

**FOR
AGENDA**

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July 30, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Guinea-Bissau - Staff Report for the 1984 Article IV
Consultation and Request for First Credit Tranche Purchase

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Guinea-Bissau and its request for a purchase in the first credit tranche equivalent to SDR 1.875 million. Draft decisions appear on page 19.

This subject has been tentatively scheduled for discussion on Monday, August 27, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Tandeciarz (ext. (5)8389) or Mr. Brou (ext. (5)8393).

Att: (1)

INTERNATIONAL MONETARY FUND

GUINEA-BISSAU

Staff Report for the 1984 Article IV Consultation
and Request for First Credit Tranche Purchase

Prepared by the African Department

(In consultation with the Fiscal Affairs, Legal, and
Treasurer's Departments)

Approved by Oumar B. Makalou and Eduard H. Brau

July 26, 1983

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I. Introduction

A staff team visited Bissau during April 4-21 and May 14-19, 1984 to conduct the 1984 Article IV consultation discussions and to negotiate a financial program to be supported by a purchase in the first credit tranche. ^{1/} The Guinea-Bissau representatives included the Governor of the National Bank, the Minister of Economy and Finance, the Minister of Commerce and Handicrafts, the Secretary of Planning, and other cabinet members and senior officials of the Government. The head of the mission was also received by General J.B. Vieira, President of the Republic of Guinea-Bissau. Mr. W.B. Tshishimbi, Alternate Executive Director for Guinea-Bissau, participated in the final round of policy discussions during May 16-18, 1984.

In the attached letter dated July 20, 1984, the Government of Guinea-Bissau requests the purchase of an amount equivalent to SDR 1.875 million, representing 25 percent of quota, in support of an economic and financial program for the year ending December 31, 1984. The adjustment program adopted by Guinea-Bissau, which was designed in close consultation with the Fund staff, began to be implemented in December 1983. This purchase would increase total outstanding Fund credit to Guinea-Bissau (after taking into account scheduled repurchases) to 49.7 percent of quota, of which the equivalent of 24.7 percent would represent purchases under the compensatory financing facility (Appendix Table I).

Guinea-Bissau has availed itself of the transitional arrangements under Article XIV. Since the middle of 1982, Guinea-Bissau has experienced frequent difficulties in discharging its financial obligations to the Fund on schedule. Delays in payments during this period have ranged from a few days to over four months, and the Executive Board has been informed on a number of occasions of the more protracted delays and the subsequent settlement of these obligations. As of July 11, 1984 Guinea-Bissau was current in its obligations to the Fund. A summary of Guinea-Bissau's relations with the Fund is presented in Attachment I.

During the last five years IBRD's operations in Guinea-Bissau have amounted to US\$53 million, through five IDA credits directed to the transport sector and petroleum exploration promotion. In addition, the World Bank is preparing an Emergency Import Credit for US\$8 million, and discussions have already begun for further nonproject assistance (Attachment II).

^{1/} During the first visit the staff representatives comprised Messrs. I.C. Tandeciarz (head), I. McCarthy, J-C. Brou (all AFR), J.C. Tavares (FAD), M. de Assis (IBRD), and Mrs. R. Llana (secretary-FAD). Mr. D. Syvrud (AFR) joined the mission April 14-18, 1984. The second mission consisted of Messrs. I.C. Tandeciarz (head-AFR), J.C. Tavares (FAD), J-C. Brou (AFR), and Mrs. V. Fuentes (secretary-BLS).

II. Background

Guinea-Bissau is among the poorest countries of the world. ^{1/} Its main resource base is the agricultural sector, characterized by a traditional pattern of subsistence farming. Known mineral resources comprise some bauxite and phosphate, and the possibility of commercial development of offshore petroleum is being explored with World Bank assistance. There are also substantial resources in fisheries and forestry, but their exploitation is still quite limited. The effects of a long liberation war that destroyed or damaged a substantial part of an already fragile infrastructure have not yet been entirely overcome, and part of the cultivated land that was abandoned during the struggle remains uncultivated.

Since achieving independence in 1973, Guinea-Bissau has experienced increasing economic and financial difficulties. The newness of the country's institutions and the limited administrative capacity to handle a system of centralized economic planning, with heavy reliance on controls, made it difficult to utilize foreign aid inflows effectively in the following years. The Sahelian droughts of the late 1970s compounded the economic problems, and by mid-1980 the country was facing shortages of basic foodstuffs and intermediate goods. Following the political change of November 1980, when the powers of the National Assembly and of the Council of State were concentrated in the Revolutionary Council, the Government began to review its approach to economic policies. However, the adoption of necessary measures was delayed by the need to reach political consensus on the degree of adjustment, particularly regarding pricing and exchange rate policies. As a result, the economic situation continued to deteriorate, and by mid-1983 the National Bank of Guinea-Bissau (NBGB) had exhausted its foreign credit lines, external payment arrears were accumulating very rapidly, oil imports had had to be severely cut, the share of output sold in official markets was at one of its lowest levels in recent history, and the incipient modern sector was virtually at a standstill. These developments made the authorities aware of the dangers inherent in current trends and of the need for substantial and rapid action.

During the 1983 Annual Meetings the authorities of Guinea-Bissau informed the Fund staff that the political decision to correct existing distortions had already been taken. Although they were already considering a substantial depreciation of the domestic currency, the additional necessary measures to support the exchange rate action (i.e., producer prices, wage policy, etc.) required further elaboration. Therefore, the authorities requested a Fund mission to assist them in the formulation of these measures.

^{1/} Although the national accounts of Guinea-Bissau must be treated with caution, because of the lack of an adequate statistical base, total GDP in 1983, measured in U.S. dollars, is estimated to have amounted to US\$154 million and per capita GDP to US\$187.

A staff team visited Bissau during October 26-November 9, 1983. On the assumption of an initial depreciation of the Guinea-Bissau peso (PG) of 50 percent (in terms of the SDR, to which it is pegged), the mission made a set of specific recommendations regarding producer and consumer prices, wage policy, marketing arrangements, and domestic demand and external debt management. Subsequent to the staff visit, the authorities of Guinea-Bissau presented some elements of their economic stabilization program to an Emergency Fund meeting of donor countries held in Lisbon during November 17-19, 1983. The measures proposed by the authorities were broadly in line with the Fund staff's recommendations, and the meeting was successful in obtaining commitments of about US\$15 million from existing aid, new aid allocation, and new lines of credit. From the end of 1983 onward, the Government began to implement its program of economic adjustment and reform. Given that it would take several years for a major restructuring of relative prices and a correction of the fiscal and balance of payments disequilibria to be fully effective, the authorities' approach has been to implement an adjustment program within the framework of a medium-term development plan.

The mission found serious deficiencies in Guinea-Bissau's statistics, which hampered the staff's efforts to assess economic developments. The mission stressed to the authorities the need for improved and more timely economic data to assist in the formulation and monitoring of economic policies, in particular, in view of their intention to request continuing financial support from the Fund. The authorities have already requested technical assistance from the Fund's Central Banking Department on accounting procedures to improve the monitoring of monetary variables. In addition, a recent technical assistance mission from the Bureau of Statistics, to evaluate the methodology used to produce monetary series, was able to familiarize the staff of the NBGB with an analytical framework for financial statistics. During this mission the inclusion of the country's page in the International Financial Statistics was also discussed, and the authorities indicated their intention to provide the required data for publication in the near future.

III. Recent Economic Performance

The severe structural imbalances that prevailed in Guinea-Bissau during most of the 1970s worsened in recent years. Although there was a recovery in 1981 and 1982 from the effect of the droughts during the previous two years, real GDP dropped again in 1983 by about 5 percent (Appendix Table II) and, according to rough estimates, it was still below the level recorded in 1978. 1/

1/ Over recent years an increasing share of trade has taken place on parallel markets or via barter. It is not clear to what extent official data on output used to estimate the national accounts cover transactions conducted outside official channels.

With agriculture accounting for about half of GDP, fluctuations in total output have been largely a reflection of this sector's performance. Inadequate and untimely distribution of rains resulted in a decline of agricultural output of nearly 4 percent in 1983, due to drops in rice and groundnut production. Other main sectors that contributed to the overall decline in output last year were commerce and transportation (as a result of lower recorded domestic and foreign trade activities) and fishing (due to the immobilization of some of the ships for repairs). Manufacturing output remained at practically the same level as in 1982, after declining for three consecutive years. This last sector, with a capacity utilization of about 30 percent, is still suffering from a clear misallocation of foreign resources that were easily available during the early post-independence years. Most of these projects face noncompetitive costs, locational deficiencies, managerial problems, and a need for imported inputs that is difficult to satisfy under present balance of payments conditions.

The fiscal imbalance remained relatively large in 1983 (at the equivalent of around 22 percent of GDP), despite a reduction in the overall deficit (after grants) of central government operations equivalent to 3-1/2 percentage points of GDP with respect to the previous year. This improvement in the fiscal performance was basically due to a reduction in capital expenditure, following a slowdown in the availability of foreign financing, coupled with restraint in current outlays. As a result, overall outlays dropped by 8-1/2 percentage points of GDP. This substantial drop in expenditure outweighed a decline in total revenue and grants, which largely reflected a reduction in foreign aid to finance specific projects. Budgetary receipts increased by 10 percent in nominal terms, covering only 44 percent of current expenditure, and the overall deficit (before grants) was equivalent to 78 percent of total outlays (Appendix Table III). Recourse to net credit from the NBGB essentially financed the deficit on the current account operations of the Central Government and amounted to about 55 percent of the outstanding money supply at the beginning of the period. As in previous years, this was basically the only source of net domestic credit expansion, since the NBGB's net domestic assets, measured on the same basis, increased by 49 percent during 1983 (Appendix Table IV). About half of this credit expansion was reflected in a further drop in net international reserves, and, therefore, the broad money supply rose by only 25 percent.

The balance of payments difficulties experienced in previous years were exacerbated in 1983, in spite of a decline in the current account deficit (including official transfers) from 20 to 16 percent of GDP. An involuntary curtailment in the value of official imports by 18 percent aggravated shortages of consumer goods and spare parts and had serious disruptive effects on the productive sectors of the economy. This was the consequence of a sharp decline in recorded exports, since inappropriate pricing policies continued, and of a substantial cutback in medium- and long-term capital inflows (Appendix Table V). As in 1982, three quarters of the overall deficit was financed by

short-term foreign borrowing, worsening the already negative net international reserves position of the NBGB, and the remainder by incurring additional payments arrears. This aggravated the external debt situation, and, by the end of 1983, total outstanding debt (including use of Fund credit, arrears, and short-term debt) amounted to US\$163 million, equivalent to 106 percent of GDP, and scheduled external debt service during the year amounted to 59 percent of exports of goods and nonfactor services (Appendix Table VI).

