

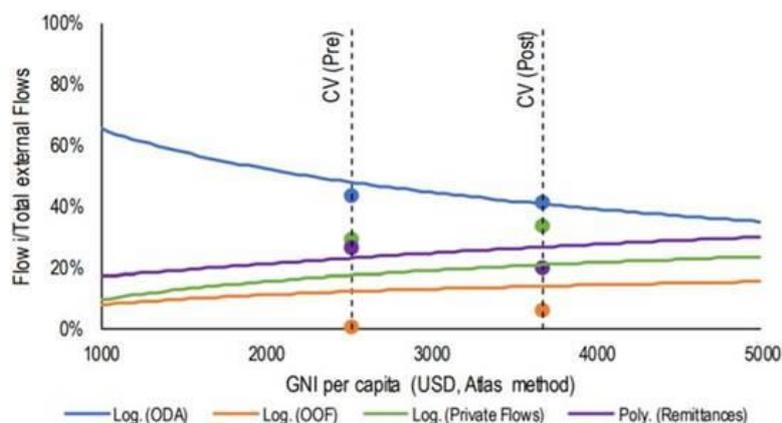
As part of its transition finance work stream, and through its new “Assessing, Benchmarking and Counseling” (ABC) approach, the DAC/OECD is carrying out several country pilots in countries facing different transition challenges as they move through the development continuum. The Cabo Verde country pilot looks particularly at the transition challenges faced by countries graduating from the Least Developed Country (LDC) category.

### ASSESSING

Cabo Verde transitioned from the LDC category in 2007, which led to new challenges: the composition of financing shifted from grants to concessional loans and access to preferential trade agreements had to be renegotiated. Moreover, ODA was phased out rapidly in key social sectors (e.g. health and education) creating transition finance gaps. In parallel, tied aid rose significantly increasing transaction costs and reducing local ownership. Cabo Verde also shares the unique vulnerabilities of other small island developing states (SIDS), compounding the challenges of its transition. LDC support provided to access climate finance funds and facilities (e.g. NAPA) was phased out, which places the country at risk of setbacks from persistent climate-related vulnerabilities.

The overall picture for Cabo Verde (Figure 1) raises several questions in the context of its LDC graduation and transition: following graduation, it remains highly dependent on ODA, at 40% of total external resources. Also, other sources of financing are not substituting at optimal rates. Beyond the share of external financing, these flows present new trade-offs to manage. For example, other official flows (OOF) remain below the overall trend after graduation mainly due to the small island exception that limits non-concessional financing by multilateral banks to SIDS, and as a consequence of the limited exposure of development finance institutions (DFIs) in small markets. Remittances face high transaction costs (9.1% in 2016), even higher than other SIDS (8.8%). Private flows, in contrast, are well leveraged and at higher levels than in other low middle-income countries (LMICs), representing 35% of the total external mix (directed mainly to the tourism sector), above the 15% average in the LMIC group.

**Figure 1. How to maximise the contribution of all resources along the journey to sustainable development?**



Note: The pre- and post-LDC graduation lines indicated above are 5-year averages before and after the 2007 graduation. The 2000 to 2016 time series is used in order to account for the impact of the global financial crisis on resources. The lines represent the predicted values from logarithmic and polynomial regressions using all ODA-eligible countries. The total external flow is the sum of ODA, OOF, private flows and remittances. Source: Author calculations based on OECD (2018[32]), Creditor Reporting System, for ODA and OOF; DAC database for private flows; World Bank (2018[8]), World Development Indicators, for remittances and GNI per capita.

More recently, Cabo Verde was classified at high risk of debt distress<sup>1</sup> creating a new roadblock to financing and implementing its private sector-led national financing strategy<sup>2</sup>. Local institutional and technical capacity building are needed to ensure that substantial investments from new actors (e.g. the People's Republic of China (PRC) and the private sector) do not exacerbate debt distress and are aligned to contribute to long-term sustainable development.<sup>3</sup> Private debt on commercial terms is the fastest growing source of external debt, increasing seven-fold since LDC graduation.

## BENCHMARKING

A comparison of the financing mix in Cabo Verde and peer countries can help to identify success and failure in policies to leverage resources during transition. Seychelles is considered an “aspirational peer” because of its success in harnessing the Blue Economy through innovative financing instruments, including blue bonds and debt swaps for environmental protection. Maldives further presents a best practice in diversifying its economy beyond tourism, notably by upgrading fishery value chains, resulting in reduced ODA dependency.

Cabo Verde provides an example for others to strengthen domestic resource mobilisation crucial to fill the transition finance gaps. Cabo Verde's national strategy will rely primarily on domestic resource mobilisation (89%). To promote coherent tax policies while attracting foreign investment (e.g. SEZ, off-shore banking), Cabo Verde recently accepted to join the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) Project.

Finally, Cabo Verde is a leader in attracting OOF in support of renewable energy (SDG7). The government's goal to achieve 50 percent renewable energy consumption by 2020 is spurring additional investment opportunities in this sector. Development partners, particularly Portugal and Japan, have responded by providing support aligned to further shift energy production toward renewables, particularly solar and wind energy.

## COUNSELLING

A co-operative approach calls on OECD DAC members to provide continued official support and play a co-ordination role throughout graduation and transition. Members must integrate financing criteria beyond income per capita, including economic and environmental vulnerabilities to help manage debt levels, build resilience and avoid socioeconomic setbacks, particularly in SIDS. Although transition support groups helped to monitor LDC graduation in Cabo Verde, these lacked sufficient co-ordination among development partners. OECD DAC members must help to avoid a proliferation of actors which contribute to duplications between ad hoc assessments and “report fatigue”.

The competitive strategy requires targeted investments to increase the competitiveness of productive and service sectors. A natural convergence can be achieved in sectors where markets exist for private sector investment (such as the banking, business, or infrastructure sectors). OECD DAC members must strive to reduce tied aid to ensure competitiveness of the local markets and to encourage local entrepreneurship. Infrastructure financing should be strengthened to ensure commercial viability (e.g. domestic travel, logistics, connectivity). The transition period in Cabo Verde was too short, and the necessary infrastructure is not yet in place to attract the private sector and to ensure a return on investment to repay growing debt.

Bridging the divide between these strategies calls for a renewed partnership. A fusion of the co-operative and competitive strategies is needed. Greater harmonisation of support by development partners and other actors is needed to operationalise the mixed approach to transition finance. The participation of civil society and South-South and Triangular co-operation can help to build capacities, ensure local ownership of the SDGs and help to tackle growing inequalities. Operationalising the strategies will require better co-ordination in addition to the promotion of innovation through new instruments and enhanced transparency for debt sustainability.

<sup>1</sup> In 2016, Cabo Verde's debt-to-GNI level reached 134% due to State Owned Enterprise (SOE) privatisation and non-concessional public lending.

<sup>2</sup> Cabo Verde (2017-2021), Bases para o Plano Estratégico de Desenvolvimento Sustentável (PEDS), [http://www.mf.gov.cv/index.php/legislacao-new/cat\\_view/55-documentos/128-direccao-nacional-do-planeamento-dnp](http://www.mf.gov.cv/index.php/legislacao-new/cat_view/55-documentos/128-direccao-nacional-do-planeamento-dnp).

<sup>3</sup> Cabo Verde's Doing Business ranking remains low (131/190 in 2018) and its competitiveness rank has fallen from 105 to 110 out of 135 countries (2017-18).