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October 15, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Guinea - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Guinea. A draft decision appears on page 20.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. McLoughlin, ext. (5)8652.

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INTERNATIONAL MONETARY FUND

GUINEA

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the
1984 Consultation with Guinea

Approved by J.B. Zulu and Eduard H. Brau

October 12, 1984

I. Introduction

The 1984 Article IV consultation discussions with Guinea were completed in Conakry during the period August 19-29, 1984.1/ The Guinean representatives included Mr. Kémoko Keita, Minister of Finance; Captain Kabiné Kaba, Minister-Governor of the Central Bank; Mr. Saidou Diallo, Vice-Governor of the Central Bank; and other ministers and senior officials concerned with economic and financial matters. The staff representatives consisted of Mr. McLoughlin (head-AFR), Mr. Clément (ETR), Mr. Kronenberg (AFR), Mr. van der Mensbrugghe (AFR), and Mrs. Ruch (secretary-ADM). Mr. Camara, technical assistant to the Executive Director for Guinea, attended the principal policy meetings. Guinea continues to avail itself of the transitional arrangements of Article XIV. Guinea's relations with the Fund and the World Bank Group are summarized in Appendices I and II, respectively.

II. Background

Following the change in Government which took place in early April 1984, the new authorities proclaimed the Second Republic and declared their intention to reverse the policy direction pursued by the former régime.

In the quarter century prior to the proclamation of the Second Republic, Guinea had been a centrally planned economy. However, as the centralized decision-making process failed to adapt to changing external

1/ A staff team visited Conakry during the period February 27-March 10, 1984 to hold the 1984 Article IV consultation discussions. On April 3, after the death of President Ahmed Sékou Touré, a military coup took place, and a new government came to power. In the circumstances, it was agreed that a further mission would be necessary to ascertain the policies of the present authorities.

and internal circumstances, growing distortions arose, giving rise to serious inefficiencies and fostering the growth of a thriving parallel economy.

Principal among the distortions which existed was a grossly overvalued official exchange rate for the syli, the currency of Guinea.1/ As the entire structure of domestic prices in the official sector was linked to this exchange rate, official prices played an insignificant role in allocating resources. Agricultural policy emphasized the creation of various types of collective farms, most recently the Fermes Agro-pastorales d'Arrondissement (FAPAs). Although the collective farms were the principal beneficiaries over the years of imported agricultural inputs and capital equipment, they were generally characterized by extremely low productivity. Private farming, on the other hand, faced severe financial disincentives imposed by production norms and official prices which were maintained at very low levels. As a result, Guinea, which had once been a major net exporter of agricultural products, has become a large net importer. Agricultural production was further discouraged by restrictions on the free movement of goods and individuals among regions within the country.

Manufacturing and commercial activities were carried out by a large number of public enterprises under the control of various sectoral holding companies and ministries which often had overlapping and ill-defined supervisory responsibilities. Operations of the public enterprises were chronically inefficient, with most units operating at around 30 percent of capacity in recent years. However, as they had access to massive disguised subsidies by importing intermediate inputs at an unrealistic exchange rate, as well as to virtually unrestricted bank credit, these enterprises were able in most years to effect net transfers to the Government.

Owing to the overvaluation of the syli, external transactions had to be closely controlled, and the exchange and trade system was highly restrictive. Most imports and exports were controlled by IMPORTEX, the state trading enterprise. In the public sector, an annual import program was prepared by each public enterprise and, following a complex review process, was submitted to the National License Committee. Imports of the mixed enterprises, imports related to the execution of the plan, and imports by private traders not involving the purchase of foreign exchange through the official market were effected outside the import program. All payments for invisibles through the official foreign exchange market

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1/ The Guinean syli has been pegged to the SDR at the rate of GS 24.6853 = SDR 1 since June 11, 1975. At the time of the change in Government in April 1984, the syli was reportedly being traded on the parallel market in the range of GS 250-300 = US$1. Although its value on the parallel market has fluctuated considerably in recent months, it was reported to be traded in late August at around GS 250 = US$1.

required authorization. IMPORTEX also established an annual export program for all public sector exports; these exports required individual licenses. All capital transfers through the official market required approval, and outward capital transfers by Guinean nationals through the official market were prohibited. Exchange transactions which were effected through the parallel market were illegal.