IV. Report on the Discussions and the 1984 Program

The discussions with the authorities, although covering all the major economic and financial developments, focused on the adequacy and impact of the measures that began to be implemented at the end of 1983 and on the additional actions required to undertake a comprehensive adjustment program. The major objectives of the program are to correct fundamental price distortions, so as to lay the basis for sustained growth in domestic output, and to start redressing the fiscal and balance of payments disequilibria.

The measures adopted at the end of 1983 included: (a) an initial devaluation of the Guinea-Bissau peso of 50 percent in foreign currency terms; (b) an increase in producer prices for the main crops; (c) steps to reorganize and liberalize existing marketing arrangements; and (d) a number of tax revenue measures. At the same time, gross wages of central government employees were raised by an average of nearly 50 percent. Adjustments in consumer prices, however, were introduced from early April onward to reflect the effect of the above-mentioned measures. 1/

Other measures and policies to be pursued during 1984 include: the adoption of a more restrictive government budget, a decision not to grant further salary increases to government employees, better control of state enterprises, the payment (for the first time) of interest on bank deposits and an increase in the rates charged on loans, the intensification of efforts to reach an early agreement on the consolidation and/or renegotiation of outstanding debt, and the continuation of flexible exchange rate and pricing policies.

1/ It would appear that the delay in increasing consumer prices until early April was due to political considerations. At the end of March 1984 elections were held to constitute regional councils that, in turn, nominated deputies who named a Council of State that approved a new Constitution. The process culminated on May 15, 1984, when the President of the Council of State, General J.B. Vieira, who had headed the Revolutionary Council since November 1980, was formally named President of the Republic.

1. Prices and marketing system

The Guinea-Bissau representatives recognized that, in recent years, the pursuit of inappropriate producer pricing policies, coupled with poorly managed marketing and distribution networks, had led to a reversion toward a subsistence economy based on barter trade and to the growth of smuggling. This, in turn, resulted in supply shortages, declining exports, and, consequently, a smaller taxable base. To redress this situation, producer prices of rice, groundnuts, palm kernels, and cashew nuts were increased by 76 percent, 90 percent, 114 percent, and 76 percent, respectively, at the end of 1983. 1/ In determining the new prices, consideration was given to prices in neighboring countries, transportation and processing costs, export prices, and the need to allow state enterprises to generate a surplus on export operations, part of which would be transferred to the Central Government (Appendix Table VII). Given the recent increase in international prices for Guinea-Bissau's main crops and the new level of the exchange rate, it is estimated that the producer prices announced at the end of 1983 will result in gross profits on export proceeds of approximately 20 percent, 40 percent, and 50 percent, for groundnuts, palm kernels, and cashew nuts, respectively. Eighty percent of these gross profits have been transferred to the Central Government since June 1984. Moreover, the Guinea-Bissau representatives noted their intention to continue adjusting producer prices so as to reflect changes in domestic and international markets. Within this context, the staff recommended that, in the next round of adjustments, additional emphasis should be placed on allowing relative producer prices to reflect more closely world market developments, so that farmers could receive the correct signals and resources be allocated more efficiently. 2/

Preliminary information would indicate that the pricing actions have already had some success in redirecting output from parallel markets to official channels. Nevertheless, this impact could be transient if the farmers are unable to find outlets on which to spend their increased revenues. Hence, for a successful outcome of the program, it is of paramount importance to increase the availability of imported goods in rural areas and to improve existing marketing arrangements. To this end the Government has started a process of reorganization calling for increased private sector participation in trading

1/ The price increases at the farmgate were somewhat lower due to the authorities' intention to stimulate private sector participation in the intermediation process.

2/ Although the new prices for rice, groundnuts, and palm kernels are now closer to their relative prices in foreign markets, this is not the case for cashew nuts. Expected export proceeds per ton are about 15 percent higher for cashew nuts than for groundnuts, while the new producer prices for these crops imply a domestic cost per exported ton that is nearly 40 percent higher for groundnuts than for cashew nuts.

and transport activities. As part of this process, (a) retail traders will receive imported products in proportion to their deliveries of traditional exportable agricultural products to the state enterprises, either in regional centers or in Bissau; (b) private traders undertaking exports of nontraditional products have been authorized to use 70 percent of their foreign exchange receipts to pay for merchandise imports; (c) most retail outlets presently owned by state enterprises will be transferred to the private sector, with at least 30 stores (out of a total of 270) expected to be in the hands of private traders by the end of 1984; and (d) price controls that used to apply to some 400 products have been restricted to the main basic commodities, although they still cover the bulk of domestic transactions.

During the last decade the distribution network has been under the control of two state enterprises with largely overlapping functions. The Guinea-Bissau representatives stated that they were considering two proposals to reorganize these enterprises (Armazens do Povo and SOCOMIN). According to one of them, Armazens do Povo would become a wholesaler, retaining retail trade only in places where this activity was socially desirable but unprofitable for the private sector, while SOCOMIN would concentrate on export and import operations. Transport of commodities between regional centers and Bissau would be handled by a single enterprise (currently, both SOCOMIN and Armazens do Povo have their own transportation fleet). The other proposal was that SOCOMIN should specialize in importing and distributing capital goods and equipment (including those for government projects), spare parts, intermediate goods, and vehicles, and that Armazens do Povo should concentrate on importing 12 to 14 basic goods such as food, cement, and iron. The mission noted that, under any scheme the authorities would be willing to adopt, emphasis should be placed upon improving the efficiency of the enterprises rather than upon delineating their areas of specialization, and that delays in taking action in this field may substantially limit the effectiveness of the measures adopted on other fronts.

As noted above, consumer prices began to be adjusted in early April, when the prices of five basic consumer goods (rice, cooking oil, sugar, flour, and soap) were increased to reflect the effects of the exchange rate depreciation and of salary increases. In the case of rice, the most important staple, the authorities were able to limit the increase in its price to 67 percent because of a reduction in the commercialization margins of state enterprises and a slower growth in labor costs. ^{1/} This action was followed by adjustments in other food items such as fish, bread, and meat, and as of May 1, 1984 the prices of petroleum products were doubled with the exception of the price of jet fuel, which increased by 189 percent, and diesel fuel for power generation, which increased by only 29 percent. The losses incurred in the sales of

^{1/} At the new price, imported rice on a commercial basis will not require any subsidy because the previous domestic price was 80 percent higher than the c.i.f. cost of imported rice.

diesel fuel for power generation at the new price, however, will be compensated for by cross-subsidization, given the higher than otherwise necessary increases in the prices of other petroleum products. ^{1/} In addition, state enterprises have received instructions determining the margins they could apply when selling imported goods. According to the authorities, these margins (which imply an overall markup at the retail level of nearly 50 percent with respect to the c.i.f. cost) would induce private sector participation in these activities.

2. Exchange rate policies

The higher producer prices announced at the beginning of 1984 were made possible by the exchange rate action taken by the Government. An initial depreciation of the Guinea-Bissau peso from PG 44 per SDR to PG 88 per SDR, effective December 23, 1983, has been followed by cumulative weekly depreciations of approximately 1 percent, and, by the end of May, the Guinea-Bissau peso had depreciated by an additional 22 percent to PG 107.7 per SDR. ^{2/} Since the last part of May, the authorities have started to slow down the pace of depreciation to an annual rate of about 15 percent, from the 67 percent annual rate recorded in the first four months of 1984. As a result, by the end of June the exchange rate reached a level of PG 109 per SDR. They indicated that one of the immediate effects of the adopted measures was to halve the ratio between the parallel and official rates from 6 to 1 to about 3 to 1, and that an increased supply of goods in official markets is expected to reduce the spread even further. Although they were aware of the negative effects of such a spread between the two rates, they noted that this differential could only be eliminated gradually as the main elements that had led to its existence (basic price distortions, large fiscal deficits, lack of foreign exchange, and consequent shortages of imported goods) were gradually corrected. The authorities seemed to be encouraged by reports that the outflow of commodities to neighboring countries had declined (and in some cases, as in groundnuts, actually reversed) during the first months of 1984. Therefore, they wanted to proceed cautiously and assess the impact of the measures already adopted before engaging in a new round of price adjustments, particularly taking into account their limited administrative capacity to implement changes. In any event, the slowdown in the pace of depreciation is con-

^{1/} Until very recently Guinea-Bissau had to purchase petroleum products in the spot market. The Guinea-Bissau representatives noted that, in early 1984, they reached an agreement with a trading partner that would supply all their needs for petroleum derivatives at lower prices and with exceptional financing (8 years maturity, 2 years grace, and 6 percent interest).

^{2/} The lack of price statistics makes it difficult to determine the degree of appreciation of the real effective exchange rate in recent years. Staff estimates indicate that the nominal effective exchange rate of the Guinea-Bissau peso depreciated by 34 percent in foreign currency terms from 1978 to the second quarter of 1984.

sidered to be of a temporary nature. It was agreed with the authorities that there will be a staff visit around the end of August to review the progress made under the program and to discuss further action that may be required, particularly in the areas of exchange rate and producer prices.

3. Fiscal policies

Although the overall fiscal deficit on central government operations (including grants) had declined by the equivalent of 5 percentage points of GDP during the last two years, the Guinea-Bissau representatives acknowledged that substantial efforts will continue to be necessary over the medium term to correct the present fiscal imbalance. Therefore, as a first step, their fiscal policy has been formulated so as to reduce the overall deficit further by 5 percentage points to 17 percent of GDP in 1984, largely on the basis of a sharp increase in revenues and grants; this is equivalent to a reduction in the ratio of the overall deficit with respect to total expenditures from 45 percent in 1983 to 30 percent in 1984 (Appendix Table III).

