) and maintenance sectors (FAMA: *Fábrica de Massas de Cabo Verde*, MOAVE: *Moagens de Cabo Verde* and SONACOR: *Sociedade Nacional de Conservação e Reparação de Equipamentos*), were privatised in 1998. Privatisation accelerated in 1999 with the sale of the two commercial banks (BCA: *Banco Comercial do Atlantico* and CECV: *Caixa Económica de Cabo Verde*), the insurance company (GARANTIA), the venture-capital firm (PROMOTORA), remaining shares in the telecom company (*Cabo Verde Telecom*), the petroleum company (ENACOL: *Empresa Nacional de Combustiveis*), the electricity and water company (ELECTRA: *Empresa de Electricidade e Agua*), a construction company (CVC: *Construções de Cabo Verde*) and travel and maritime companies (ARCA VERDE and ANV: *Agência Nacional de Viagens*). The government retained a minority share in both the banks and the utilities. Three large companies remain to be privatised during the course of 2000, the airline company (TACV: *Transportes Aéreos de Cabo Verde*), the public procurement company (EMPA: *Empresa Pública de Abastecimento*) and the port administration (ENAPOR: *Empresa Nacional de Administração dos Portos*), as well as several medium and small companies, mainly in the transport, shipyard and food sectors.

The implementation of the privatisation programme has proceeded more slowly than planned when the privatisation programme was designed in 1998. A main reason is that the government has underestimated the time necessary for the implementation of privatisation (estimation of the value of a company, organisation of the sale, time necessary for interested buyers to participate, selection of the most suitable buyer, etc.). In some cases the delay arose from the very nature of the economic activities of the enterprises to be privatised, and the difficulties met with in estimating the value of such enterprises and/or in rapidly designing a suitable regulatory framework in the case of natural monopolies. This applies, for example, to the company in charge of port administration, ENAPOR. It applies also to the public procurement company, EMPA, which was in charge of the import and distribution of

¹⁰ For a list of the enterprises and sectors concerned, see IMF (1999), p. 33. For the receipts expected and the time schedule enterprise to be privatised, see Republic of Cape Verde (1999a), Annex B.

food products (mostly obtained through food grants) and other key commodities (like cement). EMPA's history is intimately associated with the kind of regulated economic system in place in Cape Verde prior to the start of reform policy.¹¹ EMPA enjoyed a monopoly (or quasi-monopoly) power in many sectors, which has been eroded by the process of import liberalisation and the opening up of some economic activities for new domestic and foreign competitors. Whereas such changes have clear, positive economic effects for the society as a whole, they affect the financial value of EMPA negatively, making the privatisation of EMPA more uncertain unless the government is willing to break it down and drastically reduce its price.¹²

In addition to its role in the financing of the Trust Fund and in reducing the public domestic debt, the privatisation programme aims to increase the scope of the private sector in the economy and improve static as well as dynamic efficiency (that is, how efficiently the resources are used in production, and the rate of innovative activities and technical progress). A serious problem that may arise in the case of Cape Verde is that most of the enterprises to be privatised are in a monopoly (or quasi-monopoly) situation, and thus privatisation may only result in the transformation of a public monopoly into a private monopoly. The small size of the Cape Verdean economy may contribute greatly to this outcome. The problem may be most worrying in the economic sectors that are insulated from foreign competition. The dominant foreign participation (mostly Portuguese) in the share-holding of newly privatised enterprises may also result in monopoly profits being transferred abroad rather than being invested and consumed in Cape Verde. It is therefore of utmost importance for the long-term success of the privatisation process for it to be accompanied by an active 'competition policy', whose main objective should be to facilitate the entry of new

¹¹ EMPA was legally created in 1975 and modelled after the People's Stores in place in the liberated areas in Guinea-Bissau prior to independence (Lobban (1995), pp. 137 and 166). The profits derived by EMPA from the sales of food aid have been used by the government to finance the labour-intensive public works programmes, the FAIMOs (*Frentes de Alta Intensidade de Mão de Obra*). The on-going transformation of the FAIMOs into an anti-poverty programme, financed mainly by foreign donors (mostly the World Bank and the European Union) should be understood in this perspective. This transformation does not only reflect the desire to improve the efficiency of the FAIMOs in combating poverty, but also the necessity to find alternative sources of finance for a form of "active" labour market policy. The newly-created special emergency fund (FEED) fulfils a similar function to the FAIMOs since it can be used to finance public work programmes in emergency situations.

competitors. A policy that encourages domestic and foreign investments in the sectors where privatised companies enjoy a monopoly situation (or benefit from a non-negligible degree of market power) is clearly the best remedy against the emergence and persistence of anti-competitive behaviour. In addition to its impact on actual competition, such a policy increases the strength of potential competition (that is the attractiveness and likelihood of new entry), which, in sectors like utilities, is the best way for the efficiency and dynamic gains of privatisation not to be captured by monopoly profits.

The way the privatisation programme has been implemented until now, in particular the large role of Portuguese business interests in the privatisation of large-scale enterprises in the banking, assurance and utilities sectors, has been the subject of lively debate in Cape Verde. Criticisms have been raised by the main opposition party, the PAICV (*Partido Africano da Independência de Cabo Verde*), the party that exercised monopoly power between 1975 and 1991. This is hardly surprising since the party has maintained a socialist economic platform. But the programme of privatisation has also been openly criticised (in a newspaper article in late 1999) by high-ranking members of the ruling party, the MpD (*Movimento para Democracia*), among others by the, at that time, mayor of Praia, Jacinto Santos and the president of the National Assembly, António Espírito Santo Fonseca. A main argument concerns the loss of national economic sovereignty implied by the privatisation of large-scale state-owned enterprises in favour of foreign, mostly Portuguese and sometimes public, companies.¹³ This argument, and the criticism, should also be seen in the light of the exchange rate agreement between Cape Verde and Portugal in 1998, which de facto implies that the country has given up its sovereignty over monetary and exchange rate policy. A second argument is that the way the privatisation has been implemented has not given sufficient attention to more strategic considerations (such as the contribution

¹² The government launched the partial privatisation of EMPA (60 percent of the shares) in mid-spring 2000 and expects to complete it by late July 2000.

¹³ The government has selected the foreign companies with the most financially advantageous bid. That this choice fell on the Portuguese competitors reflects the fact that Portuguese companies offered the most attractive bids. What remains a puzzle, however, is the fact that when several companies were involved, like for example in the case of ELECTRA, the bid of the Portuguese company was so much higher than its competitors.

to long-term growth, the development of domestic entrepreneurial capacities, the building up of human capital and the promotion of dynamic competition).

The criticisms have led to serious frictions inside the ruling party between the critics (and their supporters) and the two key figures in the government, the Vice Prime Minister, António Gualberto do Rosário, the main architect of the privatisation programme, and the Prime Minister, Carlos Veiga. The political 'crisis' inside the MpD led eventually to a cabinet reshuffle in late 1999.¹⁴ The government has affirmed that the timing, scope and form of what is left of the privatisation programme will be implemented as planned, because the credibility of reform policy and the financing of the Trust Fund rest on it. It is uncertain, however, how the political turmoil within the MpD will affect political stability and the broad consensus on reform policy in the country in the longer term. The MpD still enjoys a comfortable majority in the National Assembly, with some 70 percent of the seats (but with the seats of the critics included). Further, an independent candidate, António Monteiro, who was backed by the MpD in both the 1991 and 1996 presidential elections, holds the presidential post. No doubt the next legislative and presidential elections to take place in 2001 will shed much light on the political impact of the dissension within the MpD.¹⁵

Regaining control over fiscal policy

The considerable increase in the domestic public debt prior to the reorientation of reform policy in 1997-1998 was the result of a rapidly growing budget deficit

¹⁴ Cabinet reshuffles have been relatively frequent in Cape Verde since 1991, often in connection with criticism of reform policy inside the MpD. In March 1993, for example, internal criticism against some measures, that were considered to benefit only a small group of people, resulted in a major reshuffling of the government (Lobban (1995), p. 143).

¹⁵ An indication of the political impact of the MpD's internal crisis is given by the Municipal Council Elections held in February 2000. Compared to previous elections, political support for the MpD decreased significantly whereas it increased for the PAICV. The MpD and the PAICV won seven of the contested councils each, the remaining three going to independent candidates. In the 1996 elections, the MpD, PAICV and the independents had won 8, 4 and 4 councils, respectively. (A new council, São Miguel on the island of Santiago, was created after 1996.) The defeat of the MpD would presumably have been larger if the Supreme Court for a too-late officially registered candidature had not disqualified the candidate of the PAICV on the island of Boa Vista. Internal dissent and dissatisfaction with some aspects of reform policy seem to have weakened political support for the MpD. A symbolically indicative election result is the defeat of the MpD and the victory of the PAICV in the capital, Praia. Jacinto Santos, the former MpD mayor and one of the main MpD "dissidents", was not a candidate in the elections.

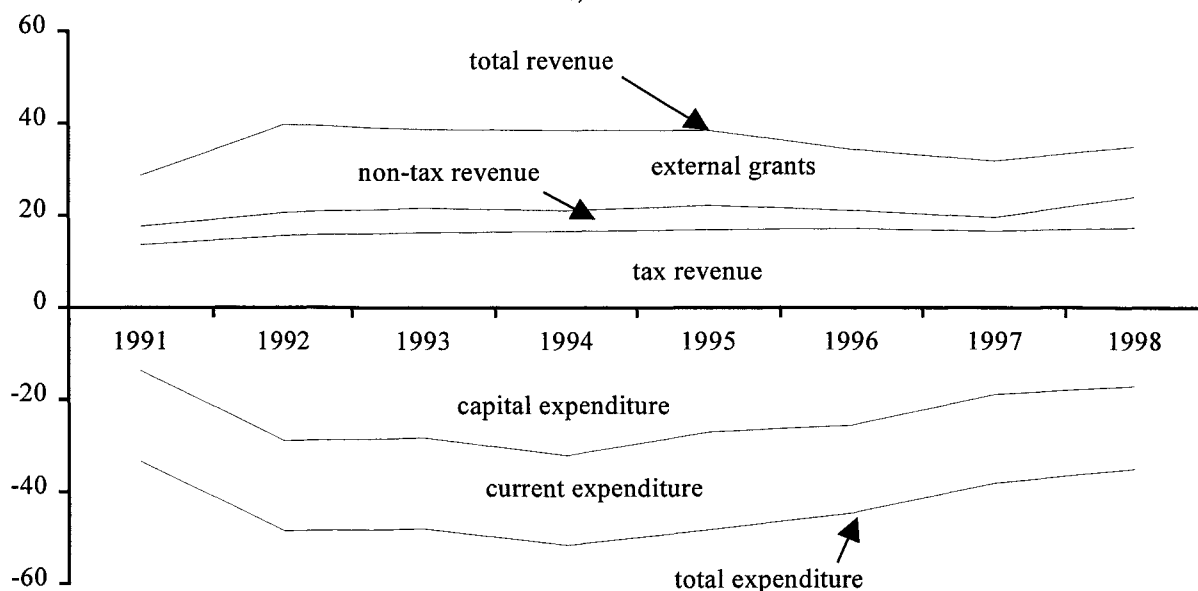
between the early and mid-1990s. (The deficit jumped from some 9 to 16 percent of GDP between 1991 and 1996.) The tax reform, introduced in two steps in 1991 and 1996, contributed to broaden the tax base and improve tax collection. In the mid-1990s, the level of tax revenue relative to GDP in Cape Verde (some 20 percent) was well in line with that found in countries with similar per capita income. The growing budget deficit could, therefore, to a large extent be ascribed to an increase in expenditures not compatible with the level of tax and non-tax revenues and external assistance. The increase in expenditures primarily concerned capital expenditures, whose share of GDP rose from 18 to more than 30 percent between 1991 and the mid-1990s. But it also concerned public salaries (which increased from some 9 to 12 percent of GDP during the same period) and interest payments on the domestic public debt that amounted to some 4 percent of GDP in 1996-1997. In short, it can be said that the government had lost control over fiscal policy in the mid-1990s.¹⁶ The budget deficit could be considered unsustainable in the sense that it was not compatible with sustainable domestic and foreign borrowing and the target for economic growth. Note that in the case of Cape Verde money creation and inflation cannot be used to stabilise (or even decrease) the domestic debt-GDP ratio, because the government's scope for inflationary policies is limited by external constraints in the form of the fixed exchange rate system and limited foreign reserves.

Regaining control over fiscal policy is the main macroeconomic priority of the reorientation of reform policy designed in co-operation with the IMF. An agreement between the Cape Verdean government and the IMF on a structural adjustment programme was signed in January 1998. The strengthening of fiscal policy rests on the success of the Trust Fund in reducing the burden of the domestic debt on public

¹⁶ Political factors contributed to this loss of control. The growing public deficit could to some extent be ascribed to the rapid increase in capital expenditure in 1994 and 1995, prior to the legislative elections of December 1995. This role of political considerations is not specific to Cape Verde. A recent study confirms the existence of political business cycles and the use of fiscal policy to influence election outcomes in developing countries (Schuknecht (2000)). A finding of this study is that increased public expenditure, rather than tax cuts, is the instrument preferred by governments to spur their popularity before elections. More specifically capital expenditure (like temporary employment in work-fare programme), rather than current expenditure, is the instrument preferred by such governments. The reason for focusing on public work programmes is that they can be fine-tuned and targeted on potential voters, are easy to interrupt once elections are over and do not imply a commitment that might be difficult to reverse after elections.

finances. But regaining control over fiscal policy also requires a reduction of public expenditures, so as to bring them to a level that is compatible with the level of tax and non-tax revenue and foreign assistance.

