I. Project Context

Country Context

Cape Verde is an island country, spanning an archipelago of 10 islands located in the central Atlantic Ocean, 570 kilometers (350 miles) off the coast of Western Africa, and covering a combined area of slightly over 4,000 square kilometers, and more than 700,000 square kilometers of Exclusive Economic Zone in the ocean. The country has an estimated population of about 500,000, with its capital city Praia accounting for a quarter of its citizens.

Cape Verde has graduated from the United Nations least developed country status and is now eligible for a blend of International Development Association (IDA) and International Bank for Reconstruction and Development (IBRD) funds over the current Country Partnership Strategy (CPS) period (2009-2012). It has also entered a Special Partnership with the European Union and joined the World Trade Organization. Cape Verde has followed a path of peaceful political transitions and prudent economic management with significant impact in terms of poverty reduction.

The country’s Gross Domestic Products (GDP) growth rate in the 2000s reached an average of six
percent (or 4.5 percent in per capita terms), but the effects of the ongoing European sovereign debt crisis have reduced Cape Verde’s growth performance and is a major threat to its macroeconomic stability. The global economic slowdown as a whole, and a sharp decline in the demand for tourism in particular, had a negative impact on GDP growth in 2008 and 2009. The incipient recovery experienced in 2010 was slowed by the worsening of the Euro Zone crisis in the second part of 2011. At 4.3 percent, GDP growth in 2012 was considered still robust, but the continuous deceleration of economic activity suggests that economic growth should slow to around 4 percent in 2013. Cape Verde however maintains its ambitious goal to boost economic growth and reduce unemployment. Reaching them may be hampered by exogenous shocks such as falls in tourism receipts, remittances, foreign direct investment and Official Development Aid (ODA). Its fiscal space is also very limited; fiscal deficit is high (7.5 percent of GDP) and the nominal stock of public debt is estimated to have risen to 97 percent of GDP in 2012 from 69 percent in 2008, although interest payments remain manageable at 8 percent of government revenues). It is therefore crucial that Cape Verde keeps pursuing its important structural reform agenda in key sectors such as energy, transportation and public administration and with a view to enhance public expenditures management.

National economic integration and social inclusion continue to be central issues to the development of Cape Verde, as reflected in the Government’s Program for the Eighth Legislature (2011-2016). Despite recent overall progress, poverty remains prevalent in some of the most remote islands and rural areas, especially in the island of Santiago. The share of the population in absolute poverty decreased from 37 percent in 2001 to 27 percent in 2010. Progress in reducing poverty has been slower in rural areas, where 72 percent of the poor live. The islands with the largest rural and isolated populations (Santiago, Santo Antão, and Fogo) still experience the highest rates of poverty and food insecurity.

The population residing in these isolated rural communities is impoverished and unable to harness economic opportunities as inadequate infrastructure and the inter-island logistic issues make central services and markets difficult to access. Unemployment remains high, particularly among youth, women and rural populations, and there are sharp differences across islands, reflecting a misalignment between skills and job opportunities and constraints in domestic migration. Promoting tourism and employment in tourist related activities remains a key thrust of the country’s growth strategy, but better inter-island transport will be essential to improve economic linkages between the various islands that constitute Cape Verde. This is because the main source of growth in the economy remains the tourism sector which is concentrated on two of the least populated islands (Boa Vista and Sal) where there is very little farming activity and transport connections with the more fertile islands remain poor.

Cape Verde stands out in Africa as a country whose economic geography poses major and unique challenges to infrastructure development. In addition to maintaining multiple road networks, the country needs a large number of functioning ports to ensure internal connectivity, and also relies heavily on air transport for both domestic and international links. Enhancing accessibility by means of an affordable and dependable transportation network connecting the rural areas to urban centers and improvements to inter-island transport and inter-modal logistics is crucial to enhance the growth potential and national integration strategic objectives for Cape Verde.

**Sectoral and institutional Context**
The Transport Sector Strategy, 2008-2020, spells out the Government’s vision for the development of the sector in support of social activities and economic growth, and equal access for the spatially dispersed population. This vision is reinforced by the Government’s Program for the Eighth Legislature (2011-2016) which highlights that “transport will be a major priority during the Eighth Legislature, in view of its importance for our agenda of building a vibrant, competitive and innovative economy, offering prosperity shared between all”. The Transport Sector Strategy is also articulated with the Sea Economy Cluster Strategic Plan (Plano Estratégico do Cluster da Economia Marítima or PECEM) which is a critical chapter of the Third Growth and Poverty Reduction Strategy Paper (Documento Estratégico de Crescimento e Redução da Pobreza or GPRSPIII) and reflects the Government’s willingness to consider the ocean as a key source of economic growth that must be sustainably tapped.