Most of the expansion in total receipts of the central government reflects the effect of the devaluation of the Guinea-Bissau peso: external grants and taxes on international trade are expected to account for 70 percent and 11 percent, respectively, of the total increase. On the other hand, main fiscal measures generating revenues are: (a) the adoption of an income tax reform that led to an increase in the average rates; (b) the conversion of consumption tax specific rates to ad valorem rates; (c) increases in the ad valorem tax rates on beverages, tobacco, gasoline, and a few luxury items, in the specific consumption tax on domestic rum, and in the poll tax; (d) an increase in stamp taxes and charges collected by customs; (e) an increase in efforts to collect arrears; and (f) transfers to the Treasury from state enterprises engaged in exporting agricultural products of 80 percent of their presumptive gross profits derived from higher export receipts. Overall, discretionary measures are estimated to account for nearly 40 percent of a projected increase in revenue equivalent to 3 percentage points of GDP, while the rise in grants in the form of commodity and project aid (reflecting mainly the effect of the exchange rate depreciation) is expected to contribute by about 11 percentage points of GDP to central government receipts.

Total expenditures in 1984 are projected to increase by about 9 percentage points of GDP, entirely because of the rebound of capital outlays from their depressed level in 1983. Even so, measured in U.S. dollar terms, the projected level of public investment will be 8 percent below the average recorded during the previous 5-year period, reflecting the Government's decision to cut by nearly 40 percent the 1984 investment program as originally prepared by the Secretariat of Planning. 1/

1/ It should be noted, however, that the investment program includes outlays for maintenance, technical assistance, and training that cannot be clearly separated from the total owing to the lack of appropriate information.

In addition, to exercise better control over the future growth of total expenditure, the authorities have centralized the execution of all government outlays at the Ministry of Economy and Finance by incorporating the investment program into the central government budget. Regarding current expenditures the Guinea-Bissau representatives noted that wages and salaries of government employees, which had been kept unchanged since 1981, were raised by an average of 49 percent at the beginning of the year. This increase is believed to only partially compensate for the impact of the exchange rate and pricing actions as well as for the higher taxes that civil servants would have to pay following the income tax reform. Nevertheless, the wage bill is expected to rise by about 58 percent in 1984, reflecting also merit increases and promotions, and the full-year impact of the new technical and managerial positions created during the second part of 1983. The authorities had also decided to fill only partially vacancies in posts not requiring technical qualifications and not to grant further salary increases during the remainder of 1984. Expenditures on other goods and services and transfers are projected to grow by only 40 percent (or at about two thirds the rate of nominal GDP), while interest payments will register an eightfold increase, reflecting the effect of the exchange depreciation and the Government's intention to become current on its obligations. To enforce budgetary discipline, the NBGB has opened an account in which the public sector will deposit the domestic currency equivalent of foreign debt service at the time that payments are due.

Bank financing of the overall deficit will decline as a ratio to GDP by 3 percentage points, although it will still represent about 55 percent of the outstanding money supply at the beginning of the period; however, it should be taken into account that the denominator of the latter ratio does not reflect the effect of the exchange rate and pricing actions. Net foreign financing is also expected to fall by about 2 percentage points of GDP, largely because of a substantial increase in amortization payments when compared to the actual payments made during 1983.

The Guinea-Bissau representatives noted that they have reached preliminary understandings with World Bank staff to conduct a study of the present situation of state enterprises with the objective of classifying them as follows: (a) those that are financially nonviable and are to be closed; enterprises in this category are those not able to cover current expenses (excluding debt service) with current receipts; (b) viable enterprises that should be privatized; (c) enterprises that can be rehabilitated and made financially viable; and (d) enterprises in sound condition. The Government intends not to reopen enterprises that have been closed unless a rehabilitation plan for this purpose has been reviewed with the World Bank. These diagnostic studies of the main enterprises are expected to be completed by mid-1985 and will include: the electric utility company (EAGB), the two state trading companies (Armazens do Povo and SOCOMIN), the fuel distribution company (DICOL), the wood-processing company (SOCOTRAM), three fisheries, and a proposed new transport company. In general, the Government aims

to strengthen the financial position of state enterprises through realistic pricing policies and improved management practices. Starting in the third quarter of 1984, these enterprises will be required to provide timely quarterly information on the main operational variables to their oversight ministry, the Ministry of Economy and Finance, the Secretariat of Planning, and the NBGB. This information will be a prerequisite to obtain credit from the latter. Moreover, to overcome the accounting deficiencies that have so far prevented the determination of reciprocal debts between the Central Government and public enterprises, the authorities are conducting surveys on the basis of which they will establish a schedule for the settlement of outstanding balances.

4. Monetary and interest rate policies

The authorities recognized that, up to now, monetary policy has been playing a passive role. The financing of budgetary deficits has accounted for almost the entire monetary expansion in Guinea-Bissau, since credit to state enterprises has stagnated on average and credit to the private sector, in relation to the money supply, has been declining in recent years, falling to a level of 6 percent in 1983. In order to use monetary policy more effectively as an instrument of demand management, the authorities have adopted a credit program for 1984 that is expected to limit the expansion of the money supply to 44 percent. The Guinea-Bissau representatives considered that a slower monetary expansion could unduly affect domestic liquidity (particularly in view of a projected growth of nominal GDP of 62 percent) and hamper their efforts to reverse previous trends toward barter operations. In addition, and taking into account the highly negative level of net international reserves, the Government has established a target of increasing them by at least US\$1.5 million. Consequently, the expansion of the net domestic assets of the NBGB will not exceed PG 1,110 million, or the equivalent of 38 percent of the initial stock of money. To attain this objective, the increase in net credit to the Central Government will be limited to PG 1,575 million (or to 55 percent of the money supply at the beginning of the period), while the deposits of DICOL (the fuel distribution company) will increase by PG 630 million as a result of exceptional import financing that was obtained during the first part of 1984. The expansion of credit to the rest of the state enterprises will also be limited, to about PG 30 million, while credit to the private sector is projected to increase by only 46 percent due to the sharp increase in interest rates described below (Appendix Table IV).

Until very recently, interest rate policy was conditioned by the belief that the role of interest rates in allocating financial resources and mobilizing domestic savings was very limited. No interest was being paid on saving and time deposits, and the NBGB charged an annual rate of 6.5 percent on loans, excluding credit to the Government, which is still interest free. Reflecting the authorities' decision to allow the market forces to play a more dominant role, in June 1984 the NBGB established for the first time interest rates on deposits and

substantially raised interest rates on loans. The new rates range from 4.5 percent for savings deposits with 15 days' notice to 16 percent for certain time deposits with one-year maturity, while lending rates were raised to a range of 12.5 to 25 percent according to the purpose of the loans and their maturity. Although recognizing that the new interest rate structure represented an important first step, the staff expressed some reservations, particularly about the overall levels (which may prove to be inappropriate depending on the evolution of domestic prices) and about the fact that the maximum deposit rate was higher than the minimum lending rate (suggesting the possibility of some disintermediation). In this respect, the Guinea-Bissau representatives indicated that it was their intention to implement these rates for a few months and then, on the basis of experience, review both the structure and levels of interest rates and make any required adjustments.

The authorities also noted that, following the approval of the Organic Law of the NBGB in August 1983, which allows for the separation of central banking from commercial banking functions, the task of the National Bank as a monetary authority would become more manageable once this reform is completely implemented.

5. Balance of payments and foreign debt management

Regarding the balance of payments targets for 1984, the Guinea-Bissau representatives expect that, as a result of the recently adopted measures in the areas of exchange rate and producer prices, a substantial share of parallel market activities will be redirected to official channels. Therefore, the U.S. dollar value of recorded exports has been projected to increase 140 percent, most of it as a result of a larger volume particularly of cashew nuts, groundnuts, and palm kernels. ^{1/} At the same time, the value of imports is estimated to grow by 22 percent to allow for a minimum increase in the supply of goods and in the level of utilization of installed capacity (Appendix Table V). Nevertheless, taking into account the initial disparity between export and import levels, their projected growth rates will result in a similar ratio of the current account deficit (including official transfers) in relation to GDP as in 1983 (i.e., around 17 percent). The Guinea-Bissau representatives noted, however, that the actual level of imports could be higher than projected depending on the possibility of accelerating the disbursement of aid already committed by donor countries. In any event, they wanted to be cautious in their estimates, and, therefore, the net inflow of transfers has been projected to decline by the equivalent of 2 percentage points of GDP. On the other hand, drawings of medium-

^{1/} It is estimated that during the first quarter of 1984 the volume of exports of cashew nuts and palm kernels increased by 125 percent and that of groundnuts by 167 percent, compared with the same period of 1983. In the case of cashewnuts, the increase includes sales of stocks carried over from the previous year.

and long-term loans are estimated to increase by 50 percent 1/ to a level of nearly US\$31 million. This amount is composed of disbursements of project loans (for which a commitment already exists) of US\$17 million; medium-term financing of imports of petroleum products of US\$8 million; and disbursements of about US\$6 million from an US\$8 million emergency import credit from the World Bank to finance spare parts and intermediate products.

The total financing available in 1984, including the use of Fund resources, will cover the deficit in the current account and will allow a modest increase in gross international reserves so as to maintain a level equivalent to about six weeks of imports. The Government believes that flexible exchange rate and producer pricing policies, coupled with restraint in domestic demand, will result in a more comfortable balance of payments position over the medium term.

With respect to the external debt, the authorities plan to intensify contacts with external creditors with the purpose of reaching an early agreement on the consolidation and/or renegotiation of scheduled debt service obligations, including arrears. Discussions have already started with the governments of Portugal and Brazil regarding outstanding debts of about US\$17 million and US\$5 million, respectively, and the authorities will make every effort to conclude ongoing negotiations to reschedule outstanding arrears by the end of the 1984. In addition, to improve the maturity profile of the external debt, the Government will not henceforth incur or guarantee debts on commercial terms, except for lines of credit from suppliers to meet strictly seasonal needs and for any rescheduling of existing arrears. As a result of the substantial increase in projected exports, the scheduled debt service ratio is estimated to decline from 59 percent in 1983 to 56 percent in 1984.

The quarterly import program is the key feature of Guinea-Bissau's exchange and trade restrictions system. Through this program the National Bank of Guinea-Bissau and the Ministry of Commerce and Handicrafts control all imports of goods and their allocation. Control of foreign currency and of export proceeds is rigid. Residents can obtain only small amounts of foreign currency with justification. Guinea-Bissau maintains a bilateral payments agreement with Algeria. There have not been changes in Guinea-Bissau's restrictive system since the last consultation discussions, except for those reflected by the further accumulation of payment arrears.

1/ Excluding the disbursement of a line of credit from Portuguese commercial banks (guaranteed by the Government of Portugal) for US\$5 million.