Figure 1: General Government Operation, 1991-1998 (as a percentage of GDP)



Note: Expenditure on interest payments on domestic and external debt is not included.

Source: Cape Verdean authorities.

Government revenue amounts to the sum of tax revenue, non-tax revenue and external assistance (grants and loans). Figure 1 shows that fluctuations in the total revenue / GDP ratio mostly reflect fluctuations in external assistance. But there is also a clear tendency for external assistance, mainly bilateral assistance, to decrease over time. On the other hand, tax revenue relative to GDP increased slowly and steadily, from some 14 percent in 1991 to more than 17 percent in 1998. This is far from negligible and results from an increase of both domestic taxes (taxes on incomes and profits) and taxes on international trade. The increase in domestic tax revenue (in terms of GDP) results from two factors: 1) the simplification of the tax system in 1996 with the unification of the taxes on salaries, self-employment income, rental income and business profits; 2) an improvement of the administration in charge of tax collection. Increased import volumes, in the wake of trade liberalisation and the rapid

expansion of the private sector, explain the increase in taxes on international trade relative to GDP.¹⁷ Non-tax revenue (principally from property income and licenses and various fees) has by and large remained constant over the period examined, with the notable exception of 1998, when it suddenly increased as a result of the repayment of debts by public enterprises. The latter has a once and for all character, and non-tax revenue is likely to return to a more normal level after the completion of the privatisation process.

Anyway, most of the adjustment efforts were concentrated on the expenditure side of the budget. This is natural since the deterioration of the fiscal policy stance in the mid-1990s was primarily due to an uncontrolled expansion of public expenditures. Ironically, the most welcome assistance in this respect came from the revision of the national accounts, in particular of the growth figures, in 1998. This revision actually resulted in an increase in the level of public expenditure, relative to GDP during the first half of the 1990s, that was significantly lower than that previously believed. This is not the whole story, however. Considerable adjustment efforts have also been made since the mid-1990s, particularly of capital expenditures, that were almost halved (as share of GDP) between 1994 and 1998.

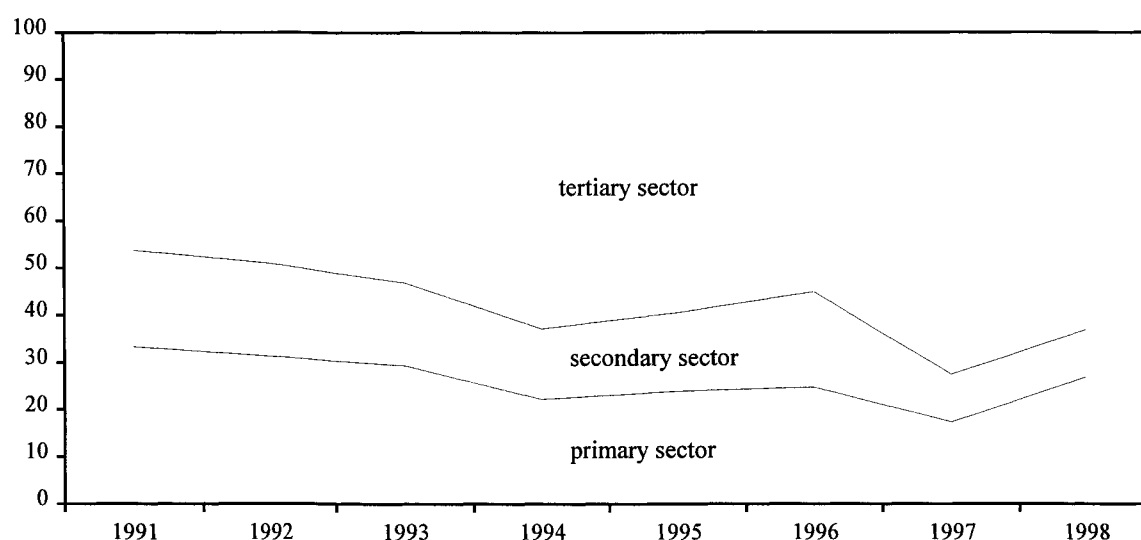
On the other hand, current expenditures, that is wages and salaries in the public sector, remained more or less constant (as a share of GDP) over most of the period examined, averaging some 19.5 percent of GDP. Two factors explain this constancy. The first is an increase of public wages that has been higher than the rate of inflation.¹⁸ The second is an increase in the number of civil servants and public sector

¹⁷ On January 1, 1999, concomitant with the elimination of the remaining quantitative import restrictions, the government increased tariffs on imports somewhat, from 15 to 20 percent on average. How these changes will affect the revenue from import tariffs is unclear, even if one may suspect that the positive impact of the removal of import quotas on import volumes will outweigh the negative impact of increased tariffs on import volumes.

¹⁸ Public sector wages in Cape Verde are low by international standards and this increase will have a limited effect on the differential between public and private wages. In the mid-1990s, for example, the average wage of civil servants to per capita GDP amounted to 1.9. (The average wage was estimated by dividing total wage expenditures by the number of civil servants.) This ratio is significantly lower than that found in most African countries (see e.g. Azam and Morrisson (1999), pp. 23-25). Note that the increase in public wages in Cape Verde has been accompanied by a widening wage differential between high-skilled and low-skilled personnel. For example, the ratio between the salaries of highly qualified workers and unskilled workers in the public sector increased from 2.8 to 3.3 between 1991 and 1998. The widening of wage differentials is still more pronounced when it comes to more

employees (mainly in the educational system) during most of the period analysed. According to official statistics, public employment increased by no less than 25 percent between 1991 and 1997.¹⁹ To curb this upward tendency, the government started an ambitious retrenchment programme for civil servants in 1998, the Voluntary Departure Programme.²⁰ The programme is progressing very slowly, however. In 1998, some 300 civil servants, mainly low-skilled employees, were concerned, that is some two percent of public employment.²¹ The high ambition of the retrenchment programme, in terms of an accompanying training and alternative employment component, its costs (including firing costs) and the condition put up by the government on external assistance financing; all these factors significantly limit its scope. But a second phase is to be initiated that should concern some 800 civil servants, that is some 6 percent of public employment, during a two-year period. Difficulties in finding external financing do, however, endanger this second phase.

Figure 2: Sector Distribution (in %) of Public Investment Expenditure, 1991-1998.



Source: Cape Verdean authorities

“political” posts. During the same period, the ratio between high-level managers and unskilled workers jumped from 3.7 to 5.3. For data on public salaries, see IMF (1999), p. 60.

¹⁹ République du Cap-Vert (1999), p. 7.

²⁰ For an official presentation, *ibid.*

²¹ Civil servants represent some 3 percent of the total population and some 10 percent of the labour force. About half of the civil servants belong to the educational system and about 60 percent are located on the main island, Santiago. *Ibid.*, pp. 7-9.

There is no doubt that most of the burden of adjustment has fallen on capital expenditures, whose share of GDP dropped from 32 percent to 17 percent between 1994 and 1998. This severe contraction ran parallel with a significant relative decrease in external assistance to Cape Verde (in % of GDP; see Figure 1). To some extent it is this decrease in external assistance that lies behind the decrease in capital expenditures, since development projects financed by external assistance often include a domestic component and require counterpart funds. In 1998, the contraction of capital expenditures also reflected the decision of the Cape Verdean government to abstain from pre-financing investment projects that are to be financed by foreign assistance but where this financing has been delayed.²²

The distribution of capital expenditures across economic sectors illustrates the priorities of the government. It also reflects the weights of the different sectors in the economy. The Cape Verdean economy is dominated by the tertiary sector, some 68 percent of GDP, followed by the secondary and primary sectors with 19 percent and 13 percent of GDP, respectively. A poor endowment in natural resources, adverse climatic conditions, the large role of the state in the economy after independence, and the huge volumes of emigrants' remittances when related to GDP (some 20 percent); all these factors have contributed to shaping the specific structure of the Cape Verdean economy. Total capital expenditures have decreased in both relative (as related to GDP) and absolute terms. How the capital expenditures have been distributed across sectors is illustrated by Figure 2. It shows that public investments have been concentrated in the tertiary sector and that this concentration has increased over time. The shares of public investments devoted to the primary and secondary sectors have decreased over time. This is particularly the case for the secondary sector and reflects the process of disengagement of the state from industrial activities. The decrease of public investments in the primary sector essentially concerns agriculture. Investments in fishery have fluctuated over time. They increased markedly between 1992 and 1994 and again and significantly in 1998, which explains the jump in public investment expenditure devoted to the primary sector at the end of the period in Figure 2.

²² IMF (1999), p. 20.

Public investments in the tertiary sector are mainly concerned with, in order of importance, transport and communications (17 percent of total public investments on average between 1991 and 1998), education (12.9 percent), energy, water and sewage (10.5 percent), and the social sector (health, social promotion and poverty alleviation, 6.3 percent). Investments in the educational and social sectors have increased in relative terms over time, reflecting the efforts made by the government to build up human capital in Cape Verde.²³ The policy of the government to modernise the public sector resulted in a similar but less pronounced trend-increase for investments in public administration, from some 9 to 11 percent of GDP between 1991-1992 and 1997-1998.

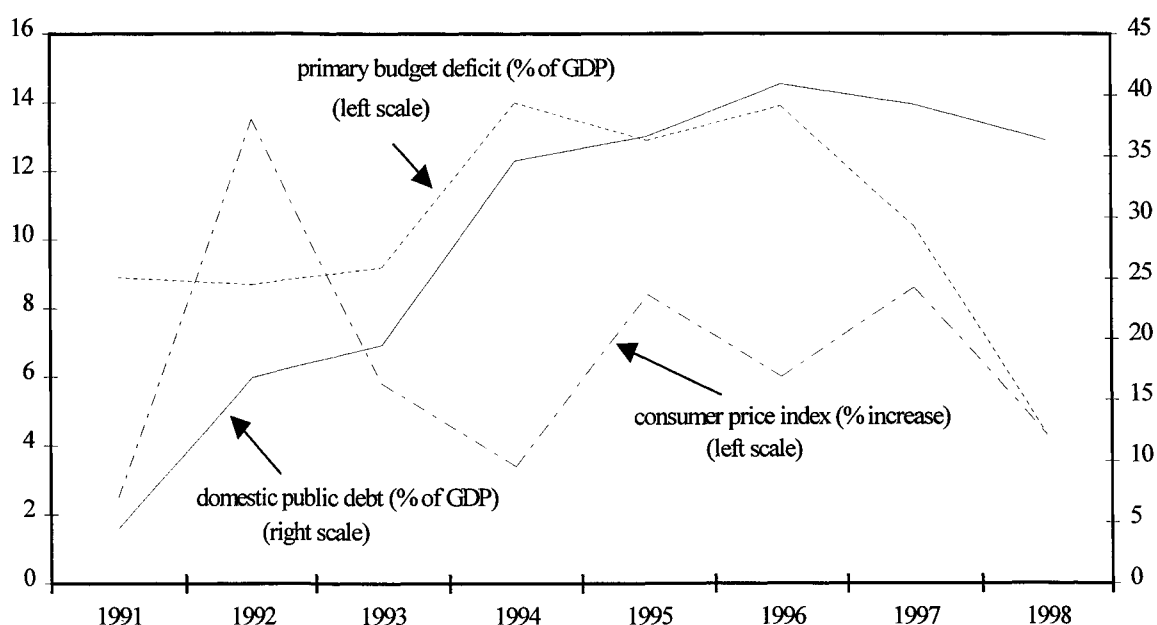
Curbing the budget deficit and containing domestic public debt without fuelling inflation

Adjustment policy in Cape Verde aims at eliminating the primary budget deficit (that is the total fiscal deficit minus the interest on the public debt) and at using the Trust Fund to gradually reduce the domestic public debt. It has been estimated that the time-requirement to pay off the whole domestic public debt is about two decades. A pre-condition for the balanced primary budget, if it is to reduce the debt-GDP ratio, is that the growth rate of GDP is higher than the real interest rate. A reduction of the debt-GDP ratio can be expected to “crowd in” private investments and permit a higher GDP growth, which actually is the main objective of the reform policy in Cape Verde. A factor that may contribute to the credibility of the government’s fiscal adjustment programme, and reduce economic agents’ expectations of the future inflation rate, is the adoption of a fixed exchange rate agreement between Cape Verde and Portugal. This arrangement has two beneficial effects on fiscal adjustment: 1) it ties the hands of the government so that it cannot use money creation and inflation to reduce the domestic debt-GDP ratio. 2) it has a disciplinary effect on fiscal policy since it

²³ The European Union is providing special technical assistance to these two sectors to improve transparency and resource allocation. The assistance of the European Union concerns the whole budgetary process and aims at streamlining procedure and improving the control of the Ministry of Economic Coordination over all public spending. It is still too early to see whether the eventual strengthening of fiscal rules and institutions will be sufficient to secure fiscal discipline and prevent expansive expenditure policies, in particular around elections.

includes the obligation for the Cape Verdean government to respect the so-called Maastricht criteria (a debt-GDP ratio below 60 percent or declining at a satisfactory rate, a public deficit below 3 percent of GDP, an inflation rate at most 1.5 percentage points above that of the three best performing countries, and a long-term interest rate at most 2 percentage points above those of the three best performing countries in terms of inflation).

Figure 3: Primary Budget Deficit, Inflation and Public Domestic Debt, 1991-1998.