The Government recognizes that in addition to rehabilitation of key infrastructure assets a comprehensive sector approach is needed to bolster the efficiency of the transport network and services providers. The possibility for transport operators to provide high value added services would increase Cape Verde’s attractiveness for high-end tourism while cross subsidizing basic intra/inter island mobility, thereby increasing accessibility and sustainability of the transport network.

The Government also recognizes that success in the transport sector is contingent upon a systemic approach to mobility and accessibility, whereby all transport modes are considered jointly and not separately: the decision to promote a better coordination between transport modes and to focus on logistics and supply chain issues is reflected in the recent approval by the Government of a by-law which creates the General Directorate of Mobility and Transport under the aegis of the Ministry of Infrastructure and Maritime Economy (Ministério das Infra-estruturas e Economia Marítima – MIEM), and in charge of the preparation of integrated, multi-modal transport policies.

Geographical dispersion and a low population density necessitate the duplication of infrastructure facilities. Despite its small population Cape Verde has no fewer than four international airports, three aerodromes, and nine ports. The very fragmented provision of utility services prevents capture of economies of scale and drives up inter-island transport costs, which are high by international standards, and result in sharp price differentials between areas of production and consumption (both tourist and the main urban areas). This erodes the competitive advantage of Cape Verdean suppliers over overseas suppliers, discourages economic activities in the peripheral islands that depend on inputs from outside, and cause post-harvest losses of up to 40 percent because the main tourism islands, mostly arid, are poorly connected with the more fertile islands from agricultural production point of view. While the government has privatized inter-island shipping, the maritime fleet remains partially obsolete, and not adapted to the inter-island traffic, providing insufficient and unreliable services.

Logistical facilities for transferring cargo from maritime to road or air transport appear to be very limited, adding to storage costs and delays that undermine competitiveness. Over the last 10 years, major investments have been undertaken to upgrade airports and port facilities, as well as to rehabilitate the core road network to a sustainably maintainable level. Nonetheless, bottlenecks in seamlessly integrating air, sea (ferry) and road transport remain to be addressed to support trade, tourism and inter-island connectivity more broadly. Rehabilitation of the core road network is ongoing and remains to be completed. Connecting rural populations to the core network through repair and upgrade of rural road networks, and delivery of transport services, remain a priority for the government.
Thanks to its geography, air and sea transport services are critical to make Cape Verde a unified and well-functioning country. The Government has invested heavily - approximately US$400 million - over the last ten years, in building up maritime and aviation infrastructure, resulting in Cape Verde having good port and airport infrastructure. However, the quality and reliability of transport services remains unsatisfactory, customer satisfaction is poor and this situation is unlikely to improve unless critical long known structural issues are addressed by the Government.

13. Corporate Governance for State Owned Enterprises (SOEs, such as the National Company of Port Administration - ENAPOR, Airports and Air Safety - Airports and Air Safety-ASA, and Cape Verde National Airline - TACV) in the transport sector is affected by state ownership function and the Government’s limited oversight over the financial and service delivery performance of SOEs. The Unit of SOE oversight within the Directorate of Treasury is understaffed, has limited capacities and the timely collection of financial data appears to be challenging in some cases. Despite significant traffic growth, the financial situation and prospects for the State-Owned Enterprises operating in the transport sector needs to be carefully monitored and is particularly worrisome for TACV, whose net result in 2011 was ECV -2.026 billion (about US$ -24 million).

Sea Transport:

In spite of significant achievements in the maritime sector such as investments in ports infrastructure, liquidation of the monopolistic publicly-owned maritime transport enterprise (Arca Verde) and opening of maritime transport to the private sector, inter-island maritime transport is not responding as expected and needed. The ships that are being operating are old, service regularity is poor and some islands remain inadequately served. Consistently with the Third Growth and Poverty Reduction Strategy which identifies the development of maritime economy as a key Government priority for 2012-2016, the Ministry of Infrastructure and Maritime Economy (Ministério de Infra-Estruturas e Economia Marítima –MIEM) is currently preparing a new maritime strategy, based on three pillars: (a) streamlining the role of the maritime regulator (Instituto Marítimo e Portuario – Port and Maritime Agency - IMP); (b) turning National Company of Port Administration (ENAPOR - Empresa Nacional de Administração dos Portos) into a port administrator, port operations being progressively delegated to private operators; and (c) promoting the establishment of logistic platforms close to the ports, adding value to imported/exported goods and making co- and inter-modality viable.