V. Medium-Term Outlook

As noted above, the Government is implementing this program of economic adjustment and reform within the framework of a medium-term development plan for the period 1983-86. The quantitative projections of the plan were based on data for 1980-81. The general objectives during the first two years of the plan, which started to be implemented with a year's delay, are to redress the internal and external imbalances, to reorganize marketing arrangements with greater participation by the private sector, to use external aid more efficiently, and to improve economic management. Considering the seriousness of existing imbalances and the presently weak institutional structure, it is recognized that stabilization measures devoted to the achievement of economic recovery will have to continue for several years.

Before describing the scenario prepared by the staff, which benefited from using more recent data, it should be noted that Guinea-Bissau has a considerable growth potential over the longer run. Currently only 30 percent of arable land is under cultivation; the potential fish catch is on the order of 300,000 tons (compared with an actual domestic catch of 6,000 tons at present); and timber production could be increased several times over present output without endangering the ecological balance. In addition, mineral resources include bauxite, phosphate, and possibly offshore petroleum. Although existing physical resources would permit a very rapid and sustained growth in output, it is the staff's view that it will take several years to overcome present institutional deficiencies as well as the scarcity of qualified manpower and managerial capacity that have been hampering economic expansion. Therefore, the staff's scenario for the period 1985-88 assumes an average annual growth of real GDP of 5 percent. The balance of payments forecast covering this period, which is presented in Appendix Table VIII, has been estimated on the basis that, in the medium term, Guinea-Bissau's import capacity will continue to be constrained mainly by the availability of foreign aid. Perseverance in maintaining flexible exchange rate and producer pricing policies, coupled with improvements in the commercialization system, could result in an average annual growth in the value of recorded exports of about 16 percent, as well as in a reduction of food imports. Therefore, this expansion in exports would permit an increase in the value of imports at the same rate as real GDP, a decline in unrequited transfers and medium- and long-term capital inflows of about 5 percentage points of GDP with respect to the level projected for 1984, a modest buildup of net international reserves (equivalent to five to six weeks of 1984 imports), and an improvement in Guinea-Bissau's debt service ratio (Appendix Table IX). Although it can be argued that the import projection may be too low, the potential for export growth is substantially larger than projected, and foreign aid, in the form of grants or concessional loans, could also increase. In this respect, it is important to note that in the mid-1950s Guinea-Bissau exported rice, while its exports of groundnuts and palm kernels alone amounted to about US\$26 million at 1983 prices; in contrast, last year

the recorded value of these exports was US\$4.7 million, and imports of rice (both in the form of aid and on a commercial basis) were equivalent to US\$7.7 million. In addition, the Government's decision to implement important measures to correct existing distortions and imbalances has encouraged foreign donors to provide more support. Thus, the increase in program assistance that became available, as a result of the donors' conferences of November 1983 and May 1984, does not appear to have been temporary, and Guinea-Bissau may well receive foreign financing at a higher level than assumed in the forecast.

The staff projections do not take into account possible payments arising from the settlement of existing arrears, because the amount and terms of payment are still being negotiated. To the extent that payments are required during the forecast period, the burden could possibly be met by additional borrowing on concessional terms. In this regard, the fall in the projected net disbursements of medium- and long-term capital may provide the necessary margin for this borrowing.

VI. Staff Appraisal

During the last decade the Guinea-Bissau economy has been suffering from increasing internal and external imbalances arising from the devastating effects of a prolonged liberation war, the newness of the country's institutions, and the lack of trained manpower and administrative capacity to handle a centrally planned economy. The cumulative impact of domestic credit expansion to finance large budgetary deficits, together with the maintenance of a fixed exchange rate, rigid price controls, and an ineffective commercialization system controlled by two state enterprises, led to a broadening of parallel market activity, a shrinking taxable base, shortages of food and basic inputs, and balance of payments difficulties that limited the expansion of real output. These problems were compounded by the droughts of the late 1970s. The political change of November 1980 signaled, for the first time, the Government's intention to review its approach to economic policy. Nevertheless, the adoption of corrective action was delayed for some time, first because of the need to overcome political opposition from various quarters and then to reach consensus on the required adjustment. Consequently, existing difficulties deepened, and, by mid-1983, the distortions in the economy became so large and evident that corrective actions became inescapable. In these circumstances, during the 1983 Annual Meetings, the authorities of Guinea-Bissau informed the Fund staff that the decision to tackle highly sensitive issues, such as the exchange rate and producer pricing policies, had already been taken and requested the Fund's assistance to design the additional measures required for a comprehensive adjustment program. On the basis of the recommendations made by a staff team, the Government started to put in place important elements of their program in December 1983.

The staff believes that the economic and financial program for 1984 described above is an important step in the right direction. The actions taken in the exchange rate and pricing areas have been significant and have been designed to bring increased supplies into the marketplace and draw parallel activities into official channels. The degree of success in achieving this objective, however, will depend on the effectiveness in utilizing pledged foreign aid and on an early improvement in the efficiency of the marketing arrangements, which up to now have been practically monopolized by state enterprises. Therefore, the staff welcomes the authorities' decision to allow a greater participation of the private sector in the commercialization system and encourages them to move as rapidly as possible towards the reorganization of the state enterprises engaged in trading activities. The staff also welcomes the authorities' commitment to continue with a flexible approach in the adjustment of the exchange rate and administered prices and their intention to review the progress made under the program and to discuss further action that may be required on the occasion of a staff visit, to take place soon after the Executive Board's consideration of their request for a purchase in the first credit tranche.

Regarding demand management, the authorities are pursuing a more restrictive policy stance than in previous years. On the fiscal front, the impact of the devaluation and the revenue measures which were introduced, together with expenditure restraint, are estimated to reduce the overall deficit in relation to total outlays by about one third in 1984. Nonetheless, the fiscal position will remain inherently weak. Even in this period of salary restraint, budgetary revenue will cover only 59 percent of current expenditure and government spending will continue to heavily rely on external funds and central bank financing. Therefore, it is the staff's view that future policy should aim at significantly reducing the central government reliance on financial resources from the NBGB. The relative decline in the overall deficit projected for this year will enable the Central Government to move toward this objective by reducing its financing requirements from the NBGB by the equivalent of three percentage points of GDP. This, together with the targeted contraction in the net credit to state enterprises, will result in a decline in domestic liquidity in relation to GDP which will help to limit excess demand pressures. In this respect, the recent modification of the interest rate structure may be considered a positive step toward stimulating savings and improving the allocation of financial resources.

Following several years of substantial deficits, the projected reversal in the overall balance of payments position in 1984 is based on a substantial growth in the value of recorded exports, accompanied by a relatively modest increase in imports as well as on disbursements of already pledged foreign aid. The outlook for the medium term indicates that the projected current account deficit could be financed with a similar inflow of medium- and long-term capital in relation to GDP as in 1984. Although the discussions that took place at the recent donors' conferences point to the feasibility of obtaining more foreign support than assumed in the forecast, the authorities should be aware that this assistance is not likely to be available unless substantial additional adjustment efforts are made to reduce the country's reliance on foreign savings.

Although the nature and magnitude of the measures already adopted are very important and show the determination of the authorities to correct distortions, the staff considers that it will take several years to overcome existing imbalances. Therefore, what is important for the medium term is perseverance in continuing prudent and realistic financial policies, while acting quickly in removing the bottlenecks presently visible. In this context, care must be taken that price incentives are maintained and that a vigorous program to improve marketing arrangements is promptly implemented. Success in this area could make possible a larger growth of exports than envisaged in the staff's outlook, which could be translated into a further improvement in the growth rate of the economy.

The critical situation of the last two years led the Government to incur additional short-term external debt. This has meant that the peak of the debt service ratio will be reached in the period 1984-85. This ratio will decline in subsequent years, even taking into account additional borrowing to finance the current account deficit and increase somewhat the level of international reserves. This decline in the debt service ratio is expected to provide some room to make payments required to settle outstanding arrears. In this respect, the staff welcomes the authorities' decision to refrain from borrowing on commercial terms, except for some short-term lines of credit from suppliers to meet strictly seasonal needs and for any rescheduling of existing arrears.

Guinea-Bissau continues to maintain restrictions on payments and transfers for current international transactions, including those evidenced by accumulated payment arrears, and continues to operate a bilateral payments agreement with a Fund member. Its present balance of payments difficulties, however, do not permit a significant immediate easing of exchange and trade restrictions, other than the partial settlement of external payments arrears and some relaxation of import controls as reflected by the higher level of imports provided for in the program. In view of the authorities' plan to settle outstanding payment arrears, the staff recommends approval of Guinea-Bissau exchange restrictions evidenced by such arrears until the end of 1984. Regarding the following years, it is the staff's view that substantial steps will have to be taken to reduce reliance on restrictive practices and eliminate payments arrears as soon as ongoing negotiations to that end are concluded and the balance of payments situation improves. The staff takes note of the authorities' wish to negotiate a financial program with the Fund for 1985 and encourages them to make every effort to improve the statistical base required for the formulation and monitoring of economic policies. It is also recommended that the next Article IV consultation with Guinea-Bissau be held on the standard 12-month cycle.

The staff considers that the adjustment program outlined in the attached letter of intent dated July 20, 1984, requesting a first credit tranche purchase equivalent to SDR 1.875 million, represents a reasonable effort in tackling Guinea-Bissau's economic difficulties and merits the financial support of the Fund.

VII. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

(i) 1984 Consultation

1. The Fund takes this decision relating to Guinea-Bissau's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1984 Article XIV consultation with Guinea-Bissau, in light of the Article IV consultation with Guinea-Bissau, conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Guinea-Bissau continues to maintain restrictions on payments and transfers for current international transactions, including external payments arrears, and a bilateral payments agreement with a Fund member, as described in SM/84/. The Fund encourages Guinea-Bissau to eliminate arrears, to reduce its reliance on other exchange restrictions, and to terminate the bilateral payments agreement with a Fund member, as soon as possible. In the meantime, the Fund grants approval until December 31, 1984 for the maintenance of exchange restrictions evidenced by the accumulation of arrears on payments and transfers for current international transactions.

(ii) First Credit Tranche Purchase

1. Guinea-Bissau has requested a purchase equivalent to SDR 1.875 million.

2. The Fund notes the intentions of Guinea-Bissau, as stated in the letter of July 20, 1984 from its Ministers of Economy and Finance and of Commerce and Tourism, and the Minister-Governor of the National Bank of Guinea-Bissau, attached to EBS/84/156, and approves the purchase in accordance with the request.