Source: Cape Verdean authorities

Figure 3 shows the development of the primary budget deficit, the domestic public debt and inflation between 1991 and 1998. The contraction of capital expenditures since the mid-1990s and the strengthening of fiscal policy brought down the budget deficit from some 14 to some 4 percent of GDP. As can be seen, the decrease of the primary budget deficit has been considerable since 1997. The fiscal situation continued to improve in 1999 as a result of further fiscal discipline and rapid output growth (about 8 percent).²⁴ The rapid decrease of the primary budget deficit in combination with the rapid GDP growth permitted, first, the containment of the rapid

increase in the domestic public debt and, eventually, a significant decrease in the domestic debt-GDP ratio, from 40 to 35 percent between 1996 and 1998. This decrease was accompanied by a slight improvement in the structure of the domestic public debt, with a minor share of the short-term and medium-term debt being transformed into long-term debt.

The new life put into reform policy has (together with the revision of the national accounts) contributed to a significant improvement of the fiscal situation in Cape Verde. The control over budgetary expenditure is, however, still deficient and a Public Expenditure Survey is being prepared with the help of the European Union to improve budgetary procedures and the control over public expenditures. Another measure that is supported by the European Union is an improvement of the ex-post control capacity of the Government Auditing Office. This was established in 1993, but its role in the control of public expenditure is strongly limited by its small size (only 13 employees) and the lack of adequate expertise. Better control over budgetary expenditure and improved transparency were conditions laid down by the European Union for an additional contribution of US\$ 5 million to the Trust Fund (the initial contribution of the European Union was US\$ 10 million). The constraints put on the working out of control procedures by the scarce human resources delayed the implementation of the arrangement between the European Union and the Cape Verdean government, but noteworthy progress was achieved during 1999 and the additional contribution from the European Union to the Trust Fund was made in late 1999.²⁵

Figure 3 shows that the amelioration of the fiscal stance has been accompanied by a somewhat fluctuating but, by developing countries' standards, relatively low inflation rate. Since mid-1998, monetary policy in Cape Verde has been subordinated to the restrictions imposed by the exchange rate agreement between the governments of Cape Verde and Portugal. Figure 3 suggests that the agreement, coupled with the

²⁴ Some fiscal difficulties in mid-1999 led to a diminution in international reserves and foreign exchange rationing. The situation was, however, rapidly corrected and foreign exchange rationing was lifted in late 1999.

²⁵ A consequence of the delay in the constitution of the Trust Fund was that interest payments on domestic debt remained at a high level in 1998 and 1999. In order to lessen the budgetary impact of the delay, Portugal accorded a so-called bridge loan of US\$ 6.5 million in 1999.

more positive fiscal stance, has been effective in reducing both current inflation and inflation expectations (where inflation expectations reflect, in the main, expectations concerning monetary financing of fiscal deficits in the future). The current inflation will also reflect the expectations of economic agents regarding the future development of prices.²⁶ The inflation rate was halved between 1997 and 1998, from 8.6 to 4.4 percent. The figure for the year 1999, 4.4 percent, confirms the lack of strong inflationary pressures in Cape Verde. The figure is, however, still higher than the average inflation rate in the Euro-zone, by some two-percentage points. This probably reflects the fact that it takes time to adjust the expectations of the development of prices in the future downward. An implication of the inflation differential between Cape Verde and the Euro-zone is a gradual loss of competitiveness for the Cape Verdean export products when compared with Euro-zone products. The large depreciation of the Euro relative to the US dollar, some 15-20 percent during 1999, implies, however, that Cape Verde's competitiveness has improved significantly relative to that of countries whose currencies are pegged to the US dollar.

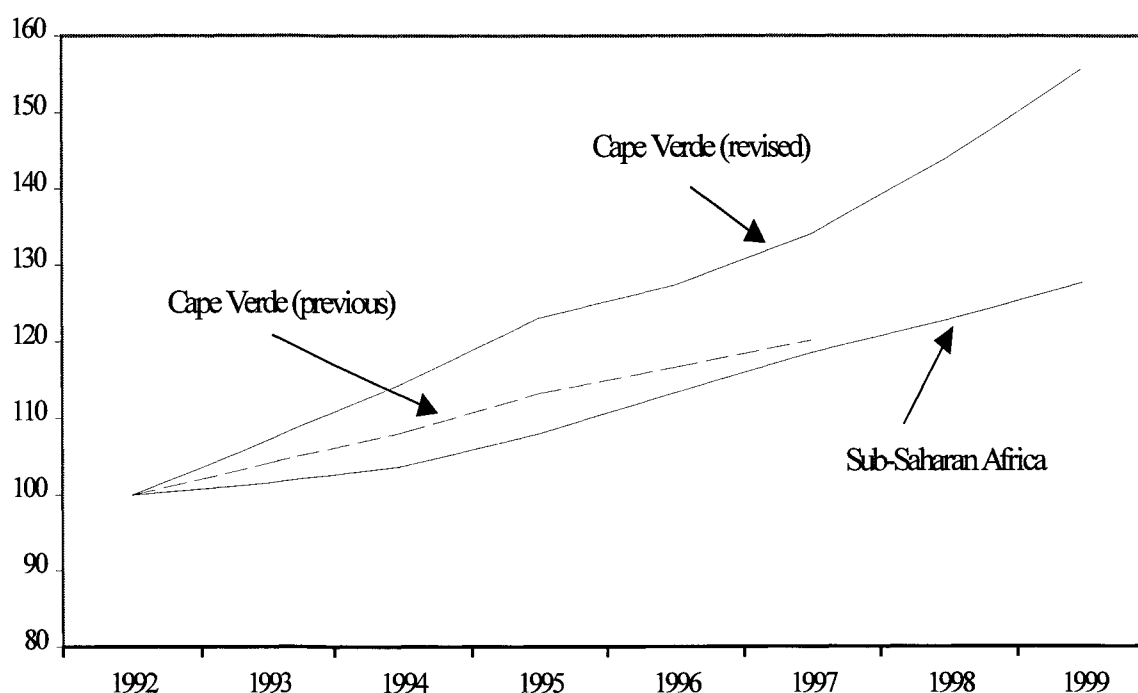
3. Harvesting the Fruits of Growth and the Expansion of Private Small Enterprises

A main objective of the reorientation of reform policy in 1997-1998 was an acceleration of the rate of economic growth. Higher growth was considered the best remedy for the dismal employment situation and the widespread poverty. Political changes within the MpD and the considerable prerogatives given to António Gualberto do Rosário, the Vice Prime Minister, altered the balance between technocratic and political forces inside the government and contributed to this greater focus on growth issues. A factor that undoubtedly played a decisive role was the (at that time) disappointing growth figures showing that the rate of economic growth was slowing down in the mid-1990s. Compared to other Sub-Saharan countries, the Cape Verdean economy was considered to have performed rather poorly, when account was taken of the impact of the mediocre growth performance of the CFA countries on average Sub-

²⁶ See e.g. Agénor and Montiel (1999), pp. 163-165.

Saharan growth, due to the severe misalignment of the CFA franc prior to its devaluation in January 1994.²⁷ Cape Verde did not suffer from such an exchange rate misalignment but was still not able to achieve a higher rate of growth. This is illustrated by Figure 4, which shows that the GDP growth in Cape Verde (using the previous official figures) was just slightly superior to that in Sub-Saharan Africa, and that the country embarked on a slower growth path after 1995.

Figure 4: Real GDP Growth, 1992-1999 (1992=100)



Note: The figures for 1999 are an estimate for Cape Verde and a projection for Sub-Saharan Africa based on the average GDP growth for the period 1995-1998.

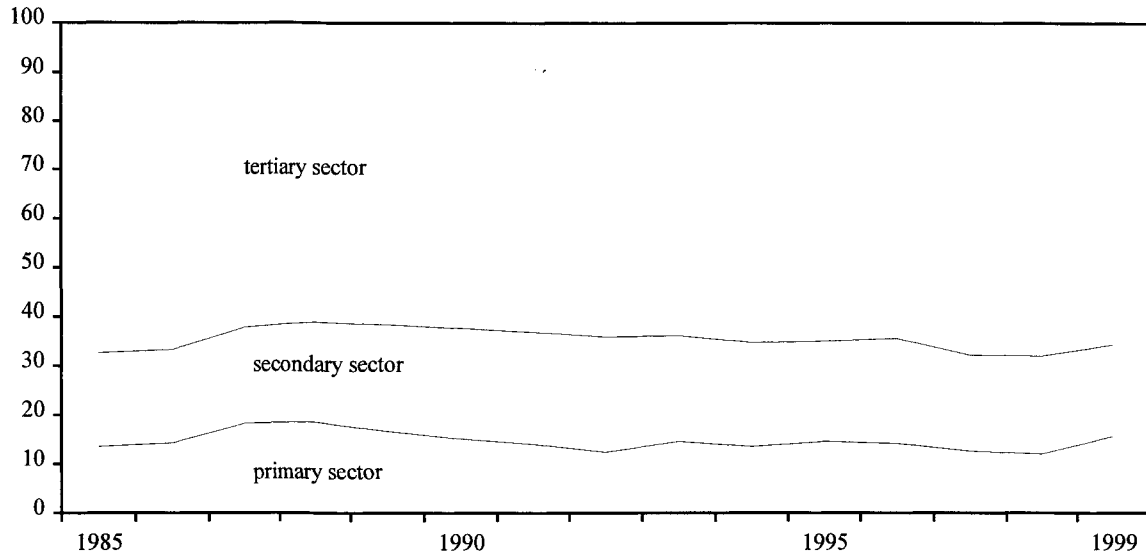
Sources: Cape Verdean Authorities and IMF statistics.

The revised National Accounts for the 1993-1997 period, first published in 1998, considerably modified the growth achievement of the Cape Verdean economy after 1992. This is well illustrated in Figure 4. GDP growth was some 3 percentage points higher between 1993 and 1995 than had first been believed. But it slowed down significantly in 1996, before again embarking on a more rapid growth path thereafter, some 7 percent on an annual basis. Figure 4 also shows that the high GDP growth in

²⁷ See e.g. Bourdet (1998), pp. 18-21.

Cape Verde over the last three years of the period put the country well ahead of the other Sub-Saharan countries.

Figure 5: Distribution of GDP by Economic Sector (in %), 1985-1999.



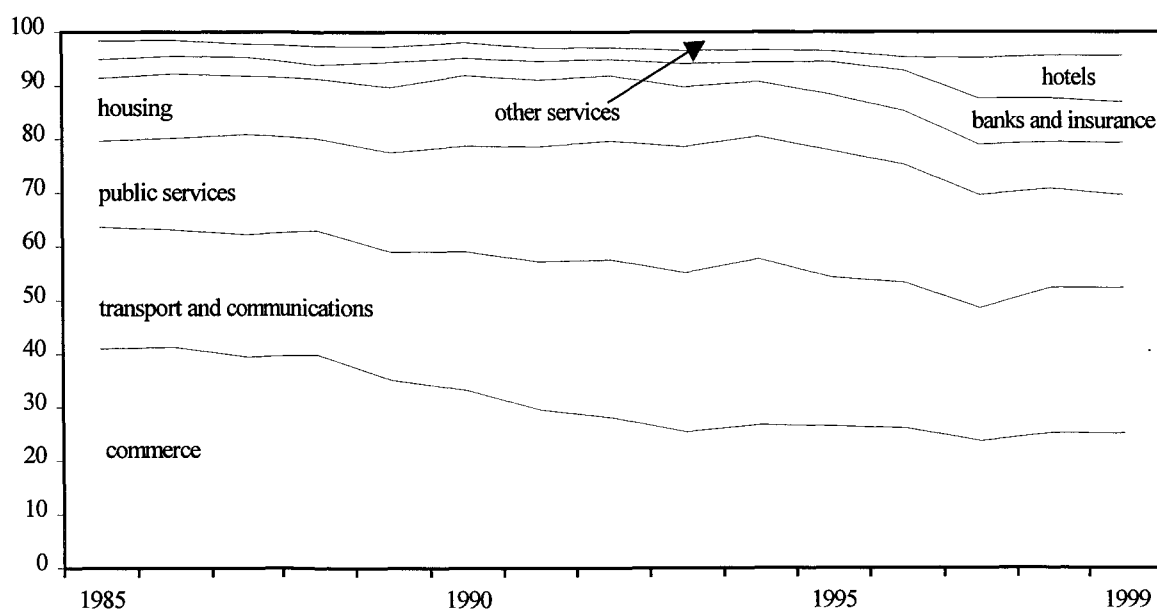
Sources: Contas Nacionais, 1985-1995, and Cape Verdean authorities.

Economic growth has been rather evenly distributed across the primary, secondary and tertiary sectors. This is illustrated in Figure 5, which shows that the rapid period of economic growth since the early 1990s has had a limited impact on the distribution of activities among the three main sectors. The slight increase in the relative size of the tertiary sector during the 1990s seems to reflect a long-term trend towards tertiarisation of the Cape Verdean economy. Note, however, that the tertiary sector experienced a more significant relative growth, in particular when compared with the secondary sector, during the last three years of the period. On the other hand, the sudden increase in the relative size of the primary sector in 1999 reflects the exceptionally favourable climatic conditions, with abundant rains, during this year and the resulting very good performance of the agricultural sector.