ENAPOR is the Cape-Verdean Port Authority and manages all ports in the country under the service port concept. Sea traffic has dramatically increased since 1998 (plus 193 percent), benefitting from the steady growth of Cape Verde’s economy. However, ENAPOR’s revenues increased at a slower pace (plus 138 percent), which reflects a decline in unit revenue (per ton) that prevents ENAPOR from reaping the full benefits of Cape Verde’s economic growth. ENAPOR has not been able to optimize its fare policy (average fares are significantly lower than West African average) and to further rationalize its cost structure. Wages have increased faster than revenues and ENAPOR is overstaffed compared to international standards, while productivity is low even compared to West African standards. It is expected that some level of private participation will materialize thanks to the increased purchasing power of end customers, could guarantee a gradual but rapid transition of Cape Verde port operations towards commercial principles. The Government is considering transitioning from the service to landlord port model, whereby frontline port activities at national ports would be gradually delegated to the private sector via management or concession contracts.
Air Transport:

Cape Verde’s domestic air transport market looks large relative to its West African neighbors due to the use of air travel to interconnect the archipelago. Relative to its small population, Cape Verde makes very intensive use of air transport; 2.4 seats are available per capita, compared to 0.2 seats in Senegal. The Cape Verde aviation sector has also greatly benefited over the past decade from the growth in the country’s economy, especially its tourism industry. Demand patterns have changed, with a recent preeminence of international flights over domestic ones (in terms of passenger-km and revenues) as a result of Cape Verde boasting four international airports (Praia, Boa Vista, Mindelo, Sal) in lieu of only one in the 90s (Sal) on which was centered a hub-and-spoke system. However, as an overwhelming share of the origination market for Cape Verde tourism industry is centered in the Euro zone where sluggish growth is likely in the near future, international traffic may well stagnate in the coming years.

Airports are managed by a state-owned enterprise, the National Enterprise for Airports and Air Safety (Empresa Nacional de Aeroportos e Segurança Aérea or ASA). The company is corporatized and has followed standard business procedures since 2001. Activities include the support of civil aviation; air traffic management; services related to the departure, arrival, and overflight of aircrafts; and management of terminals and freight couriers. ASA’s financial situation contrasts favorably with ENAPOR’s even though ASA has also benefitted from Government subsidies in the form of concessional sovereign loans. Profitability has improved since 2008 and unit labor costs are under control. About two-thirds of ASA’s revenues are generated by over flight activities through fees paid by international airlines crossing the Cape Verdean air space, while the remaining one-third stems from airport activities. Airport activities are cross-subsidized by over flight activities, contrary to the principles underpinning over flight tariff setting. This equilibrium may be weakened as over flights activities are expected to stagnate or decrease due to the overall crisis.

There are plans in the medium-term to raise the airport tax to US$25 per international passenger. Its current level of US$17 per international passenger is about half the African average. When effective, the tax increase is expected to improve the long term financial sustainability of airport operations, and the prospects to attract private sector participation in their management and/or financing.

19. Cape Verde National Airline (TACV – Transportes Aéreos Cabo Verde) long term financial solvency has been hampered for years by an array of structural and governance issues such as the lack of economically viable routes and ticket pricing, high labor costs, revenue leakage, rapidly accumulating arrears etc., and it has only been able to continue operating due to ASA’s tacit support. The Government has expressed its willingness to tackle the financial challenges facing TACV, and the newly appointed Board has focused its attention on debt management and renegotiation. The medium to long term options on the table include privatizing the company or selling a majority share of TACV’s capital to a private investor. However, neither of these two options looks likely to succeed unless the current restrictive labor and business practices that prevail in Cape Verde are reformed.