Table I. Guinea-Bissau: Fund Position During Period of Arrangement,
August-December 1984

	Outstanding at beginning of arrangement, July 31, 1984	1984	
		Aug.- Sept.	Oct.- Dec.
(In millions of SDRs)			
Transactions under tranche policies (net) <u>1/</u>	--	1.875	--
Purchases	--	1.875	--
Repurchases	--	--	--
Transactions under special facilities (net) <u>2/</u>	--	--	-0.231
Purchases	--	--	--
Repurchases	--	--	-0.231
Total Fund credit outstanding (end of period)	1.850	3.725	3.494
Under tranche policies <u>1/</u>	--	1.875	1.875
Under special facilities <u>2/</u>	1.850	1.850	1.619
(As percent of quota) <u>3/</u>			
Total Fund credit outstanding (end of period)	24.7	49.7	46.9
Under tranche policies <u>1/</u>	--	25.0	25.0
Special facilities <u>2/</u>	24.7	24.7	21.6

Source: IMF, Treasurer's Department.

1/ Ordinary resources only.

2/ Compensatory financing facility.

3/ SDR 7.5 million.

Table II. Guinea-Bissau: Selected Economic and Financial Indicators, 1981-84

	1981	1982	1983 Est.	1984 Proj.
(Annual percent changes, unless otherwise specified)				
National income and prices				
GDP at constant prices	18.0	4.2	-5.1	5.9
GDP at current prices	31.7	21.4	17.1	61.9
GDP deflator	11.6	16.5	23.4	52.9
External sector (on the basis of U.S. dollars)				
Exports, f.o.b.	23.0	-15.1	-27.1	140.7
Imports, f.o.b.	-14.8	33.5	-17.7	21.7
Export volume	15.0	-4.2	-34.9	130.2
Import volume	-12.6	41.6	-12.4	21.5
Terms of trade (deterioration -)	-23.6	-6.0	19.2	7.8
Official grants	13.7	118.4	-11.5	3.9
Central government operations				
Total revenue and grants	-31.6	41.1	-1.0	149.1
Budgetary revenue	14.2	--	10.2	109.4
Current expenditure	16.5	20.2	6.6	58.6
Capital expenditure	-20.0	35.1	-5.9	127.1
Money and credit				
Net domestic assets ^{1/}	38.6	61.8	49.0	38.4
Of which: Central Government ^{1/}	(81.6)	(56.2)	(54.7)	(54.5)
State enterprises ^{1/}	(-30.2)	(14.8)	(-0.8)	(-21.6)
Private sector ^{1/}	(-0.6)	(1.0)	(1.0)	(2.7)
Money supply (M ₃)	30.6	25.0	25.4	43.6
(In percent of GDP, unless otherwise specified)				
Central government current account deficit (excl. grants)	12.9	15.1	13.4	9.7
Central government overall deficit	27.3	25.8	22.3	17.3
Bank financing	(17.4)	(12.8)	(13.3)	(10.3)
Foreign financing and other ^{2/}	(9.9)	(13.0)	(9.0)	(7.0)
Balance of payments current account deficit ^{3/}				
Including official transfers	13.3	20.3	16.4	16.8
Excluding official transfers	26.3	46.2	44.4	42.2
Balance of payments overall deficit (-)	-3.6	-11.6	-11.2	0.2
External debt, including arrears ^{4/}	56.0	71.9	90.8	104.2
External payments arrears ^{4/}	3.3	5.5	8.2	8.4
Debt service ratio ^{5/}	8.6	22.5	26.4	51.2

Sources: Data provided by the Guinea-Bissau authorities; and staff estimates and projections.

^{1/} In relation to the initial stock of money supply (M₃).

^{2/} Includes differences between accrual and cash basis and statistical discrepancies.

^{3/} GDP figures in U.S. dollars have been derived by adjusting the 1981 level by the real growth in GDP and by the GDP deflator of Guinea-Bissau suppliers in U.S. dollar terms in the following years (see Appendix Table X).

^{4/} Medium- and long-term debt.

^{5/} In percent of exports of goods, nonfactor services and private transfers. Actual amounts paid reported by the authorities until 1983. For 1984, staff estimates, without including the repayment of existing arrears.

Table III. Guinea-Bissau: Central Government Operations, 1980-84

(In millions of Guinea-Bissau pesos)

	1980	1981	1982	1983 Est.	1984 Target
Total revenue and grants	<u>2,642</u>	<u>1,806</u>	<u>2,549</u>	<u>2,523</u>	<u>6,284</u>
Tax revenue	578	714	787	829	1,467
Income taxes	(118)	(137)	(124)	(137)	(270)
Taxes on international trade <u>1/</u>	(290)	(369)	(477)	(459)	(859)
Consumption tax on domestic goods	(81)	(97)	(84)	(105)	(178)
Other	(89)	(111)	(102)	(128)	(160)
Nontax revenue <u>2/</u>	234	214	141	194	675
External grants <u>3/</u>	1,830	878	1,621	1,500	4,142
Total expenditures	<u>3,827</u>	<u>3,621</u>	<u>4,626</u>	<u>4,623</u>	<u>8,929</u>
Current expenditure	<u>1,532</u>	<u>1,785</u>	<u>2,146</u>	<u>2,289</u>	<u>3,629</u>
Wages and salaries	(904)	(1,059)	(1,188)	(1,268)	(2,000)
Other goods and services	(408)	(439)	(652)	(670)	(1,071)
Transfers	(190)	(242)	(268)	(321)	(320)
Interest on public debt	(30)	(45)	(38)	(29)	(238)
Capital expenditures	2,295	1,836	2,480	2,334	5,300
Overall deficit	<u>1,185</u>	<u>1,815</u>	<u>2,077</u>	<u>2,100</u>	<u>2,645</u>
Central bank financing	689	1,152	1,035	1,260	1,575
Foreign financing	496	663	956	764	1,070
Other <u>4/</u>	--	--	86	76	--
<u>Memorandum items</u>					
Overall deficit before grants	3,015	2,693	3,698	3,600	6,787
Current account deficit	720	857	1,218	1,266	1,487

Sources: Data provided by the Guinea-Bissau authorities; and staff estimates.

1/ Includes consumption tax on imports.2/ Includes unclassified receipts.3/ Mostly proceeds from sale of food aid.4/ Includes discrepancies due to differences between cash and accrual accounts, occurring mostly with respect to expenditures, and errors and omissions.

Table IV. Guinea-Bissau: Summary Accounts of the National
Bank of Guinea-Bissau, 1980-84

	1980	1981	1982	1983 1/ Est.	1984 2/ Target
(Flows within years; in millions of PG)					
Net foreign assets	-304	-113	-679	-544	150
Net domestic assets	533	545	1139	1128	1108
Central Government (net)	689	1152	1035	1259	1575
Rest of general government (net)	--	-480	167	197	-4
State enterprises (net)	18	-426	272	-19	-624
Private sector	47	-8	19	22	79
Medium- and long-term foreign liabilities	-77	-493	-115	66	169
Other accounts (net)	-144	800	-239	-397	-84
Money supply	229	432	460	584	1258
Currency in circulation	188	266	274	421	817
Private sector deposits	41	166	186	163	441
(12-month percentage changes) 3/					
Net foreign assets	-25.7	-8.0	-36.8	-23.6	5.2
Net domestic assets	45.1	38.6	61.8	49.0	38.4
Central Government (net)	58.3	81.6	56.2	54.7	54.5
Rest of general government (net)	--	-34.0	9.1	8.6	-0.1
State enterprises (net)	1.5	-30.2	14.8	-0.8	-21.6
Private sector	4.0	-0.6	1.0	1.0	2.7
Medium- and long-term foreign liabilities	-6.5	-34.9	-6.2	2.9	5.8
Other accounts (net)	-12.2	56.7	-13.0	-11.6	-2.9
Money supply	19.4	30.6	25.0	25.4	43.6
Currency in circulation	15.9	18.8	14.9	18.3	28.3
Private sector deposits	3.5	11.8	10.1	7.1	15.3

Sources: National Bank of Guinea-Bissau; and staff estimates.

1/ Accounts denominated in foreign exchange valued at PG 40.07 per U.S. dollar.

2/ Accounts denominated in foreign exchange valued at PG 100 per U.S. dollar.

3/ In relation to the initial stock of money supply.

Table V. Guinea-Bissau: Summary Balance of Payments, 1980-84

(In millions of U.S. dollars)

	1980	1981	1982	1983 Est.	1984 Target
A. Current account	-26.4	-23.1	-35.2	-25.1	-27.5
Trade balance	-49.8	-38.1	-57.6	-48.5	-48.8
Exports, f.o.b.	11.3	13.9	11.8	8.6	20.7
Imports, f.o.b.	-61.1	-52.0	-69.4	-57.1	-69.5
Services (net)	-15.8	-4.5	-11.6	-8.7	-8.9
Transfers (net)	39.2	19.5	34.0	32.1	30.2
B. Capital account	20.1	24.2	24.1	15.2	27.8
Medium- and long-term	20.1	24.2	24.1	15.2	27.8
C. SDR allocation	0.5	0.5	--	--	--
D. Errors and omissions	-3.0	-8.0	-8.9	-7.3	--
E. Overall balance (A+B+C+D)	-8.8	-6.4	-20.0	-17.2	0.3
F. Net foreign assets (increase -)	8.1	2.2	15.8	13.0	-1.5
Use of Fund credit	-0.7	2.8	-0.3	-0.4	1.3
Changes in other net foreign assets	8.8	-0.6	16.1	13.4	-2.8
G. Payments arrears (decrease -)	0.7	4.2	4.2	4.2	1.2 ^{1/}
Medium- and long-term	0.7	4.2	4.0	3.6	1.2
Short-term	--	--	0.2	0.6	--
<u>Memorandum item:</u>					
Current account excluding official transfers	-78.4	-46.2	-79.9	-68.1	-68.9

Sources: National Bank of Guinea-Bissau; and staff estimates.

^{1/} Incurred before June 30, 1984.

Table VI. Guinea-Bissau: External Public Debt, 1980-84

(End of period; in millions of U.S. dollars)

	1980	1981	1982	1983	<u>1984</u> Proj.
Total disbursed debt outstanding	64.6	96.3	134.7	163.1	193.0
Medium- and long-term <u>1/</u>	62.2	89.7	119.1	133.9	161.7
Of which:					
Arrears	(1.0)	(4.7)	(7.7)	(10.3)	(10.6) <u>2/</u>
Short-term <u>3/</u>	--	1.6	10.2	23.2	23.2
IMF	1.4	3.9	3.4	2.7	4.0
Arrears on interest	1.0	1.1	2.0	3.3	4.1
Medium- and long-term	(1.0)	(1.1)	(1.8)	(2.5)	(3.3) <u>2/</u>
Short-term	(--)	(--)	(0.2)	(0.8)	(0.8)

Sources: Ministry of Economy and Finance; National Bank of Guinea-Bissau; and staff estimates.