The Cape Verdean economy differs substantially from most of those of the Sub-Saharan countries in terms of the dominant role played by the tertiary sector, some two thirds of GDP. Changes in the size and composition of this sector are therefore of great importance for overall growth performance and the structure of

employment. Figure 6 repeats the exercise of Figure 5 but for the tertiary sector alone. A striking finding is that the intra-sectoral changes in the tertiary sector are much larger than those in the other two main sectors. Another finding from Figure 6 is that the share of commerce was almost halved over the last one and a half decades of the period while that of transport and communications increased somewhat. A third finding concerns the public sector. The share of public services increased significantly during the first half of the 1990s, reflecting the expansive fiscal policy conducted by the government. After 1997, however, it is noticeable that there was a decrease of the share of public services in the tertiary sector, as a result of the contraction of public expenditures. The most significant sub-sector changes in Figure 6 concern the very rapid relative expansion of banks and insurance, hotels and, to a lesser extent, other services since the mid-1990s. Their cumulated share of the tertiary sector almost doubled, jumping from some 10 to 20 percent. This rapid expansion no doubt contributed to the rapid growth in Cape Verde during the second half of the 1990s. Financial liberalisation, the establishment of branches of foreign banks, the privatisation of the commercial banks and the insurance companies, and the promotion of tourism are the factors that explain this expansion.

Figure 6: Distribution of Activities in the Tertiary Sector (in %), 1985-1999.



Sources: Contas Nacionais, 1985-1995, and Cape Verdean authorities.

The expansion of private small firms

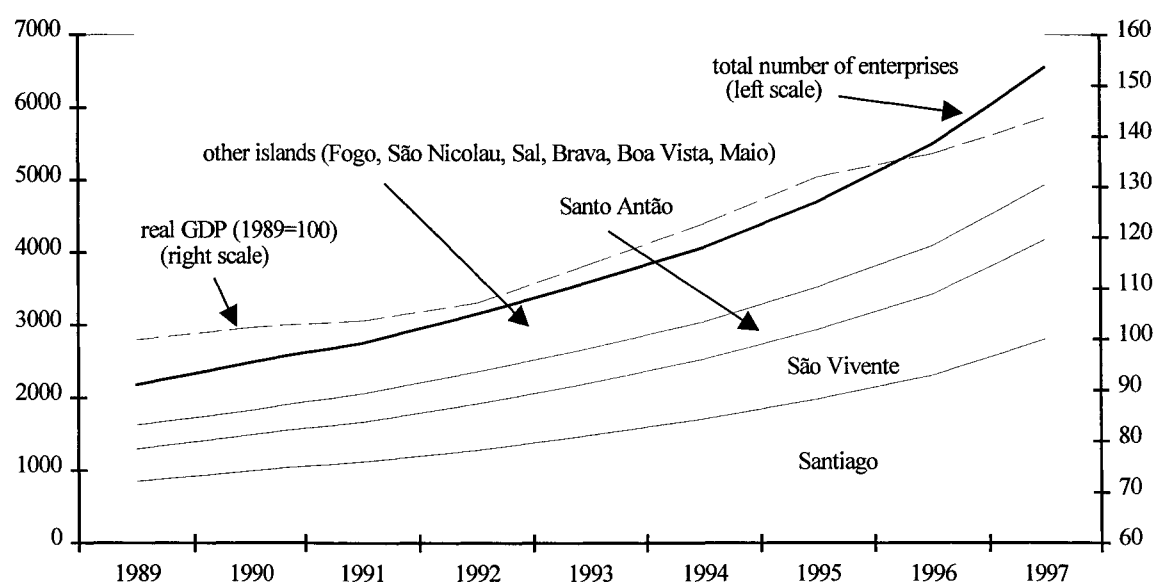
But there remains the puzzle of the factors behind the rapid (revised) GDP growth during the first half of the 1990s. Some light on this may be shed by the rapid increase in the number of small and medium sized enterprises since the early 1990s. This is illustrated in Figure 7, which shows that there is a strong correlation between the rate of growth of GDP and the increase in the number of non-rural enterprises in Cape Verde. The figures are from an Enterprise Survey (*Recenseamento Empresarial 1997*) that covers the period between 1990 and 1997 but was first published in 1999. A large part of the good growth performance since the early 1990s can thus probably be attributed to the rapid increase in the number of enterprises, in particular small and medium sized enterprises. The increase of GDP by some 50 percent between 1989 and 1997 ran parallel with a three-fold increase of the number of enterprises.

The overwhelming majority of these non-rural enterprises is of small, even very small size. In 1997, 89 percent of the total number of enterprises employed only one to five persons, and an additional 9 percent six to twenty persons. More than half of the enterprises (about 54 percent) were concerned with food retailing and catering. An additional 20 percent belonged to the industry sector (manufacturing and construction). Some 97 percent of the enterprises were privately owned by Cape Verdeans, an additional 2 percent foreign-owned (totally or partly), and the remaining one percent owned by the state (totally or jointly with private interests). Around one fifth of the enterprises were not officially registered. (This has probably contributed to the underestimation of the growth figures.) There is a clear gender dimension with women accounting for only one third of employment in non-rural enterprises. Further, there is a clear gender bias in the sector repartition with half of the female employment being concentrated in food retailing and catering. Male employment is more evenly distributed among economic activities with only a fifth in food retailing and catering, 15 percent in transport and related activities, 12 percent in the food and drink industry, 10 percent in wholesale trade and 8 percent in construction.

The growth in non-rural enterprises over time is relatively well distributed among the islands. This may provide some evidence of a relatively well balanced

growth in Cape Verde. In order to illustrate this point, Figure 7 decomposes the total number of enterprises among the three main islands, Santiago, São Vicente and Santo Antão, and the remaining small islands grouped together. By and large, increases in the number of enterprises on Santiago, São Vicente and the small islands followed the aggregate trend. The increase on the island of Santo Antão is less pronounced than on the other larger islands. This is further confirmed by Table 1, which gives the percentage increase in the number of enterprises between 1990 and 1997. The largest increases, superior to the national average, have occurred (in order of rank) on the islands of Sal, Brava, São Vicente and Santiago. Below the national average, but still very significant, increases are to be found on the other islands.

Figure 7: Growth in the Number of Enterprises, Total and by Islands, 1989-1997.



Source: Instituto Nacional de Estatística (1999).

Looking only at the distribution of the total number of enterprises may, however, give a somewhat biased picture of the level of business activities across the islands since the enterprises may be of different size. This is illustrated in Table 1 by the average number of employed per enterprise. The average (employment) size of enterprises is biggest on the islands of Sal, São Vicente and Santiago and smallest on the islands of Brava and Fogo, with the rest of the islands in between. Figures on

average turnover (sales) confirm this result (see Table 1). The larger differences between the sizes of enterprises, when measured with average sales as compared with employment figures, reflect the higher capital intensity of larger enterprises. Concentrating on large enterprises confirms the uneven distribution of large enterprises across the islands: larger enterprises, with more than 70 employees, are actually only found on the islands of Santiago, São Vicente and Sal. The medium-sized enterprises (with 21 to 70 employees) and the enterprises with 6 to 20 employees are somewhat more evenly distributed across the islands, with 85 percent and 66 percent, respectively, being located on these three islands.

Table 1: Distribution, Increase, Size and Intensity of Non-Rural Enterprises, 1997.

	No. of Enterprises	Increase (%) 1997/1990	Average size employment	sales	Enterprise intensity
Boa Vista	147	133	3.2	2,404	2.3
Brava	157	191	1.8	967	2.0
Fogo	563	154	2.1	2,058	1.2
Maio	173	134	2.6	4,084	2.0
Sal	266	250	6.9	17,163	1.5
Santiago	2,826	183	5.1	12,252	0.8
Santo Antão	771	110	2.8	1,431	1.0
São Nicolau	281	105	2.6	1,793	1.4
São Vicente	1,407	185	6.2	16,181	1.2
Total	6,591	165	4.6	10,001	-

Notes: 1) Increase (in %): number of enterprises in 1997 divided by the number of enterprises in 1990. 2) Average size. Employment (no. of employed) and total sales divided by the number of enterprises. (Sales data are in thousands escudos). 3) Enterprise intensity: island's share of the total number of enterprises divided by the island's share of the total active population; the higher the value of the index, the higher the enterprise intensity, and vice versa.

Sources: Computed from *Instituto Nacional de Estatística* (1999) and *Instituto do Emprego e Formação Profissional* (1997).

In order to better grasp the differences between the islands when it comes to the conditions for entrepreneurial activity, Table 1 also calculates an enterprise intensity index (the fifth column). This index shows whether the island's share of the total number of enterprises is larger than its share of the total population. The higher the value of the index, the better the conditions for entrepreneurial activities can be presumed to be, and vice versa. The index should, however, be interpreted with some

care for several reasons. One is the unequal distribution of civil servants and public sector employees across the islands; such public employment tends to “crowd out” private economic activities. A second is the fact that the index does not take into account the size of the enterprises. Both limitations work strongly in disfavour of the island of Santiago, where some 60 percent of the civil servants and the majority of the larger enterprises are located (of the enterprises with more than 70 employees more than half, 53 percent, are located there). The second limitation also pertains to the islands of São Vicente and Sal, where the remaining larger enterprises are located. Bearing these limitations in mind, the results of Table 1 suggest that entrepreneurial activities are rather well distributed across the islands. Two exceptions may be the islands of Santa Antão and Fogo, which have neither larger enterprises nor a large share of public employment.

The index value for Santiago is somewhat surprising, even when account is taken of the above limitations, but decomposing the island by council provides a clearer picture of the factors at work. The value of the index for Praia amounts to 1.2 while it remains in the 0.7-0.9 range for the councils of São Miguel, São Domingos, Tarrafal and Santa Catarina (and 1.0 for Santa Cruz). Further, the average employment size of enterprises in Praia is 7.6 employees whereas it is 2.1-2.8 employees in the other councils of the island. Sales data provides evidence of even greater discrepancy between the average size of enterprises in Praia and the rest of the island. Average sales per enterprise in Praia are some 14 times higher than for the rest of the island. Whereas comparison between the islands provides very little evidence of agglomeration tendencies, comparison between the councils of Santiago provides evidence of clear agglomeration effects within the island.

In sum, the rapid increase in private economic activities to a large extent explains the rapid growth achieved by Cape Verde since the early 1990s. This increase was largely bypassed by previous statistics that failed to accurately reflect the huge growth in the number of private enterprises. The increase in business activities and GDP growth seem to have been relatively well distributed across the main economic sectors and the islands. Santo Antão, São Nicolau and certain regions (councils) on the island of Santiago seem, however, to have benefited less from this long period of

expansion. New impulses coming from the deepening of reform policy and the subsequent rapid increase in banking, insurance, tourism and other service activities explain the acceleration of GDP growth since the mid-1990s. These additional growth gains are likely to be less evenly distributed across the islands, by the very nature of the sub-sectors concerned.

4. The Achilles Heel of the Reform Policy: High Unemployment and Persistent Poverty

The employment situation is historically bad in Cape Verde. This is indicated by low employment rates (the number of employed relative to the total population), high and persistent levels of unemployment, and the existence of a large informal sector with precarious jobs. The poor employment outcome is mainly due to the interaction of several factors of a more structural character. A first factor is the, by developing countries' standards, small size and low productivity character of the agricultural sector. Adverse climatic conditions, with repeated and often long-lasting droughts, and the structural lack of water resources to a large extent explain the poor performance and low productivity of the agricultural sector. A second factor is the rather small industrial base. Severe localisation disadvantages (in the form of huge transport costs to export markets), a very limited home market (some 400,000 inhabitants) and an inadequate stock of human capital have put limits on the size and growth of the industrial sector. These two factors, together with a large service sector that to some extent is an outgrowth of foreign aid and emigrant remittances, have contributed to producing an economic structure that looks like that of a developed country, but with significantly lower average productivity and income per capita.

Employment: structure and forms

According to the 1996 Labour Force Survey, some 57 percent of the population aged 14 and above belonged to the labour force in 1996. Six years earlier, in 1990, the labour force participation rate had amounted to some 62 percent. Labour force participation rates vary significantly between the islands (in the range 49-66

percent in 1996), above the country's average on the islands of Sal, São Vicente, Maio, Santiago and Boa Vista, and below the average on the remaining islands. Not only geography, but also gender, matters for participation rates. The relatively small change in the total participation rate between 1990 and 1996 hides wide, but converging, differences between the participation rates of men and women. Labour force participation rates for men and women amounted to 87 and 42 percent in 1990 while the corresponding figures for 1996 were 69 and 47 percent. This convergence in participation rates between the sexes probably reflects changes in the school leaving age, the age of retirement and increased participation of women in market activities.

Although the labour force participation rate decreased over time, the absolute size of the active population increased significantly during the same period as a result of sustained population growth. (Population growth has been estimated at 2.7 percent during the 1990s.) Between 1990 and 1996, the active population increased from some 116,000 to some 136,000.²⁸ The distribution across economic sectors of the part of the active population that is employed changed significantly over the same period. This is illustrated in Table 2. A first striking finding from Table 2 concerns agriculture, livestock and fishery, whose share of total employment almost halved between 1990 and 1996. The relative decrease in primary employment reflects to some extent the decreasing relative role of agriculture in the economy (see Figure 5). But the magnitude of the decrease between 1996 and 1990 is hardly realistic, because the share of the primary sector in GDP contracted only slightly. Such a decrease could only be explained by a huge, unreported increase in labour productivity in the agricultural sector. Seasonal factors (the survey was performed during the third quarter of 1996) and the bad performance of agriculture in 1996 seem more realistic explanations. This may not be the whole story, however. Table 2 suggests that the decrease in primary sector employment was much stronger for women than for men. Furthermore, the

²⁸ The figures are not directly comparable since the 14 year-olds are included in the active population in 1996 but excluded in the 1990 figures. The 1990 Population Survey that we use for estimating the participation rate in 1990 includes the whole 10-14 year old group without information on the number of 14 year-olds. We subtracted the whole group of 10-14 year-olds in our estimation of the active population and the participation rate for 1990. An implication of this is that the increase in the active population is somewhat less than that indicated in the text, and the decrease in the labour force participation rate somewhat lower.

changes in primary sector employment were mirrored by large changes in the opposite direction in commerce, restaurants and hotels. The changes in the two sectors may be in some way related, reflecting changes in the division of labour in rural families and/or statistical difficulties in separating the production and marketing of vegetables and other agricultural products.