In the interim, the recently appointed board of TACV has hired, under the ongoing Road Sector Support Project (RSSP) project an individual consultant to define their immediate strategy and a three-year business plan and the International Air Transport Association (IATA) to carry out a fuel efficiency study expected to generate savings of more than US$1,200,000, equivalent to three
percent of TACV current fuel consumption based on their current flights schedule. In addition, an international consulting firm, financed under TACV’s own resources, is working on a Master Plan to reduce TACV’s losses. TACV Board is currently implementing concrete measures which already aim at reducing their operating costs and improving the company’s financial situation. Those measures which are expected to substantially improve the financial health of the company include, inter alia: (a) implementation of a financial management and management information systems to provide accurate real-time financial data; (b) discontinuing loss generating routes; (c) rationalization of operational expenditure such as aircraft maintenance costs through a policy of cost comparison to achieve cost-efficiency; and (d) review of free travel benefits extended to staff in view of its reduction and rationalization. It is worth noting that TACV’s 2011 financial accounts (see key figures in Table 16, annex 6) have been approved, audited and published, which contrasts with the situation prevailing over the past five years.

Corporate Governance of State Owned Enterprises

Beyond specific challenges, the Transport Sector in Cape Verde is also affected by the overall Corporate Governance of SOEs. Cape Verde’s five major SOEs, including three in the transport sector (TACV, ASA and ENAPOR), have long been a source of contingent liabilities for the government due to their generally weak commercial and financial performance. While Cape Verde has a solid legal framework and structured SOEs boards of directors, the state oversight capacity of its SOEs portfolio is limited and transparency is impacted by the irregular frequency and the lack of timeliness of external audits.

The effectiveness of state oversight and ownership is hampered by the institutional framework and oversight capacity. State ownership and oversight of SOEs is ensured by the Ministry of Finance and Planning (MOFP), legally responsible for this function, through the SOE Unit from the General Directorate of Treasury. The effectiveness of this institutional framework is limited by the capacity of the SOE Unit and its institutional authority. Experience shows that successful public oversight structures usually have highly trained and specialized staff, with audit, legal and sector skills, understanding the business of SOEs, complemented with external consultant resources, who advise in the inter-actions between the ownership functions and the SOEs. The current ownership framework (a sub-unit of the General Directorate of Treasury) is also potentially affected by its visibility and authority to exert the shareholding oversight role of the state upon 27 SOEs, with assets amounting to 32 percent of GDP.

The activity of the SOE Unit is also impacted by the lack of monitoring instruments such as performance agreements. Electra is the only major SOE with a performance agreement, supported by a Bank funded project. Monitoring of performance from both a financial and a service delivery point of view cannot be effective without definition of targets against which to measure progress.

Road Sector:

In the road sector, the objectives of the Government’s Program for the Eighth Legislature are to be achieved through a balanced approach which entails completing the rehabilitation of the core road network accompanied by consolidation of institutional capacity for planning, implementation and management of road investments and maintenance.

Cape Verde road network consists of 1,350 kilometers (about 44 percent asphalted and the rest is
paved with cobblestones) spread among the nine inhabited islands (334 km/1,000 km² compared to 81.5 km/1,000 km² for Africa as a whole). The comparatively dense road network is characterized by: (a) major roads (often a “ring road” around the island) which extend from each island’s principal port and airport to municipalities and serve small towns and rural communities; (b) secondary roads which serve smaller ports and fishing and agricultural communities farther off the main axes; and (c) municipal town roads and tracks. Maximum volumes of traffic can be found on the islands of Santiago (3,300 vehicles per day on the road from Praia to São Domingos), Sal (2,230 vehicles per day between the airport and Santa Maria) and São Vicente (1,444 vehicles per day between Mindelo and São Pedro).

The estimated value of the country’s road infrastructure asset base is about US$535 million (31 percent of GDP, a relatively high value compared to other African countries (25 percent average, 14 percent for Senegal). However, the road network is vulnerable and expensive to maintain because of the geography (steep slopes), geology (unstable and crumbly terrain conducive to landslides, subsidence and rock falls), and climate (heavy rains likely to become more and more common). In addition, most of the roads in the network were designed decades ago for much lower traffic volumes and with inadequate drainage structures that do not adequately cater to recent heavy rainfall patterns. Many would need to be re-engineered if not reconstructed. In addition, Cape Verde’s policy of extending the network to low population areas, in which economic returns are lower, have raised maintenance costs and made it all the more important to implement a more cost effective maintenance strategy.

Steady progress has been achieved in advancing the institutional reforms in the road sector as seen in a functioning road fund (Fundo Autónomo de Manutenção Rodoviária - FAMR), generating approximately Cape-Verdean Escudo (CVE) 500 million annually (about US$6 million) through a fuel levy of CVE7 per liter, establishment of a dedicated road agency (Instituto do Estradas - IE), and improved capacity in the MIEM to support planning and decision making.