1/ Includes a loan from the Islamic Development Bank, which was US\$1.2 million, US\$11 million, and US\$15 million outstanding in 1980, 1981, and 1982, respectively.

2/ Stock of arrears as of end of March 1984.

3/ Based upon incomplete information as of end of May 1984 and corresponds to lines of credit to the NBCB.

Table VII. Guinea Bissau: Volume and Price Indicators
for Main Export Crops, 1980-84

(Volume and purchases in thousands of tons;
prices in Guinea-Bissau pesos and U.S. dollars per ton)

	1980	1981	1982	1983	1984
Groundnuts					
Output volume	20.0	30.0	35.0	22.0	30.0
Purchases by state enterprises	17.6	6.5	18.4	17.4	19.0
Export volume	6.8	3.7	8.0	8.3	10.0
Export price (in U.S. dollars)	397	595	400	410	540
Farmgate price (in PG)	7,500	7,500	9,000	9,000	15,500
Farmgate price (in U.S. dollars)	228	198	222	215	155
Palm kernels					
Purchases by state enterprises	8.8	8.7	9.5	6.2	11.0
Export volume	6.0	9.0	7.2	5.3	10.6
Export price (in U.S. dollars)	317	267	222	245	390
Farmgate price (in PG)	5,500	5,500	6,000	6,000	11,500
Farmgate price (in U.S. dollars)	163	146	148	144	115
Cashew nuts					
Purchase by state enterprises	1.0	2.5	3.4	4.7	7.0
Export volume	0.9	2.3	1.5	2.0	9.0
Export price (in U.S. dollars)	444	652	733	600	600
Farmgate price (in P.G.)	6,900	8,600	9,500	9,500	17,500
Farmgate price (in U.S. dollars)	204	228	235	227	175

Sources: Data provided by the Guinea-Bissau authorities; and staff estimates.

Table VIII. Guinea-Bissau: Balance of Payments Outlook, 1984-88

	Target	Projections			
	1984	1985	1986	1987	1988
(In millions of U.S. dollars)					
A. Current account	-27.5	-29.1	-29.3	-30.4	-29.8
Trade balance ^{1/}	-54.8	-55.1	-54.8	-54.4	-53.8
Exports, f.o.b.	20.7	24.2	28.4	33.0	38.0
Imports, c.i.f.	-75.5	-79.3	-83.2	-87.4	-91.8
Services (net)	-2.9	-4.0	-4.0	-4.0	-4.0
Of which: interest					
on public debt	-4.0	-6.3	-5.5	-6.1	-6.3
Transfers (net) ^{2/}	30.2	30.0	29.5	28.0	28.0
B. Capital account (net)	27.8	31.1	31.3	32.4	31.8
Medium- and long-term ^{3/}					
capital (net)	27.8	31.1	31.3	32.4	31.8
C. Errors and omissions	--	--	--	--	--
D. Overall balance (A+B+C)	0.3	2.0	2.0	2.0	2.0
E. Reserves (increase -)	-1.5	-2.0	-2.0	-2.0	-2.0
Of which: IMF	(1.3)	(-1.0)	(-0.7)	(-0.5)	(-1.0)
F. Payments arrears	1.2	--	--	--	--
(decrease -)					
(In percent of GDP)					
Current account	-16.9	-17.0	-16.3	-16.1	-15.1
Goods and services	-35.4	-34.5	-32.7	-30.9	-29.2
Transfers (net)	18.5	17.5	16.4	14.8	14.1
Capital account ^{3/}	17.1	18.2	17.4	17.1	16.1
Overall balance	0.2	1.2	1.1	1.0	1.0
Memorandum item:					
(In millions of U.S. dollars)					
Current account (excluding official transfers)	-68.9	-70.0	-69.7	-69.3	-68.7

Sources: Data provided by the Guinea-Bissau authorities; and staff estimates and projections.

^{1/} Projections of export prices are based upon IBRD commodity price forecast and Fund staff estimates. Assumes that the terms of trade will increase by 7.8 percent in 1984, decline by 7.5 percent in 1985, before increasing at an average rate of 5 percent a year through 1988. Imports c.i.f. are projected to grow at the same rate as real GDP (about 5 percent per year) due to a gradual liberalization of the import system and an increase in foreign exchange availability. After growing sharply in 1984, the volume of traditional exports is expected to increase at an average annual rate of 8 percent, reflecting the impact of the maintenance of producer price incentives. As a result, the current account deficit (excluding official transfers) as a percent to GDP is expected to improve by almost 8 percentage points between 1984 and 1988:

	1984	1985	1986	1987	1988
Current account deficit (excluding official transfers)	42.3	40.9	38.8	36.7	34.8

^{2/} Net transfers are projected to decline progressively and to finance about 53 percent of the trade balance--the average over the period 1985-88--as opposed to 62 percent in the period 1982-84.

^{3/} Assumes net medium- and long-term capital inflows (mainly project loans) to increase from 17.0 percent of GDP in 1984 to 18.2 percent in 1985, on the basis of commitments obtained during the donors' conference held in Lisbon in May 1984. It is implicitly assumed that all new commitments are of a concessionary nature and carry a grace period of 5 years and an interest rate of 0.7 percent; (the effective interest rate due on Guinea-Bissau's total debt averaged 1.8 percent a year over the period 1980-84).

Table IX. Guinea-Bissau: External Public Debt Projection, 1984-88

	1984	1985	1986	1987	1988
(In millions of U.S. dollars)					
I. Total outstanding debt (end of period) <u>1/</u>	<u>188.9</u>	<u>219.0</u>	<u>249.6</u>	<u>281.7</u>	<u>313.2</u>
Medium- and long-term	<u>165.7</u>	<u>195.8</u>	<u>226.4</u>	<u>258.5</u>	<u>290.0</u>
Existing disbursements	<u>161.7</u>	<u>148.7</u>	<u>139.9</u>	<u>130.3</u>	<u>120.5</u>
New disbursements <u>2/</u>	--	44.1	84.2	126.2	167.8
IMF	4.0	3.0	2.3	2.0	1.7
Short-term <u>3/</u>	<u>23.2</u>	<u>23.2</u>	<u>23.2</u>	<u>23.2</u>	<u>23.2</u>
II. Debt service <u>4/</u>	<u>12.7</u>	<u>20.3</u>	<u>15.0</u>	<u>15.0</u>	<u>16.4</u>
Amortization	<u>8.7</u>	<u>14.0</u>	<u>9.5</u>	<u>9.9</u>	<u>10.1</u>
On existing disbursements	<u>8.0</u>	<u>13.0</u> <u>5/</u>	<u>8.8</u>	<u>9.6</u>	<u>9.8</u>
On new disbursements <u>2/</u>	--	--	--	--	--
IMF	0.7	1.0	0.7	0.3	0.3
Interest	<u>4.0</u>	<u>6.3</u>	<u>5.5</u>	<u>6.1</u>	<u>6.3</u>
Medium- and long-term debt	<u>2.8</u>	<u>4.9</u>	<u>4.1</u>	<u>4.7</u>	<u>4.9</u>
On existing disbursements	(2.6)	(4.5) <u>5/</u>	(3.5)	(3.9)	(3.8)
On new disbursements <u>2/</u>	(--)	(0.2)	(0.4)	(0.7)	(1.0)
IMF	(0.2)	(0.2)	(0.2)	(0.1)	(0.1)
Short-term debt <u>3/</u>	<u>1.2</u>	<u>1.4</u>	<u>1.4</u>	<u>1.4</u>	<u>1.4</u>
(In percent of exports of goods, nonfactor services, and private transfers)					
Debt service					
Including the Fund	51.2	72.0 <u>5/</u>	46.3	43.2	39.0
Excluding the Fund	47.6	67.7 <u>5/</u>	43.5	42.2	38.1
<u>Memorandum item:</u>					
(In millions of U.S. dollar)					
Exports of goods, nonfactor services, and private transfers	24.8	28.2	32.4	37.0	42.0

Sources: Data provided by the Guinea-Bissau authorities; and staff estimates.

1/ Does not include arrears on interest.

2/ From 1985 onward, drawings from new commitments are shown on a cumulative basis. It is assumed that all new commitments are of a concessionary nature and carry a grace period of 5 years and an annual interest rate of 0.7 percent. These terms are similar to average existing terms on multilateral and bilateral assistance.

3/ Refers mainly to lines of credit of the NBGB with Portuguese banks. Projections based upon incomplete and tentative information as of March 1984.

4/ Does not include the settlement of existing arrears.

5/ Includes repayment of a US\$5.0 million line of credit from Portugal.