Table 2: Distribution of Employment by Sector and Sex (in %), 1990 and 1996.

Economic sector	Total	1990		Total	1996	
		Men	Women		Men	Women
Agriculture, livestock and fishery	31.1	30.6	31.9	15.9	20.8	8.0
Manufacturing	6.1	6.8	4.8	6.3	8.1	3.4
Energy	0.9	1.2	0.4	1.0	1.4	0.2
Construction	21.0	27.1	10.6	10.6	15.0	3.3
Commerce, restaurants and hotels	13.5	8.3	22.3	19.5	11.9	31.8
Transport and communications	6.2	8.5	2.2	8.5	12.1	2.5
Banks and insurance	0.9	0.8	1.0	1.2	1.2	1.1
Public, social and personal services	19.4	15.8	25.6	36.4	28.8	49.1
Undefined activities	0.9	0.9	1.0	0.6	0.7	0.6
Total	100	100	100	100	100	100

Sources: Computed from *Ministério do Trabalho, Juventude e Promoção Social* (1995) and *Instituto do Emprego e Formação Profissional* (1997).

A second major change concerns the rapid expansion of public, social and personal services, whose share in total employment almost doubled over the period examined. Women have been the main beneficiaries of this rapid expansion, since the sector now accounts for about half of total female employment. The expansion of the public sector during the first half of the 1990s presumably accounts for a large part of this increase. In 1996, public services accounted for half of the public, social and personal services, with some 25 percent employed in the educational system, some 2 percent in the health system and the remaining 23 percent in other public services.²⁹ The share of total employment in banking and insurance increased slightly between 1990 and 1996. That the increase was so modest was to be expected, since most of the structural changes in this sector occurred in the wake of the deepening of reform

²⁹ *Instituto do Emprego e Formação Profissional* (1997), p. 41.

policy, in particular the privatisation of commercial banks from 1997 onwards (see Figure 6).

A third major change concerns the construction sector. Its share of total employment almost halved between 1990 and 1996. This is not that surprising since the two other components of the industry sector, manufacturing and energy, increased their respective shares, while the whole secondary sector in terms of GDP contracted during the period examined (see Figure 5). But the magnitude of the decrease in employment in the construction sector remains something of a puzzle that deserves further investigation. Finally, a fourth major change is the significant increase in transport and communications from 6.2 to 8.5 percent of total employment. This was expected because of the increase in this sub-sector's share of the output of the tertiary sector between 1990 and 1996 (see Figure 6). This employment increase benefited mainly male employment.

The changes in the sectoral distribution of employment have been accompanied by changes in the distribution among various forms of employment. This is to be expected since the forms of employment differ across sectors, and consequently changes in the sectoral distribution of output tend to automatically lead to changes in the repartition of different forms of employment in the economy. But it can also be the case that the distribution of forms of employment within sectors changes over time as a result of e.g. changing attitudes on the part of both employers and employees and legislative changes. Some of the changes over time in Cape Verde may thus be the result of the reform of labour legislation, which has facilitated labour reallocation across sectors through the simplification of rules for hiring and dismissal and favoured the emergence of new forms of employment. Table 3 shows that, among employees, permanent jobs constitute only 42 percent of total jobs, temporary jobs 16 percent and other forms of job contracts 42-43 percent. The absence of corresponding figures for the early 1990s impedes us from assessing changes over time. But there are figures on the distribution between the same forms of employment contracts in the urban centres of Mindelo, Praia and São Filipe.³⁰ Comparing the two studies suggests that both permanent and temporary jobs have increased in relative terms over time, at

³⁰ Computed from *Ministério do Trabalho, Juventude e Promoção Social* (1995), pp. 79-80.

the expense of other forms of employment contracts, but that the increase in temporary jobs is much more rapid. A look at the distribution within economic sectors (see Table 3) indicates that permanent jobs are most common in the service and energy sectors. No doubt the high share of permanent jobs in these sectors mirrors the dominant role of public employment.

Table 3: Forms of Employment (in %), 1996.

Economic sector	Permanent jobs	Employees Temporary jobs	Others	Total	Self-employment in % of total employment
Agriculture, livestock and fishery	28.6	12.0	59.4	100	39.6
Manufacturing	32.6	21.7	45.7	100	34.9
Energy	50.8	17.6	31.6	100	0
Construction	12.9	26.6	60.5	100	19.7
Commerce, restaurants and hotels	45.9	13.8	40.3	100	55.6
Transport and communications	49.0	9.7	41.3	100	12.8
Banks and insurance	57.2	17.1	25.7	100	6.6
Public, social and personal services	50.0	14.8	35.2	100	6.2
Undefined activities	33.4	28.6	38.2	100	39.0
Total	41.8	15.7	42.5	100	25.2

Source: Instituto do Emprego e Formação Profissional (1997).

On the other hand, the share of temporary jobs in the total number of employees varies less across sectors even if temporary jobs are most frequent in two sectors dominated by male labour, manufacturing and construction. Table 3 also provides evidence of the importance of self-employment for the country as a whole and across sectors. Comparing the figure for the whole country, 25 percent of total employment, with the share of self-employment in the urban centres in the mid-1980s (14-19 percent) suggests that self-employment has grown in importance over time. Not surprisingly, the share of self-employed individuals in sectoral employment is most sizeable in commerce, hotels and restaurants and the primary sector. Typically, all

these sectors rely mainly on the provision of labour by owners (and their families) without formal employment contracts.

Another important aspect of employment is thus the large informal sector in the economy, a main feature of which is the absence of formal employment contracts. In urban areas, the informal sector is mainly made up of small, privately owned enterprises in the service sector that employ unskilled workers. By the very nature of this sector, figures on the extent of the informal sector must be interpreted with care. According to the 1996 Labour Force Survey, the informal sector in Cape Verde was estimated to account for some 40 percent of total employment, well in line with its size in other developing countries. The study also provides some estimates of the extent of the informal sector across economic sectors: 50 percent of the employment in commerce, restaurants and hotels, 34 percent in manufacturing, 25 percent in construction, 17 percent in personal services and 9 percent in transportation.³¹ The high share of informal sector employment in commerce, hotels and restaurants suggests that the informal sector may even have grown in importance during the 1990s and that it may have “crowded out” formal employment in this sector. The difficulties associated with measuring such activities may also explain the relative decline of commercial activities in the tertiary sector illustrated in Figure 6.

A survey conducted in five urban centres, Mindelo, Praia, Assomada (Santiago island), Espargos (Sal island) and São Filipe (Fogo island) in 1997 sheds further light on the characteristics of the informal sector in Cape Verde.³² First, some 95 percent of the enterprises in the informal sector employ less than five persons, compared with 58 percent in the formal sector. Second, commerce is clearly the dominant economic activity, with some 56 percent of all enterprises, followed by restaurants and hotels, with some 19 percent. Measuring in terms of employment confirms this sectoral distribution. Third, about 40 percent of the enterprises are open seven days per week and an additional 55 percent five to six days. Fourth, the level of educational attainment of the owners is low, 86 percent of them having only primary education or less, and their age is also relatively low, 63 percent being less than 45

³¹ *Instituto do Emprego e Formação Profissional* (1997), p. 17.

³² *Instituto do Emprego e Formação Profissional* (1998).

years old. Fifth, informal enterprises are mostly family businesses: three fourths of those engaged in informal activity work either as owner or for a family member. Sixth, about half of those engaged in informal sector activities are remunerated as owners, 28 percent enjoy a fixed wage, 3 percent are paid by the hour or by commission and some 15 percent (family members) are not paid. And last, but not least, a large proportion (42 percent) of the owners of the enterprises in the informal sector had a job in the public sector before the creation of their enterprise, and many owners combine a public sector job with informal sector activity.

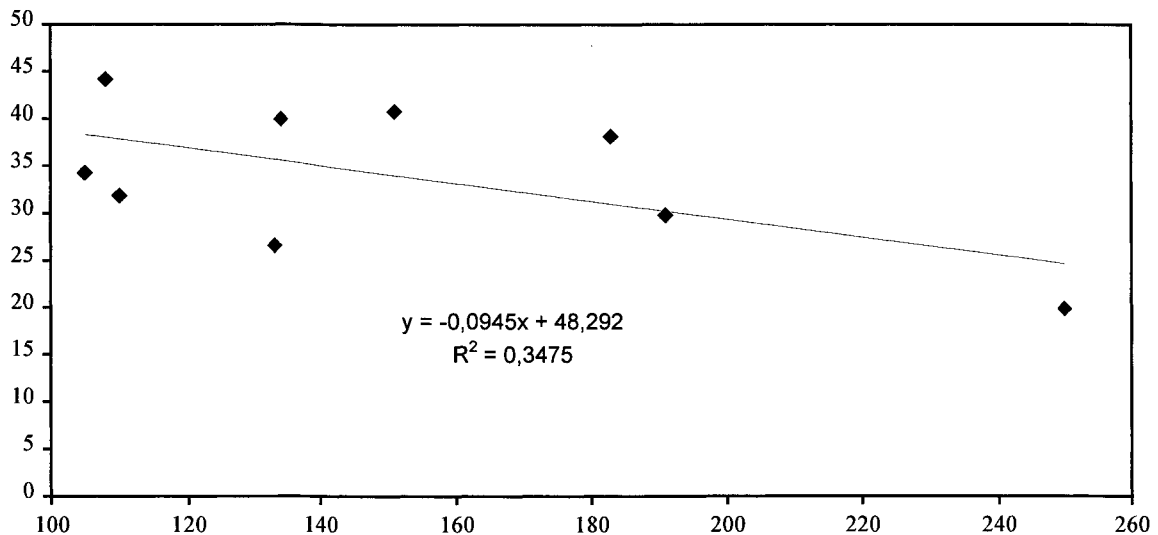
The picture that emerges from the informal sector survey is thus that of a sector mainly composed of very small enterprises that produce mostly services and other non-tradables. Informal enterprises are often family-based and enjoy a low level of human capital. Women are over-represented, in particular in commerce. Labour legislation is very imperfectly enforced and the degree of wage flexibility is relatively high, since only about one fourth of informal employment benefits from a fixed wage. These features correspond to those found in other developing countries. One notable exception might be the relatively large number of former and current public sector employees among the owners, suggesting non-negligible mobility between the formal and informal sectors. This should be seen in the light of the large role of the state in the Cape Verdean economy after independence. The encouragement given to private activities since the early 1990s has probably contributed to this mobility.

Unemployment and the expansion of small enterprises

Unemployment is chronically high in Cape Verde. As suggested above, this is to a large extent due to the small productive base and the specific structure of the economy. The understanding of the magnitude and characteristics of unemployment is complicated by the existence of two competing views on its extent. The first, the official governmental view, focuses on certain islands and urban centres while the second, derived from the 1996 Labour Force Survey, covers the whole country and the

whole economy. Both types of statistics are used here since they rather complement each other in geographical terms and cover different periods.³³

Figure 8: Unemployment Rate (Y-axis) and Non-Rural Enterprise Growth (X-axis) by Island (in %).



Notes: 1) The unemployment rate is the number of unemployed divided by the number in the labour force. Unemployment comprises people without work, available for work and looking for work. Unemployment data are from the Labour Force Survey and pertain to the year 1996. 2) Non-rural enterprise growth is the percentage increase in the number of enterprises between 1990 and 1997 (see Table 1).

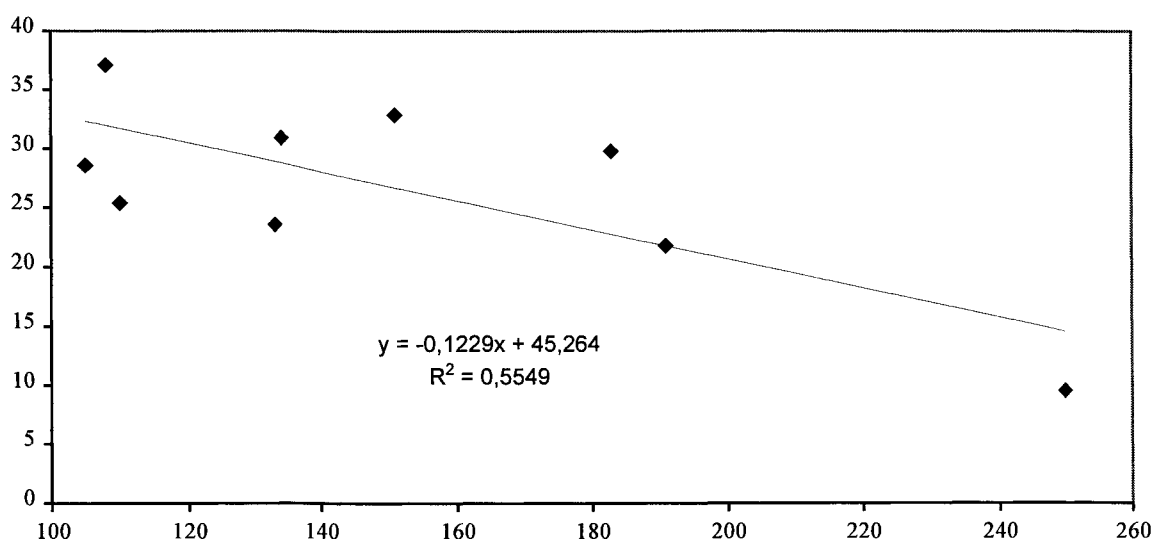
Sources of data: Instituto do Emprego e Formação Profissional (1997) and Instituto Nacional de Estatística (1999).