The use of two-year performance based maintenance contracts (PBMC) piloted under ongoing IDA financed RSSP has been expanded by IE, with the FAMR providing the funding. The timely availability of funds for road maintenance through the FAMR, and the consolidation of sector responsibilities at IE are creating a sustainable institutional structure for the planning and management of the road network. Due to the positive track record of the IE, especially in terms of making sure road works remain within budget and stay on schedule, the MIEM has decided to scale up the IE’s responsibilities.

Notwithstanding the progress achieved in road maintenance with the introduction of PBMCs, there are considerable challenges that hamper sustainability of road asset capital stock, mainly: (a) limited but growing road fund sources, (b) limited coverage of the first generation of PBMCs which only covered 44 percent of the road network; (c) unmet rehabilitation demand for aging roads to bring them to maintainable standards; and (d) significant emergency works backlog caused by exceptional storms.

According to a 2009 estimate, about US$200 million would be needed over the next twenty years to cover all needs in terms of rehabilitation, routine and periodic maintenance and emergency works, with some level of frontloading to bring existing degraded roads to a maintainable condition. Taking into account the emergency works backlog estimated at US$25 million, this means that about US$12 to US$15 million per year would be needed over the next five years. This represents about 0.7
to 0.9 percent of GDP.

Road Safety:

The General Directorate for Road-Based Transport (Direcção Geral dos Transportes Rodoviários - DGTR) prepared the 2011-2020 National Road Safety Plan (NRSP) which was approved in 2012, followed by the 2013-2016 Strategic Road Safety Action Plan prepared in December 2012. This action plan focuses on: (a) awareness raising campaigns especially targeting the main accident victims, i.e. pedestrians and 2-wheeler users, (b) transit law enforcement, including compliance with speed limits, (c) fight against driving under the influence of drugs or alcohol, (d) implementation of guidelines for safer road infrastructure, and (e) creation of a National Road Safety Observatory to collect reliable road traffic injury data.

According to the data available on road safety, between 2002 and 2011, on average, there have been about 4,000 accidents per year. The number of fatalities (resp. injuries) has oscillated between 47 and 77 (resp. 690 and 950) over the same time period, about twice as much per capita as in the European Union. Interestingly enough, most accidents are concentrated in the municipalities of Praia (62 percent) and São Vicente (12 percent), overwhelmingly in urban areas and attributable to drivers’ behavior.

II. Project Development Objectives

39. The objective of the project is to improve efficiency and management of the Recipient's national road assets and lay the groundwork for transport sector SOE reform.

III. Project Description

Component Name

Component 1: Road Asset Preservation including PBMC on selected road network in targeted islands, and Emergency Works
Component 2: Institutional Strengthening and Project Management in the Road Sector
Component 3: Road Safety
Component 4: TA in support of the Government's inter-island transport strategy
Contingencies

IV. Financing (in USD Million)

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V. Implementation

The existing Project Coordination Unit (PCU) is already implementing the ongoing IDA financed RSSP, with adequate fiduciary arrangements in place to implement the activities of the proposed new project. The Project Coordination Unit (PCU) has acceptable financial management arrangements and the fiduciary system in place which satisfies the Bank’s minimum requirements under OP/BP10.02. The Financial Management (FM) system is adequate to provide, with reasonable assurance, accurate and timely financial management information on the status of the project.
required by the World Bank. The PCU will delegate the review of sector technical issues to: (a) the IE for the road sector, (b) the MOFP for the SOE component, (c) under the overall supervision of the MOFP and the Ministry of Infrastructure, to TACV and Civil Aviation Agency (Agência de Aviação Civil – AAC) for the air transport sector, and to the IMP for the port sector, and (d) the General Directorate for Road-Based Transport for the road safety component.

The institutional arrangements for the implementation of the proposed project will build on the existing arrangements of the RSSP. The project will continue to be directly managed by the Ministry of Transport and Maritime Economy (MIEM) through the Project Coordination Unit (PCU). The existing PCU in charge of the implementation of the RSSP will manage the funds of the proposed project and will prepare the annual financial statements of the projects. A new operational manual is being prepared, based on the one used under the RSSP.

VI. Safeguard Policies (including public consultation)

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VII. Contact point

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