Table X. Guinea-Bissau: Basic Data

Area, population, and GDP per capita

Area	36,125 square kilometers
Population: Total (1983 est.)	825,000
Growth rate (1983)	2.2 percent
GDP per capita (1983)	SDR 175

<u>National income and prices</u>	<u>1981</u>	<u>1982</u>	<u>1983</u> est.	<u>1984</u> proj.
Nominal GDP (in millions of PG)	6,638	8,061	9,439	15,280
GDP (in millions of U.S. dollars) ^{1/}	176	173	154	163
Real GDP (in millions of PG, at 1981 prices)	6,638	7,355	6,893	7,406
Agriculture (percent of total)	51.5	52.2	53.0	53.0
Manufacturing (percent of total)	5.8	5.5	5.8	6.0
Government (percent of total)	16.0	16.4	17.8	17.5
Growth rate of real GDP (percent)	18.0	4.2	-5.1	5.9
Consumption (percent of nominal GDP)	99	105	101	105
Investment (percent of nominal GDP)	26	28	24	31
GDP deflator (percent change)	11.6	16.5	23.5	52.9

Central government operations

(In millions of Guinea-Bissau pesos)

Budgetary revenue	928	928	1,023	2,142
External grants	878	1,621	1,500	4,142
Current expenditure	1,785	2,146	2,289	3,629
Capital expenditure	1,836	2,480	2,334	5,300
Overall deficit	1,815	2,077	2,100	2,645
National Bank financing	1,152	1,035	1,260	1,575
Foreign financing and other	663	1,042	840	1,070
Overall deficit before grants	2,693	3,698	3,600	6,787
Current account deficit	857	1,218	1,266	1,487

Money and credit (NBGB) ^{2/}

Net domestic assets	2,322	3,461	6,458	8,243
Of which: Central Government (net)	3,848	4,883	6,142	7,717
Rest of general gov't (net)	-480	-313	-116	-120
State enterprises (net)	-146	126	107	-520
Private sector	130	149	171	250
Money supply	1,843	2,303	2,887	4,145

Table X. Guinea-Bissau: Basic Data (concluded)

<u>Balance of payments</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
	(In millions of U.S. dollars)			
Exports, f.o.b.	13.9	11.8	8.6	20.7
Imports, f.o.b.	52.0	69.4	57.1	69.5
Net services	-4.5	-11.6	-8.7	-8.9
Net transfers	19.5	34.0	32.1	30.2
Current account	-23.1	-35.2	-25.1	-27.5
Medium- and long-term capital	24.2	24.1	15.2	27.8
Overall surplus or deficit (-)	-6.4	-20.0	-17.2	0.3
<u>International reserves position of the</u>				
<u>NBGB (end of period) 2/</u>				
Gross foreign reserves	15.1	8.4	7.6	9.1
Net foreign reserves	-12.7	-28.9	-42.5	-41.0
Gross foreign reserves (in weeks of c.i.f. imports)	14	6	6	6
<u>External public debt (end of period)</u>				
Medium- and long-term (disbursed)	93.5	119.1	133.9	161.7
IMF	3.9	3.4	2.7	4.0
Short-term 3/	1.6	10.2	23.2	23.2
Interest in arrears	1.1	2.0	3.3	4.1

1/ GDP figures in U.S. dollars have been derived by adjusting the 1981 level by the real growth in GDP, and by the GDP deflator of Guinea-Bissau suppliers in U.S. dollar terms in the following years.

2/ Accounts denominated in foreign exchange valued at PG 37.8, at PG 40.07, at PG 84.06, and at PG 100 per U.S. dollar in 1981, 1982, 1983, and 1984, respectively.

3/ On the basis of incomplete and tentative information as of March 1984.

GUINEA-BISSAU--Relations with the Fund
(As of June 30, 1984)

I. Membership Status

Date of membership	March 1977
Status	Article XIV

A. Financial Relations

II. General Department

Quota	SDR 7.5 million
Total Fund holdings of Guinea-Bissau pesos	SDR 9.35 million (124.7 percent of quota), of which SDR 1.85 million (24.7 percent of quota) are from purchases under the CFF
Reserve tranche position	SDR 417 (0.01 percent of quota)

III. SDR Department

Net cumulative allocation	SDR 1.21 million
Holdings	None

IV. Administered Accounts

Guinea-Bissau was not eligible for Trust Fund drawings (or distribution of gold or profits from gold sales), since it joined the Fund after August 1975.

V. Overdue Obligations to the Fund

Although there are no overdue obligations at the present time, over the past two years Guinea-Bissau has been late on several occasions in discharging its obligations to the Fund.

B. Nonfinancial Relations

VI. Exchange System

On December 23, 1983 the Guinea-Bissau peso was depreciated from PG 44 = SDR 1 to PG 88 = SDR 1. This adjustment has been followed by weekly depreciations of about 1 percent, and by the end of June the rate was PG 109 = SDR 1. The intervention currency is the U.S. dollar. As of June 30, 1984, the buying and selling rates for the Guinea-Bissau peso were PG 104.7 = US\$1 and PG 105.4 = US\$1, respectively.

VII. Latest Article IV Consultation

Discussions were held in March 1983; the consultation was completed by the Executive Board on June 8, 1983 (SM/83/81, 5/13/83; and Correction 1, 6/6/83 and SM/83/95, 5/23/83).

The Executive Board adopted the following decision:

1. The Fund takes this decision relating to Guinea-Bissau's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Guinea-Bissau, in the light of the Article IV consultation with Guinea-Bissau conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Guinea-Bissau continues to maintain restrictions on payments and transfers for current international transactions, including external payments arrears and a bilateral payments agreement with a Fund member, as described in SM/83/95. Guinea-Bissau's external payments arrears have increased since the last Article IV consultation. The Fund encourages Guinea-Bissau to eliminate arrears for current international transactions as soon as possible. The Fund also encourages Guinea-Bissau to reduce its reliance on other exchange restrictions and, in particular, to terminate the bilateral payments arrangement with a Fund member as soon as possible.

VIII. Technical Assistance

There are currently three Fund experts giving technical assistance in Guinea-Bissau. A CBD expert (Mr. Brcich) is serving as Advisor to the Governor of the National Bank. A fiscal panel expert (Mrs. Wood-Sanchez) is serving as Advisor to the Ministry of Economy and Finance on government budgeting and financial management. Another fiscal panel expert (Mr. Gouveia) is advising on the implementation of tax reform proposals made by a FAD technical assistance mission in 1979. A staff member from the Bureau of Statistics visited Bissau in April 1984 to familiarize officials of the National Bank with an analytical framework for financial statistics and to discuss the inclusion of the country's page in the IFS. In addition, an advisor on accounting procedures has been requested by the National Bank, and CBD is trying to find a suitable candidate.

GUINEA-BISSAU--World Bank Group Lending Operations

(In millions of U.S. dollars)

A. IDA Operations (as of March 31, 1984)

<u>Project</u>	<u>Total (including undisbursed)</u>	<u>Disbursed</u>
Roads I	9.0	8.8
Petroleum I	6.8	5.4
Petroleum II	13.1	10.2
Bissau Port	16.0	--
Roads II	8.0	--
Total	<u>52.9</u>	<u>24.4</u>
Repaid		--
Outstanding		24.4

B. IDA Loan Disbursements

1979	.1
1980	1.8
1981	7.8 <u>1/</u>
1982	3.0
1983	10.7
1984 (projected)	13.2 <u>2/</u>
1985 (projected)	16.3 <u>3/</u>

Source: IBRD.

1/ Includes US\$3 million disbursed between 1979 and 1981 for which exact disbursement dates are unavailable.

2/ Includes US\$6 million in disbursements from an emergency import credit for US\$8 million expected to be approved on or about the end of the third quarter of 1984.

3/ Includes disbursements under further nonproject assistance.

NATIONAL BANK OF GUINEA-BISSAU
The Governor

Bissau, Guinea-Bissau
July 20, 1984

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosière:

1. During the last decade, Guinea-Bissau has been experiencing increasing difficulties, particularly as regards its balance of payments, following a long armed struggle for national liberation which destroyed or damaged a substantial part of an already fragile infrastructure. The newness and limited administrative capacity of the country's institutions hampered the effective utilization of foreign aid inflows and prevented achievement of the expected economic growth. Inappropriate pricing policies intended to protect the living conditions of the urban population led instead to supply shortages, increased reliance on foreign aid to finance imports of basic necessities, and a growing proportion of output being diverted to parallel markets. Existing imbalances were exacerbated in recent years by recurrent droughts and the adverse evolution of the terms of trade, which helped to intensify the difficulties facing our country. Despite the deteriorating economic situation, the required domestic adjustments were not made and by mid-1983 the country was facing the virtual exhaustion of the National Bank's disposable foreign reserves, a rapid accumulation of external payment arrears, and the consequent reduction of essential imports, which seriously affected output in major sectors of the economy.
2. In view of these developments, the Government has embarked upon an important and far-reaching program of economic reform. The basic objectives of this program are: (1) to revive agricultural production and restore the viability of enterprises, which are presently operating well below their actual output capacity; (2) to increase employment opportunities; (3) to stimulate savings and investment; and (4) to reduce the pressure on the balance of payments. This program, which we prepared and analyzed in depth, requires a major restructuring of relative prices and a correction of the budgetary and financial imbalance. It is obvious that it will take several years to overcome the present situation. Therefore, our approach has been directed toward implementing a short-term adjustment program within the framework of a medium-term development plan. We are aware that our adjustment program implies considerable hardship for the vast majority of our population; if the program is to be successful, however, it will also be essential to have additional support from the governments and multilateral organizations that have helped us in recent years. Many of the more important measures of the adjustment program have already

been implemented. These measures, together with other elements of the program, are described in sections 3 to 7 below. Under these circumstances, the Government of Guinea-Bissau wishes to purchase an amount equivalent to SDR 1.875 million, in support of a one-year financial program ending December 1984. The Government would also like to indicate, at this time, its intention to request in future years continued financial support from the Fund for its medium-term reform and Economic Stabilization Program.

3. Prices and Marketing System

3.1 As noted above, we recognize that at the root of the economic crisis that we are trying to overcome there were fundamental price distortions and a lack of essential goods to encourage production and exports. To address this problem, since the beginning of 1984 we have raised producer prices for our main crops as follows: rice, 76 percent; groundnuts, 90 percent; palm kernels, 114 percent; and cashew nuts, 76 percent. In so doing, we had in mind the need to: (a) redirect output from the parallel market to official channels; (b) provide production incentives; (c) reallocate resources toward those products in which the country has a comparative advantage; and (d) allow state enterprises to generate an overall export surplus, most of which will be transferred to the Treasury.

3.2 As to consumer prices, it should be noted that we were able to limit the increase in the price of rice, the most important staple, to 67 percent through a reduction in the commercialization margins of the state enterprises and by a slower growth in the labor costs involved in processing. Even so, in the case of rice imported on a commercial basis, the new consumer price does not require any subsidy, because the previous domestic price was 80 percent higher than the c.i.f. cost of imported rice. The retail prices of other essential products, such as vegetable oil, sugar, flour, soap and fish, were also increased and now reflect the effects of the exchange devaluation and wage increase. Since May 1984 the prices of oil derivatives have been increased by 100 percent, except for aviation fuel, which increased by 189 percent, and gas-oil used to produce electricity, which increased by only 29 percent. Losses incurred in the sale of gas-oil for electricity production will be offset by the larger-than-necessary increases in other oil products.