The 1996 Labour Force Survey provides evidence of mass unemployment in 1996 with some 38 percent of the active population being unemployed. It reveals that the main features of unemployment in Cape Verde are: 1) a high proportion of long-term unemployed (12 months or more), about half of total unemployment. 2) a high proportion of youth unemployment (14-24 age group), some 58 percent of total unemployment. 3) a very high proportion of unemployed with low educational attainment, some 91 percent of the total number of unemployed with less than or only

³³ One critical factor behind the differences between the two competing views has to do with the way the seasonal, labour-intensive public works, the FAIMOs, are integrated in the calculations. Categorising them as employed (and not as a type of unemployed), as seems to be the case in the official view (Republic of Cape Verde (1999b), p. 18), almost halves the unemployment figures. In the mid-1990s, some 17,000 people a year were employed in the FAIMOs.

primary education. 4) a clear difference by gender with 48 percent of the female labour force being unemployed but “only” 30 percent of the male labour force. 5) a clear concentration in certain sectors of the economy with construction and public works accounting for 31 percent of the total number of unemployed, public administration for 18 percent, the service sector (public administration and education excluded) for 13 percent, the primary sector for 11.5 percent, and commerce (restaurants and hotels included) for 8.5 percent.³⁴

Figure 9: Male Unemployment Rate (Y-axis) and Non-Rural Enterprise Growth (X-axis) by Island (%).



Sources of data: Instituto do Emprego e Formação Profissional (1997) and Instituto Nacional de Estatística (1999).

Unemployment varies significantly across the islands and we can expect the differences in the growth rates of new non-rural enterprises to play a role here. This is illustrated by Figure 8, which suggests that the higher the growth of the number of non-rural enterprises, the lower the rate of unemployment. The lack of corresponding data on initial (1990) unemployment across the islands prevents us from relating changes in unemployment to changes in the number of enterprises, and thus from

³⁴ For a detailed analysis of unemployment in Cape Verde, see *Instituto do Emprego e Formação Profissional* (1997). For a summary, see Bourdet (1998), pp. 21-25.

drawing more definitive conclusions on the quantitative size of the beneficial impact of entrepreneurial activities on job generation and unemployment.³⁵ The relation is, however, rather weak, even if it shows the expected sign. (The size of the coefficient suggests that a 100 percent increase in the number of non-rural enterprises decreases the rate of unemployment by some 9 percentage points. This figure should be interpreted with much care because, *inter alia*, of the low number of observations.) One reason behind the relatively weak relation probably is the existence of a matching problem, with the distribution of new non-rural enterprises across economic sectors differing significantly from that of the unemployed. The most illustrative example is commerce, restaurants and hotels, which accounted for more than half of the non-rural enterprises in 1997, whereas only 8.5 percent of the unemployed in 1996 came from this sector.

Another factor that may explain the relatively weak relation between total unemployment and growth in business activities is the fact that men are over-represented among those employed in non-rural enterprises. According to the Enterprise Survey, men constituted about two thirds of the total employment in such businesses in 1997. An implication of this is, of course, that the development of business activities is likely to have a stronger effect on male unemployment than on female (and total) unemployment. Figure 9, which relates male unemployment rates across the islands to the growth of non-rural enterprises, confirms that this actually is the case. The stronger relation (as measured by the estimated coefficient for the X (i.e. the enterprise growth) variable in the regression lines: 0.12 instead of 0.9) clearly indicates that male unemployment is more responsive to changes in non-rural business activities and economic growth.

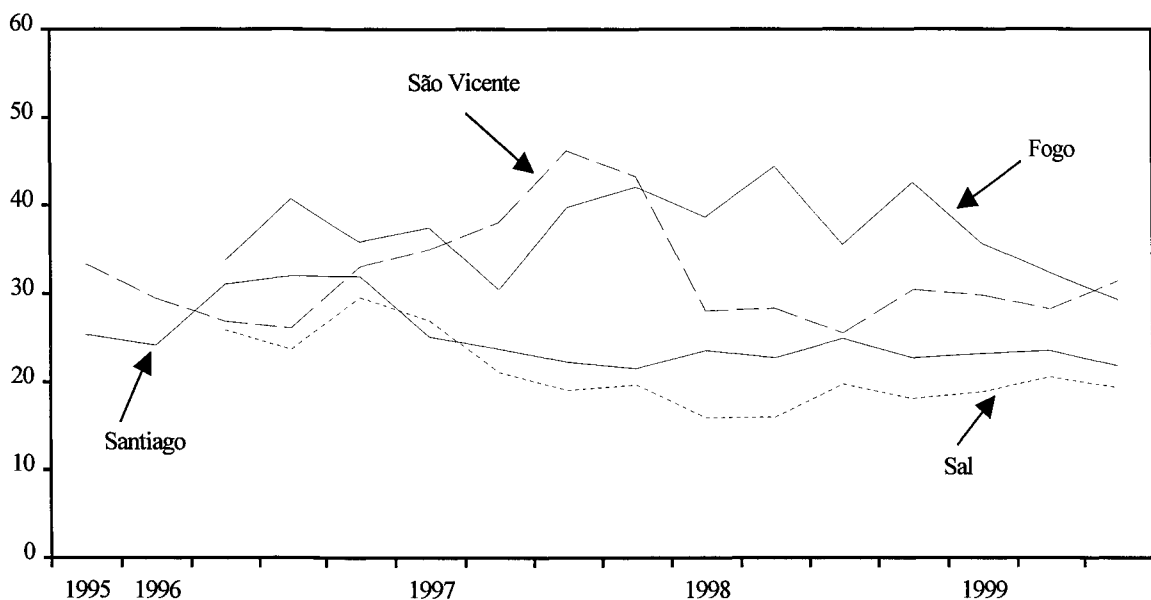
Slowly decreasing urban unemployment

Concentrating on the data focusing on urban unemployment (and not on data from the Labour Force Survey) sheds further light on the influence of reform policy on urban unemployment. Figure 10 portrays the levels and the development of urban

³⁵ In an effort to circumvent the problem, we also used the index of non-rural enterprise intensity (see Table 1) instead of the growth of new enterprises. The results were, by and large, similar to those portrayed in Figure 8 with higher enterprise intensity being associated with lower unemployment rates.

unemployment on the islands of Santiago (Praia and Assomada), São Vicente, Fogo and Sal. It evidences several interesting aspects of the dynamics, geography and structure of unemployment. First, comparing the unemployment figures in Figure 10 with those available for the cities of Praia (on Santiago) and São Filipe (on Fogo) in 1993, 24 and 36 percent respectively, and Mindelo (on São Vicente) in 1992, 35 percent, suggests that urban unemployment remained more or less constant in Praia and Fogo between 1993 and 1996 and decreased slightly on São Vicente between 1992 and 1996.³⁶ From 1995 one can notice a slow trend-decrease in urban unemployment for Santiago and Sal, but only erratic movements for São Vicente. A second finding emerges when comparing the unemployment figures of Figure 10 with those of the Labour Force Survey that was conducted during the third quarter of 1996. The figures in Figure 10 are lower than those of the Labour Force Survey, with the exception of those for Sal. The figures are, however, rather close to each other with the exception of São Vicente for which the Labour Force Survey exhibits a significantly higher figure (44 percent compared to 26 percent).

Figure 10: Unemployment Rates, fourth quarter 1995 – third quarter 1999.



Sources: Instituto do Emprego e Formação Profissional, Observatório de Migrações e Emprego, Quarterly Bulletin, 1995-1999.

³⁶ The figures for Praia, São Filipe and Mindelo are available in *Ministério do Trabalho, Juventude e Promoção Social* (1995), p. 95.

A third striking finding concerns the lack (or, at best, very low level) of integration between the islands' labour markets. Unemployment levels are rather different and the changes over time are not correlated. The labour market in Cape Verde thus seems to be strongly geographically segmented. Anecdotal observations provide evidence of mobility between the various islands, but this mobility has not been sufficient to level out unemployment disparities and correlate the changes in unemployment over time. Emerging exceptions are Sal and Santiago where changes in (urban) unemployment over time now seem to be more correlated (see Figure 10).

A fourth finding is the absence of significant effects on unemployment of the high growth rate experienced by Cape Verde between 1997 and 1999 (some 7 percent on average). A reason may be the fact that the growth has been concentrated in capital-intensive sectors like banking and insurance. A fifth finding is the very large fluctuation in unemployment over such a relatively short period. This concerns in particular São Vicente and, to a lesser extent, Fogo. In São Vicente, the unemployment rate almost doubled between mid-1996 and mid-1997 and eventually halved between the third quarter of 1997 and 1998. In most cases, due to the small size of the local labour force, it is easy to relate these fluctuations to specific investment projects. In the case of São Vicente in 1997 and 1998, likely factors are the establishment of foreign companies in the Export Processing Zone of Mindelo and public works related to the enlargement and improvement of port facilities.

A sixth interesting aspect highlighted by the urban unemployment figures concerns the gender distribution of unemployment (see Table 4). With the exception of Sal, women had higher unemployment rates than men in the mid-1990s, but this situation was reversed from 1998 onwards. The relative improvement in the unemployment situation of women is at first sight surprising, since it was shown above that men benefited more from the rapid growth in new economic activities. A reason might be the expansion of the informal sector where women are over-represented. This is to some extent supported by the high ratio of female to male unemployment for Sal, where the informal sector is of limited size due to the kind of activities that dominate the island's economy (airport activities and tourism).

Table 4: Structure of Unemployment by Gender and Duration, 1995-1999.

	Santiago	São Vicente	Fogo	Sal
Female unemployment rate / male unemployment rate				
1995	1.3	1.1	n.a.	n.a.
1996	1.4	0.8	0.7	1.0
1997	1.2	1.1	1.6	0.7
1998	0.9	0.8	0.9	1.4
1999	0.9	0.8	1.0	1.7
Short-term unemployment / total unemployment (in %)				
1995	14.1	9.1	n.a.	n.a.
1996	17.5	14.0	20.9	22.3
1998	53.7	38.3	29.5	55.9
1999	52.7	44.4	38.0	69.8

Notes: 1) A ratio of the female to male unemployment rate greater than one means that women are more unemployed than men, and vice versa. 2) Short-term unemployment is defined as being unemployed up to six months or less. There is some ambiguity as to whether the sixth month is included in the data reported for the years 1995 and 1996 since unemployment (in the official statistics) is divided between one to six months and six months to one year. This ambiguity was later removed, the data being divided between one to six months and seven months to one year. This ambiguity may explain part of the large jump between 1996 and 1998. The calculations are based on the fourth quarter for 1995, the first and second quarters for 1996, the third and fourth quarters for 1997, all four quarters for 1998 and the three first quarters for 1999. Data for other quarters were not available.

Sources: Computed from *Instituto do Emprego e Formação Profissional, Observatório de Migrações e Emprego*, Quarterly Bulletin, 1995-1999.

A last result of interest concerns unemployment duration. High growth is generally associated with structural changes within and/or between sectors, new hirings and firings, and more rapid labour turnover. This in turn means larger inflows into, and outflows from, unemployment, and changes in the duration structure of unemployment towards a larger proportion of short-term unemployed. The figures in Table 4 confirm this to be the case for Cape Verde by showing that short-term unemployment as a percentage of total unemployment has increased significantly over time, in particular for the islands of Sal and Santiago. (It is worth pointing out that these figures should be considered with care because of the limitations described in the notes to Table 4.) The FAIMOs may also have contributed to breaking long periods of unemployment and thus to the increase in the share of short-term unemployment.

Since total unemployment has decreased moderately during the same period (see Figure 10), the increase in the share of short-term unemployment means a clear improvement in the structure of unemployment with most probably a decrease in long-term unemployment. Since long-term unemployment and above all rural underemployment are main entry doors to poverty, this development should be considered a positive sign for the future dynamics of poverty in Cape Verde.³⁷

Activating the poor?