3.3 A key factor for the success of the adjustment in producer prices is the need to improve the functioning of the marketing system. For many years, the distribution network in the country has been under the control of two state enterprises with largely overlapping functions. This policy was not always successful in its objectives of channeling agricultural output to urban centers and ensuring timely delivery of basic commodities to the rural population; shortages occurred with increasing frequency and parallel markets developed. To correct this situation we have started a process of reorganization of the marketing structure, calling for increased private sector participation in trading and transport activities. As part of this liberalization

process, retail traders will receive imported products in proportion to their deliveries of traditional exportable agricultural products to the state enterprises, and the price controls (preços máximos ou tabelados, preços homologados and margens de comercialização) that used to apply to some 400 products have been restricted to the principal basic commodities. In addition, we have started transferring to the private sector retail outlets presently owned by state enterprises, and we expect that by the end of 1984 at least 30 of a total of 270 retail outlets will be in the hands of private traders or will have been closed.

4. Exchange Rate and External Trade

4.1 The higher levels of producer prices mentioned above were made possible by the recent exchange rate action implemented by the Government. Effective December 23, 1983 the Guinea-Bissau peso was devalued from PG 44 = SDR 1 to PG 88 = SDR 1. This action has been followed by cumulative weekly devaluations of 1 percent, and by the end of May the Guinea-Bissau peso had depreciated by an additional 22 percent in domestic currency terms, to PG 107.7 = SDR 1.

4.2 We are aware of the existence of a still substantial spread between the parallel market and the official exchange rate, and of the negative effects that this spread has on resource allocation, Treasury revenues, the balance of payments, and the standard of living of the urban lower-income groups. But in Guinea-Bissau's present circumstances, the restrictions that give rise to such problems can only be phased out gradually, as the basic distortions that led to their imposition are corrected.

4.3 As part of our Economic Stabilization Program, we have taken steps to promote increased private sector participation in external trade. Private traders undertaking exports of nontraditional products have been authorized to use 70 percent of their foreign exchange receipts to pay for their merchandise imports. The marketing margins currently applicable to imported products will also be revised with a view to encouraging private sector participation in these activities. Furthermore, during the period of the program, the Government of Guinea-Bissau does not intend to impose new or intensify existing restrictions on payments and transfers for current international transactions.

5. Fiscal Policies

5.1 Another element that has contributed significantly to the present difficulties is the budgetary deficit and its associated bank financing. In recent years, central government operations resulted in overall deficits (after grants) equivalent to approximately 45 percent of total outlays, and budgetary revenue (before grants) covered less than

45 percent of current expenditure. Fiscal policy for 1984 has been formulated so as to reduce the overall deficit (after grants) to 30 percent of total outlays. On the revenue side, the 1984 budget already calls for the following measures intended to increase revenue: (a) income tax reform; (b) increase in the stamp tax and charges collected by customs; (c) increase in the consumption tax specific rate on domestic sugarcane rum and review of the tax base; (d) conversion of consumption tax specific rates to ad valorem rates, and increase in the rates on beverages, tobacco and gasoline; (e) strengthening of revenue administration, including increased efforts to collect arrears; and (f) an increase in transfers from public enterprises to the Treasury. In addition, starting in May, the enterprises engaged in exporting agricultural products will transfer to the Treasury the larger part of the gross profits derived from higher export receipts resulting from the devaluation and improved world market prices. The amount to be transferred will be determined on a presumptive basis and will be collected immediately after receipt of the export proceeds. We expect that these measures, together with the effects of the exchange rate adjustment, will increase budgetary revenue by about 110 percent. Future efforts in the area of tax policy will be directed toward broadening the tax base, increasing the progressiveness and generality of the tax system, and improving procedures used in tax assessment, auditing and collection.

5.2 Considering that in the short run the fiscal situation cannot be much improved through additional revenue measures, the Government will continue to observe austerity in its spending. As a result of the *impact of the other adopted measures on consumer prices*, the 49 percent average gross adjustment in civil servants' wages granted at the beginning of the year represents a substantial cut in their real salaries. In addition, although dismissals from government employment cannot be envisaged in current circumstances, measures have been adopted to fill civil service vacancies only partially and to prevent the creation of new posts except for technical and managerial positions. Observance of these instructions, together with the limiting of further salary increases, will restrict the expansion of the wage bill to not more than 58 percent during 1984. The increase in other current outlays will be limited to 56 percent provided that interest payments on the foreign public debt reach PG 238 million.

5.3 To exercise better control over the growth of overall expenditures, the Investment and Development Budget has been incorporated in the General State Budget and all expenses will come under the control of the Ministry of Finance. Following a real decline of 4 percent in 1983, capital expenditures are projected to increase slightly in 1984 to a level which will still be below the 1982 outlays. We consider that a further slowdown of investment spending may compromise our development objectives in the medium and long term. We also recognize that the level of investment expenditure, though limited to available foreign financing, should increase in coming years. At the same time, in 1984 we will continue to give priority to the maintenance and completion of ongoing projects.

5.4 It is also the Government's intention to strengthen the financial position of state enterprises through realistic pricing policies as well as improved management practices. To achieve these results, in addition to the measures described above with respect to the marketing system, the following action has been undertaken: (a) the prices of oil derivatives and of other commodities with price controls have been adjusted to reflect the exchange rate depreciation, the salary increases, and prevailing prices in neighboring countries, and we have instructed public enterprises in the import trade to adjust the domestic prices of imported goods on the same basis; and (b) we have also instructed all state enterprises to implement basic accounting procedures so as to provide timely quarterly information to their oversight ministry, the Ministry of Finance, the Ministry of Economic Coordination, Planning, and International Cooperation, and the National Bank of Guinea-Bissau. Credit will not be obtained from the latter unless accounting records are submitted to it. Management indicators applicable to each sector must be furnished starting in November 1984 (for the third quarter) and should include the following, as applicable: volume and value of purchases, sales and inventories, and exports, by major product; capacity utilization, personnel expenses, and number of employees; payments and receipts; and other data as specified by the oversight ministries.

5.5 Accounting deficiencies have so far prevented proper assessment of the financial relationship between the Central Government and the public enterprises. For this reason, we are conducting surveys, to be concluded by the end of this year, to determine the reciprocal debts between the Central Government and public enterprises. On the basis of these surveys, we will establish a schedule for the settlement of outstanding balances.

5.6 To enforce budgetary discipline, facilitate the settlement of the external debt, and monitor the level of arrears, we have opened an account at the National Bank where public sector institutions will deposit the domestic currency equivalent of foreign debt service at the time that payments are due. Moreover, the Government intends to remain current in its obligations and not incur arrears.

6. Monetary and Interest Rate Policies

6.1 Monetary developments in Guinea-Bissau have always been closely related to the financial needs of the public sector. The resources of the National Bank have been used almost exclusively to cover budgetary deficits, with the private sector receiving only 5 percent of all domestic credit. The projected improvement in public sector finances is expected to allow for a more adequate supply of credit to support the reactivation of private sector production and investment. The credit program for 1984 calls for an expansion of total liquidity by about 44 percent, although GDP in current prices is projected to rise by some 62 percent. Given that it is essential to raise the level of

net international reserves of the National Bank, we have established the target of increasing them by US\$1.5 million. Accordingly, and considering the projected credit needs of the public and private sectors, the growth of net domestic assets of the National Bank (defined as the difference between net international reserves and the money supply) will be limited to PG 1,110 million. To reach this objective, the increase in net credit to the Central Government (comprising advances to the Treasury, revenues, discounts, project accounts, National Investment Fund, and Marketing Fund) will be limited to PG 1,575 million. This limit was set on the assumption of foreign debt service payments of PG 868 million by the Central Government and will be adjusted to reflect the amounts actually paid or deposited in the account opened for the purpose at the National Bank. In addition, the net position of state enterprises with the National Bank will be reduced by at least PG 600 million, through an expected equivalent increase in deposits by the fuel distribution company as a result of exceptional import financing.

6.2 For the first time, as of June 1984, the National Bank started to pay interest on savings and time deposits. The annual rates range from 4.5 percent for savings deposits with 15 days' notice to 16 percent for certain time deposits with maturities of one year. At the same time, lending rates were increased from 6.5-8 percent to 12.5-25 percent. In determining these rates, the Government had to balance the need to provide adequate incentives for the growth of financial savings and the need to avoid hampering productive activity.

6.3 Starting in July 1984, the National Bank of Guinea-Bissau will report monthly to the IMF on the principal monetary variables, to allow monitoring of the Monetary Program.

7. Balance of Payments and Debt Management Policies

7.1 The Guinea-Bissau economy has been suffering from shortages of a wide range of imported goods. The adjustment effort we are now embarking upon has been designed to achieve an immediate and adequate expansion of urgently required imports to stimulate domestic production and exports. Furthermore, to be able to sustain a reasonable rate of economic growth, exports will have to grow very rapidly on a continuing basis. The Government believes that the pursuit of flexible exchange rate and producer pricing policies, together with domestic demand restraint, will help achieve a more comfortable balance of payments position in the medium term. Within this framework, we estimate that the recently adopted measures will result in an expansion of about 140 percent in the U.S. dollar value of recorded exports in 1984, accompanied by a growth of 22 percent in the value of imports. However, given the initial disparity between export and import levels, these projected growth rates will result in an increase of about US\$2 million in the current account deficit. The financing

expected to be available in 1984 will cover this deficit and permit net reserves to increase to a level equivalent to one week of imports. This moderate increase in net reserves will provide a minimum element of flexibility, considering that the economy is in a process of reform and that uncertainties regarding the prospects of world prices for our main exports continue to loom large.

7.2 While we continue to require substantial aid and other financing from abroad, we are fully cognizant of the need to persevere with prudent policies regarding the terms of foreign borrowing and the management of the external debt. Accordingly, we will basically seek long-term foreign financing from governments and multilateral agencies. As a consequence, during the period of the program, the public sector will not incur or guarantee debts on commercial terms, except for some short-term lines of credit from suppliers to meet strictly seasonal needs and for any rescheduling of existing arrears.

7.3 It is also our intention to establish a schedule for the orderly elimination of all payment arrears. In this connection, we will strive to conclude by the end of 1984 the ongoing negotiations with our creditors to reschedule outstanding arrears. In addition, we are preparing a proposal to be presented to our creditors with the objective of reaching an agreement on a debt restructuring program that would substantially improve the maturity schedule of the external debt.

8. The Government of the Republic of Guinea-Bissau believes that the policies described in this letter are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. The Government will consult with the Fund on any policy adaptation that may be appropriate in the attainment of its objectives in accordance with the Fund's policies on such consultations.

Sincerely yours,

/s/

VICTOR FREIRE MONTEIRO
Minister of Finance

/s/

PEDRO A. GODINHO GOMES
Minister-Governor
National Bank of Guinea-Bissau

/s/

MARIO CABRAL
Minister of Commerce and Tourism