Poverty is endemic in Cape Verde. It is the small productive base that explains that it is widespread and persistent. The last comprehensive study on the extent of poverty in Cape Verde was published in 1994, but based on figures from the late 1980s.³⁸ A new Household Survey that will permit a better understanding of the geography, extent and depth of poverty is planned for the year 2001. A main, expected result of the 1994 study was that poverty was mostly a rural phenomenon with a little more than two thirds of the poor and 85 percent of the very poor living in rural areas. Poverty was most widespread on the islands of Brava, Santo Antão and São Nicolau.³⁹ Another main, equally expected, result was that women (and households headed by them) were over-represented among the poor. A third result concerned the very low educational attainment of the poor (for example, 45 percent of illiterate-headed households were poor). By and large, the characteristics of poverty in Cape Verde are similar to those found in other Sub-Saharan countries.⁴⁰ A difference, however, is the lower share of rural poverty in total poverty in Cape Verde, which reflects the smaller role played by the agricultural sector in this country.⁴¹ The share of urban poverty has

³⁷ Regressing poverty (in % of the island's population) across islands on long-term unemployment (12 months or more) as a percentage of total unemployment suggests that the larger the share of long-term unemployment, the higher the extent of poverty. Two exceptions (statistical outliers) are Brava, with the lowest share of long-term unemployment and the highest poverty, and Fogo, with one of the highest shares of long-term unemployment but the lowest poverty. The periods covered by the unemployment and poverty data do not exactly match, but the structural nature of both phenomena suggests that this might not be a problem. The poverty data are from Republic of Cape Verde (1999c, p. 13) and the unemployment data from the 1996 Labour Force Survey.

³⁸ World Bank (1994).

³⁹ For a description of poverty across and within islands, see Republic of Cape Verde (1999c), pp. 13-20.

⁴⁰ See e.g. Sahn *et al.* (1997), chapter 2.

⁴¹ Averaging rural poverty as a share of national poverty in the 14 Sub-Saharan countries quoted in Sahn *et al.* (p. 27) gives a share of 83 percent to be compared with 68 percent in Cape Verde.

presumably widened during the last decade, following the acceleration of rural-urban migration in Cape Verde, in particular on the main island Santiago.⁴²

The labour-intensive public work schemes, the FAIMOs (*Frentes de Alta Intensidade de Mão de Obra*), have played a central role in the authorities' attempts to alleviate poverty, or at least make it politically sustainable.⁴³ The FAIMOs were created at the independence of the country in 1975. They have been used from time to time, often after adverse climatic conditions and droughts have hit food production, in order to give the poor temporary, low-wage work in projects aimed at developing infrastructure, mostly roads, and protecting the environment. The size of the FAIMOs is considerable when related to the active population. In the mid-1990s they concerned on average between 10 and 15 percent of the labour force.⁴⁴ FAIMO workers are paid a minimum subsistence wage that is just enough to cover food expenditures. The jobs are seasonal and vary from 3 to 8 months per year according to the conditions in, and the performance of, the agricultural sector. The financing of the FAIMOs has been secured by the proceeds from the sales of international food-aid, at world market prices so as not to have adverse effects on domestic food production.

The characteristics of the FAIMO workers correspond to those of the poor in Cape Verde.⁴⁵ First, FAIMOs mostly concern the rural poor, in particular those with little or no access to agricultural land. Second, women make up 40 percent of the FAIMO workers, and up to 70 percent in the centre and the north of the island of Santiago. Third, households headed by single mothers account for 51 percent of the women involved. Fourth, FAIMO workers are unskilled with a very low educational attainment. Finally, youth are over-represented with 40 percent of the FAIMO workers being between 15 and 29 years old.

⁴² Lesourd (1994), p. 115 and 124, and Republic of Cape Verde (1999c), pp. 12-13.

⁴³ For a comprehensive analysis of the FAIMOs, see Resal (1999). On the origin of the food-for-work philosophy that inspires the FAIMOs, see Davidson (1989), p. 133.

⁴⁴ Various figures have circulated on the size of the FAIMOS. In a recent official publication, the figure of 25,000 jobs per year is mentioned (Republic of Cape Verde (1999b), p. 18). This can be compared to the total size of the labour force in Cape Verde, which amounts to some 136,000. More likely figures, between 15,000 and 20,000 jobs per year, are found in publications of international agencies (see e.g. PNUD(1997), p. 37, and Resal (1999), p. 10).

⁴⁵ See Resal (1999), p. 9, and Republic of Cape Verde (1999c), p. 6-7.

There exists no strict, quantitative evaluation of the FAIMO scheme, but comparing its characteristics with those of a good work-fare programme suggests that the FAIMO may pass such a test.⁴⁶ Note that the characteristics required for a good work-fare programme also maximise the chances for a work-fare programme to be cost-effective and raise the current incomes of the poor. First, the wage rate in the FAIMOs is a subsistence wage below the market wage for unskilled labour. Second, the FAIMOs have been targeted on the poor, most often in connection with agro-climatic shocks. Third, the labour intensity of the FAIMO is significantly higher than for similar projects carried out by private enterprises. Fourth, the FAIMO projects have concentrated mostly on poor rural areas, which means that the infrastructures created (minor roads, soil conservation, water protection and reforestation) are of greater value for the poor than for the rest of the population.

Several criticisms have, however, been raised against the FAIMO scheme. One is that the FAIMOs are not productive enough and that in most cases the projects are implemented without any control of their efficiency. This, cost-benefit inspired, type of criticism has mostly been directed towards the municipalities, which make use of the FAIMOs to prevent a deterioration of the situation on the local labour market and do not target the projects on the poorest.⁴⁷ Another related criticism is that the FAIMOs tend to lock in the poor and undermine the incentives for their future integration on the regular labour market.

A reform of the FAIMOs has been initiated to address these two shortcomings. A first important aspect of the reform is the larger influence given to actors of the civil society, such as rural organisations and non-governmental associations, in the design and implementation of the public works. This has permitted a better control of the quality of FAIMO projects (rural organisations having a long-term interest in their outcome), and in some cases it has even generated extra revenue that has been used to finance other public works.⁴⁸ A second aspect of the reform is the emphasis put on the

⁴⁶ On the elements required for a good work-fare programme, see Ravallion (1999), p. 42.

⁴⁷ Resal (1999), p. 11.

⁴⁸ For an illustrative example at Porto Novo on the island of Santo Antão, *ibid.*, p. 14. A further refinement currently being discussed is to give private firms instead of the government and municipalities the responsibility for implementation of public works (Republic of Cape Verde (1999c), p. 36).

contribution of FAIMOs to integration of the poor into the economy, by helping them to find employment on the regular labour market (for example through vocational and on-the-job training) or to become self-employed (through access to micro-credits). A third main aspect is the strengthening of institutional capacity by better co-ordination between the various actors (the National Poverty Alleviation Committee, the municipalities, the rural organisations, etc.).⁴⁹

The reform of the FAIMOs (sometimes renamed “income generating activities” in official documents) is part of a recent ambitious National Poverty Alleviation Programme.⁵⁰ The programme, that will stretch over a ten-year period, is mainly financed by the donor community, in particular the World Bank, the African Development Bank, the European Union, and bilateral donors (Germany, Austria, etc.).⁵¹ A main characteristic of the programme is a far-reaching decentralisation so as to reach the very poor. A second is the emphasis put on the building up of human capital (education and health) in order to integrate the poor into the labour market. A third is the development of an institutional framework on three bases, the government agencies, the municipalities and the organisations of the civil society, in order to improve overall efficiency. This poverty programme has just started up and some years are needed before it will be possible to appraise its results in alleviating poverty.

5. Putting Reform Policy into More of a Strategic Growth Perspective

A critical role in the reorientation of reform policy is assigned to fiscal policy. It is mostly the macroeconomic role of fiscal policy, and the best way to achieve internal balance, that is emphasised. Putting fiscal policy into a longer term perspective requires a greater focus on the kinds of expenditures preferred by the government and their contribution to the accumulation of physical and human capital. Critical here is the choice between 1) a relatively high remuneration for civil servants, relatively few civil servants and relatively low expenditures on health and education,

⁴⁹ Republic of Cape Verde (1999c), pp. 8-9.

⁵⁰ For a presentation, *ibid.*, pp. 33-50.

and 2) a relatively low remuneration for civil servants, relatively numerous civil servants and relatively high expenditures on health and education.⁵² Cape Verde has chosen the second alternative. As compared to other West-African countries, the ratio between public and private wages is low in Cape Verde, 1.9 (footnote 18), and the number of public sector employees relative to the total population (about 3 percent of the total and 10 percent of the active population) much higher. Further the country enjoys relatively high levels of primary school enrolment (not least among girls) and other social indicators.⁵³ This policy choice reflects historical priorities and seems to transcend the political parties even if some differences do exist between them. In this respect, the political shift that occurred in Cape Verde in the early 1990s provides an illustrative example, with the public spending devoted to education and health, and the relative wage between the public and private sectors remaining more or less constant thereafter (see Figure 11). An exception, however, is the increase in the average salary of high-level managers relative to that of other public employees in the early 1990s (see Figure 11). Note, however, that education and health expenditures in Cape Verde are biased in favour of urban areas.⁵⁴

While the countries that have embarked on the first alternative (high public wages, few civil servants and low expenditures on education and health) have often experienced social unrest, rural discontent, limited legitimacy and political fragility, the countries that have embarked on the second alternative have benefited from a higher degree of social and political stability.⁵⁵ Not surprisingly the latter group of countries have exhibited more rapid human capital accumulation, better long-run growth performance and improved standards of living. The process is cumulative in

⁵¹ The total cost of the programme is estimated at 75 million US\$, of which some 70 percent is covered by the donor community. The real contribution of the donor community is still larger since some 60 percent of the domestic component come from proceeds from the food aid fund.

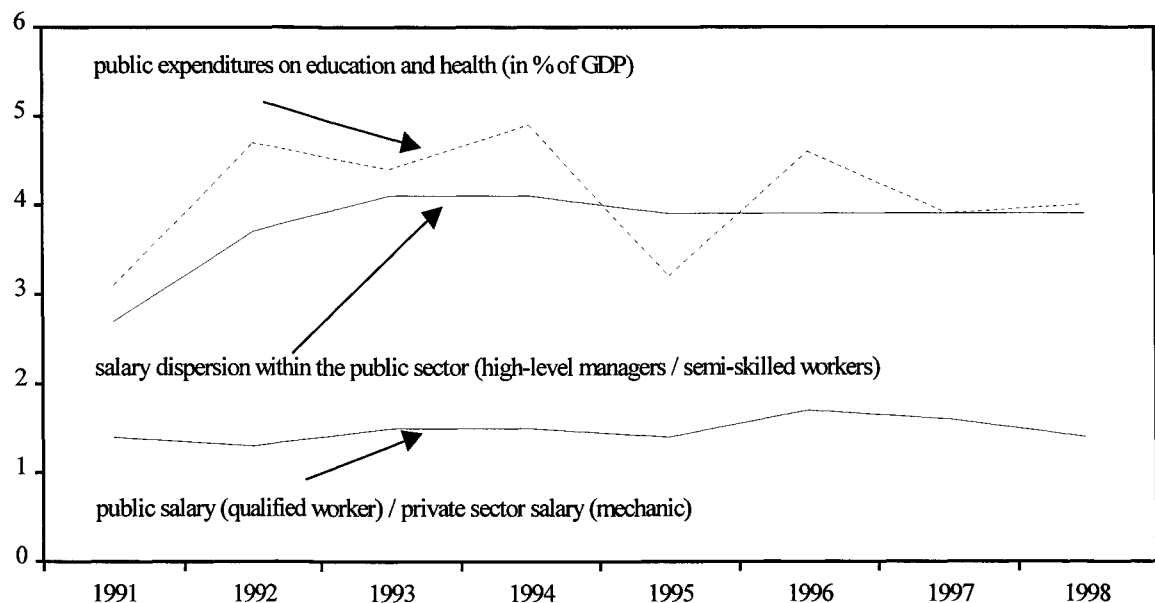
⁵² See Azam and Morrisson (1999), pp. 23-25.

⁵³ In 1997, the illiteracy rate was 29 percent in Cape Verde as compared to 42 percent in Sub-Saharan Africa and the primary school gross enrolment rate was 131 percent as compared to 75 percent. The secondary school enrolment rate was, however, of the same order of magnitude, some 25-30 percent. This last figure represents a non-negligible achievement for Cape Verde, because the secondary enrolment rate in the country in the mid-1980s was only about half of its level in the mid-1990s and only about half that found in other Sub-Saharan countries (see Foy (1988), p. 149).

⁵⁴ In this respect, Cape Verde looks like most other Sub-Saharan countries (see e.g. Sahn et al. (1997), p. 186). The smaller share of the rural sector in Cape Verde means, however, that the bias is detrimental to a smaller share of the total population.

the sense that social and political unrest leads to increased military public spending, in order for political rulers to retain power, and decreased expenditures on health and education. By the same token, long-lasting political stability makes it easier to motivate decreased military expenditures and increased expenditures on health and education. The distribution between different kinds of public expenditures, which reflects these different choices, is to a large extent endogenous in the sense that it is the result of historical factors. But there remain some degrees of freedom that give political leaders the opportunity to alter the distribution. The political shifts that have occurred in Cape Verde in the 1990s have only marginally affected the country's historically-determined public-policy mix.

Figure 11: Public Expenditures on Health and Education (in % of GDP) and Relative Public Salaries, 1991-1998.



Notes: 1) Salary statistics for the private sector only give average daily salary by occupation. In order to calculate the ratio between the monthly salary for a qualified worker (grade I) in the public sector and the monthly salary for a mechanic in the private sector, we multiplied this daily salary by 21. 2) The ratio for the salary dispersion in the public sector relates the monthly salary of high-level managers (grade A) to the monthly salary of semiskilled workers (grade O).

Sources: Computed from data provided by the Cape Verdean authorities and from IMF (1999), pp. 59-60.

⁵⁵ For a more exhaustive discussion, see Azam and Morrisson (1999), pp. 17-27.

Improving trade and longer-term growth performance

The question that remains now is whether Cape Verde's commitment to long-term development will be sufficient to achieve a form of self-sustaining growth with investments mainly financed by domestic savings, and imports covered by the earnings from exports of both goods and services. A critical factor here is the insufficient size of the productive base when related to the size of the population. In order to expand the productive base and employment relative to total population, a broad approach is required for the three economic sectors, combined with a strong commitment to human capital accumulation. The relative decrease in public expenditures devoted to agriculture is questionable since it does not seem to be coupled with an improvement of the efficiency of the remaining expenditures. Agriculture still accounts for about 10 percent of GDP and produces a mere 10-15 percent of the domestic food consumption. A kind of Rybczynski effect has contributed to the poor performance of the agricultural sector, with high population growth resulting in the substitution of cash crops by food crops, which are more detrimental from a soil erosion point of view.⁵⁶ Therefore, an improvement of agricultural performance requires not only an improvement of production methods and better inputs, but also a lower rate of population growth, which in turn depends upon an increase in educational attainment in rural areas.

More also needs to be done to improve the performance of the industry sector, and several measures have been introduced to spur industrial growth and improve the country's trade performance. The results are encouraging, since merchandise exports increased from 4 to 12 percent of merchandise imports between 1990 and 1998. Nevertheless, export earnings have long way to go before they can cover a substantial

⁵⁶ The Rybczynski theorem deals with what happens with output when the factor endowment of the economy changes but the prices are constant. It shows that if the endowment of one of the production factors grows, the output of the product using this factor intensively will grow while that of the other products will decrease. For a formal proof, see Rybczynski (1955). For an illustration, see Bourdet and Lundahl (1992), pp. 80-81. The process is cumulative in the sense that the decrease in arable-land areas caused by soil erosion, combined with continued high population growth, result in further substitution of cash crops by food crops, and so on. Certain aspects of the land reform introduced in the early 1980s may actually and unintentionally have accelerated this process, as illustrated by the situation on Fogo: "The owners want to plant more land with their excellent coffee, the "guardians" (i.e. the farmers) want to plant more beans and maize, while the Land Commission tries to find a compromise." (Davidson (1989), p. 184).

share of imports. Recent research in international economics emphasises the role of high transport costs and remoteness in the pattern of trade, production and factor incomes.⁵⁷ High transport costs negatively affect the ability of remote countries to participate in the world economy and imply lower prices for the exports of these countries. According to a recent empirical study of the impact of transport costs on trade volumes, the elasticity of export with respect to transport costs is very high: a doubling of transport costs reduces trade flows by more than 80 percent.⁵⁸ This theoretical and empirical research is highly relevant for Cape Verde because of the remoteness of the country and the resulting high costs of transport. The fact is that Cape Verde is isolated not only by high, but also volatile transport costs. This was illustrated in connection with the civil war in Guinea Bissau that led to a significant decrease of shipping traffic between Portugal and Cape Verde, and eventually to still higher transport costs. According to this new line of research, not only the volume but also the pattern of trade and the kind of products produced by the remote countries are shaped by the extent of transport costs. All other things being equal, the higher the transport intensity, that is the cost of transport of both the final product and the intermediate products used in production, the more likely it is that production will be located in the centre as opposed to the periphery (remote areas), and vice versa. This result is also relevant for Cape Verde because the high transport costs may not permit Cape Verde to realise its comparative advantage for certain commodities as derived from its factor abundance (relatively low labour costs).

It is partly to overcome the constraints of remoteness and smallness that measures (such as tax benefits, right to transfer profits out of the country, etc.) have been introduced to improve incentives for foreign companies to locate production in Cape Verde. The creation of Export Processing Zones (EPZ) in Mindelo and Praia, with tax exoneration for the first ten years and tariff exemption on import of raw materials and intermediate products, is one example of the kind of measures

⁵⁷ For a theoretical underpinning, see Venables and Limão (1999).

⁵⁸ See Limão and Venables (1999), p. 19.

introduced to lessen the constraints on export of remoteness and high transport costs.⁵⁹ Most of the foreign companies established in the EPZs belong to the footwear and textile industries, more than 90 percent over the 1997-1999 period.⁶⁰ The share of exports from the EPZs in total exports has increased from zero in the early 1990s to more than half of total exports in the late 1990s. This growth has ran parallel with a drastic decrease in the export of agricultural (bananas) and fish and sea food products, which accounted for some 90 percent of total exports in 1990 but for less than 10 percent in 1998. The impact of the EPZs on employment is, however, limited, some 1,500 jobs according to the estimate of the Central Bank of Cape Verde (*Banco de Cabo Verde*). But it is expected that the realisation of planned foreign investments will more than double the number of jobs created.⁶¹ Improving the attractiveness of the EPZs should be a priority for the authorities, because they have permitted a sharp increase in exports, even if this is partly hidden by the collapse of primary exports, and have contributed to a non-negligible increase in employment opportunities. Experiences from other countries with EPZs provide three lessons that can improve the design and outcome of EPZs in Cape Verde.⁶² The first is that a decentralisation of EPZs, in the case of Cape Verde to the island level, and a greater consideration accorded to private interests in their design and conduct, improve their attractiveness to foreign direct investments. The second is that a further liberalisation of overall trade policy would maximise the positive effects of EPZs on the rest of the economy, via the so-called catalyst effects (demonstration effects, export know-how, on-the-job accumulation of human capital, and labour mobility). The third is that the development of EPZs should be accompanied by an active policy of human capital accumulation in order to improve labour productivity and retain foreign investments. The building up

⁵⁹ In Cape Verde it might be more correct to speak of Export Processing Firms since tax exemptions and other benefits are granted all enterprises that export more than 85 percent of their production regardless of their localisation. The development of infrastructures in Mindelo and Praia explains the concentration of export processing firms to these two “zones”.

⁶⁰ The same industry concentration is found in other countries. See e.g. UNCTAD (1993).

⁶¹ Data from September 1999 show that the realisation of all the planned foreign direct investments should create 4,162 jobs, of which more than half are in Portuguese companies. The figures of the PROMEX (*Centro de Promoção Turística do Investimento e das Exportações*) were still more optimistic: at the end of 1999 some 7,700 jobs were expected to be created, of which 61 percent in industry and 34 percent in tourism.

of human capital is also the best way to move to higher-value production and a more diversified export structure, which in turn are prerequisites for the development of substantial linkages (both backwards and forwards) and a more dynamic and balanced economic growth.

The last sort of measures should be directed towards the service sector, which is the dominant sector in the Cape Verdean economy, albeit mainly composed of non-tradables. The sector is also the most rapidly growing in the world. Services have long played an essential role in Cape Verde's trade balance, accounting for some 40 percent of the total export of goods and services in the mid-1990s. The service export consists mainly of various port and airport services, communications, ship chartering and, to a lesser extent, tourism. Tourism has a substantial development potential because of the country's endowment in (natural) resources demanded by tourists (year-round sun and warm temperatures), and in leisure activities that can be offered (wind-surfing, sport fishing, etc.). The country is only a three-hour flight from Western Europe, where year-round tourism is expanding rapidly, and it enjoys a strong cultural image that has not yet been fully exploited. Tourism has increased over the past few years, in particular on the islands of Sal and Boa Vista. Among the planned and realised foreign investment projects in Cape Verde no less than 30 percent are in the tourism industry, principally by Italian, Portuguese and German companies. More, however, needs to be done by the authorities to realise this potential. Here too insufficient human resources are an obstacle to expansion. Further, more infrastructure investments, preferably by private interests in view of the current budgetary restrictions, need to be realised on the other islands, in particular on Santiago and São Vicente, and also in communications between the islands in order to increase the returns from tourism. The coming privatisation of the national airline, TACV, should also give the company better opportunities to integrate and develop tourist tours. Finally, further liberalisation of the labour legislation is necessary to improve the services for tourists.

All in all, putting reform policy into a more long-term strategic perspective suggests that its long-term success ultimately depends on the building up of more

⁶² There is a growing literature on EPZs and the factors that shape their outcome. See e.g. Johansson and Nilsson (1997), and the recent survey by Madani (1999).

human capital. This is also the only way for labour productivity to attain the same level as the average income per capita, which today to a large extent reflects the high volume of external transfers. The investments in human capital should mainly concern secondary and vocational education, where the country's performance is modest in an international perspective. But human capital policy should also aim at better distribution of primary education expenditures, with more of them being directed towards rural areas in order to lessen poverty. At a second stage, development of higher education should also be considered. The small size of the country and its scarce resources do, however, put severe limits on the development of higher education in Cape Verde, and the most cost-effective alternative is, presumably, in co-operation with the donor community, to localise higher-education of Cape Verdean students abroad. In order to boost long-term growth this policy of building up human capital should be accompanied by a genuine and long-standing commitment to foster competition in product and factor markets and to combat rent-seeking activities. This is necessary because of the small size of the domestic economy, the existence of non-competitive market structures in many sectors and the historically widespread state intervention in the economy of Cape Verde.

6. In the Guise of Conclusion: The Dynamics of Exit, Voice and Loyalty

Emigration has played a considerable role in the history of Cape Verde. This concerns both voluntary emigration, in particular to the United States, Western Europe and Western Africa, and forced emigration, in the form of labourers sent by the Portuguese colonial authorities to São Tomé and Príncipe, Guinea-Bissau and Angola, to work on the plantations there. Emigration has worked as a safety valve that, in periods of adverse economic conditions, has permitted the reduction of the extent of dissatisfaction with, and the pressure on, policy makers. This was particularly the case prior to independence when it was possible for the population of Cape Verde to emigrate, at least to Portugal. Independence in 1975, coupled with the more restrictive immigration policies in Western Europe and in the United States (at least for the low and unskilled workers who constitute the lion's share of the labour force in Cape

Verde), has by and large closed the door for the exit option.⁶³ This means that voice has remained the only available alternative for individuals interested in influencing economic policy and strategy so as to improve their living conditions and those of their children.⁶⁴ The increased role of voice, as a consequence of it being the only mechanism left for improvement and correction, has ran parallel with an eroding loyalty for the policy-makers that led the country to independence and ruled the country thereafter. This concerns particularly the new generations, for which the name of Amílcal Cabral is often no more than a name on a poster. The high rate of population growth, some 2.7 percent, and the growing share of youth in the total population explain why political loyalty is fading away. The strong demand for institutional changes in the 1980s, which eventually led to the installation of democracy in Cape Verde in the early 1990s, should be seen in this perspective, and not only as a result of the overall democratisation process in Sub-Saharan Africa.

An implication of this is, of course, that the expectations of the population, especially the youth, regarding the new development policies and strategies, are much higher than would have been the case if democratisation had only been the result of external pressures from the Western World. Economic growth in Cape Verde has been high by Sub-Saharan standards during the 1990s, 5.3 percent on average. This has permitted Cape Verde to achieve one of the best growth performances in Sub-Saharan Africa and a large increase of per capita income. In 1999, the GDP per capita in Cape Verde was over 1,200 US\$, which is more than twice the average GDP per capita for

⁶³ The exit option is still well alive in the people's mentality and even in official publications. The institute in charge of the analysis of unemployment (*Instituto do Emprego e Formação Profissional*) devotes several pages in its quarterly publication to the study of the desire of people to emigrate (extent and factors behind it). According to this publication more than half of the population of the four main islands wants to emigrate. The figures vary somewhat across the islands. The main factors behind the desire to emigrate during the third quarter of 1999 were "too low remuneration" (30 %), "family reasons" (23 %), "aspiration of a better life" (20%) and "unemployment" (16 %). The improvement of the employment situation between 1996 and 1999 is mirrored in a decreasing role for unemployment as a factor behind the desire to emigrate. In mid-1996, 28, 23, 22, 20 and 18 percent put forward unemployment as a reason to emigrate on the islands of Santo Antão, Sal, Santiago, São Vicente and Fogo, respectively.

⁶⁴ On the role of exit, voice and loyalty in public decision-making, see Hirshman (1970). The easier exit is, the less likely it will be for voice to develop, since voice is costly in terms of effort, time and organisation. Voice may also be deterred by free riding. On the other hand, less availability (that is higher cost) of exit means that voice can turn out to be the best available option from a cost-benefit point of view.

Sub-Saharan Africa. Even when using Purchasing Power Parity (PPP), that is taking into account the relative prices of consumption and investment, the GDP per capita in Cape Verde is about twice that of Sub-Saharan Africa.⁶⁵ Further, the government has maintained the high level of education and health expenditures that is necessary for future human capital accumulation, labour productivity growth, and higher incomes per capita. But there remain very high levels of unemployment, in particular among the youth, and the widespread poverty is far from eradicated.

The restrictions put on economic policy and development strategy by natural, geographical and historical conditions mean that the country will have to rely, for a rather long time ahead, on external assistance in the forms of emigrant remittances and foreign assistance, if the current high level of income per capita is to be maintained. Both these two external sources of assistance are, however, likely to diminish in the future; remittances because of the drop in emigration during the last two decades, and foreign assistance because the country's relatively high level of income per capita makes it less eligible for assistance from several donor countries. Time, and a committed development strategy mainly based on human capital accumulation, are required in order to achieve, in the longer term, a form of self-sustaining growth and a more balanced economic development between and within the islands. Now that exit has become a limited alternative for the population and the "straitjacket" of loyalty has been relaxed, voice remains the main alternative. The capacity of the political system in Cape Verde to conciliate the aspirations expressed by voice with the severe natural, geographical and economic constraints faced by the country will be decisive for the political sustainability of reform policy and for the country's economic future.

⁶⁵ World Bank (2000), p. 318.

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ISBN 91-586-8998-2

ISSN 1404-031x