These circumstances, particularly the growing parallel market activities, made it very difficult to assess economic and financial developments in quantitative terms. Analysis of the situation was further complicated by the reluctance of the previous government to supply external agencies, including international organizations, with disaggregated raw data, and, as a result, serious inconsistencies existed among the fiscal, monetary, and balance of payments data. The new authorities recognize the shortcomings in this area, and they fully shared the mission's view that a major and rapid improvement in the statistical base is required if future policy decisions are to be based on solid grounds. Nevertheless, their attempts to reconstruct accurately the key economic and financial series have so far met with only limited success. Accordingly, the description of recent economic developments through 1983 presented in Section III below needs to be approached with caution, especially insofar as quantitative material is concerned. Moreover, the compilation of current data continues to suffer from unconventional accounting practices and inadequate coordination among the statistical services of the various ministries. It is apparent that considerable technical assistance will be required to establish an adequate statistical base. These efforts would have to include, as a minimum, a consolidation of government financial operations which fully captures and identifies all elements of current and capital expenditures, transfers to public enterprises, and sources of domestic and foreign financing, as well as monetary statistics which properly include all government deposits.

III. Recent Economic Developments

Since the last consultation discussions, which were held in early 1983, the overall performance of the Guinean economy has continued to be disappointing. 1/ Economic growth in 1983 is estimated to have been only about 1.3 percent, or roughly half the rate of population increase. This evolution was in line with trends in recent years; in fact, during the period 1979-83 real gross domestic product (GDP) grew at a compound annual rate of only 1.6 percent, implying a steady decline in real per capita income. Available data suggest that in 1983 nearly all the principal sectors recorded slow growth. Agricultural production, which expanded by less

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1/ The analysis in this section is based on available statistical material which relates almost exclusively to transactions in the official sector.

than 1 percent, was adversely affected by below average rainfall. In the secondary sector output virtually stagnated, as an expansion in construction activity was more than offset by declines in manfacturing and mining production. Growth in the tertiary sector, at 2.1 percent, was more rapid than elsewhere, and reflected mainly increased activity in commerce.

In 1983 there was a substantial deterioration in the already weak public finance situation, with the overall deficit on central government operations almost quadrupling to reach GS 6.3 billion, or the equivalent of 38 percent of expenditure (Table 1). This was due largely to a 40 percent decline in revenue in 1983 from the record level achieved in 1982, which in turn reflected a major effort to collect tax arrears and prepayments of certain obligations by the mining companies. Current expenditure fell by GS 1.5 billion to GS 7.8 billion and helped cushion the impact of the precipitous decline in revenue on the overall deficit. The lower level of current outlays was attributable essentially to a major reduction in spending on materials and supplies, in keeping with a long-standing policy of making large purchases every few years and in the intervening period curtailing expenditure to the strict minimum. Capital outlays and transfers to the public enterprises in 1983 were roughly at the same level as in 1982; transfers to the public enterprises reached GS 5.8 billion, or 35 percent of total expenditure. Foreign financing of the deficit was GS 1.2 billion in 1983, or about the same amount obtained from that source during the previous several years. Thus, the bulk of the deficit, some GS 5.1 billion, was financed from domestic sources, of which GS 2.1 billion came from the banking system. The remainder was financed largely from use of deposits which are not reflected in the monetary statistics.1/

Since 1981 various measures have been taken to improve the financial situation of the public enterprise sector. This has involved the closure of certain units deemed to be nonviable, and a reduction in the scale of operations of others. Although these measures were appropriate, their impact on the budget has, paradoxically, been negative for two basic reasons. First, loss-making enterprises were making a contribution to the budget (although this appears to have been financed by bank borrowing), and, consequently, their closure had a negative effect on revenue in 1983. Second, the Government made very large transfers to the public enterprises in 1982 and 1983 in an attempt to absorb the accumulated debts of the sectoral holding companies which were abolished in 1981 and to provide new capital for a number of viable enterprises which were facing a liquidity squeeze.

1/ The deficit-determining items in Table 1 are compiled from a number of sources, including the Ministry of Finance, the Ministry of the Plan, and the Central Bank. It is believed that these entries are reasonably accurate and are close to a cash basis. Reflecting weaknesses in accounting procedures, especially in monetary statistics, it is not possible to identify the sources of domestic financing as precisely as can be done in other cases.

Table 1. Guinea: Central Government Financial Operations, 1979-84

(In billions of sylis)

		1979	1980	1981 1/	1982 1/	1983 1/ Prel.	1984 Proj.
I.	Revenue	9.8	10.3	11.7	17.1	10.2	13.8
	Tax	(6.0)	(7.0)	(8.5)	(11.0)	(6.7)	(9.0)
	Nontax	(3.8)	(3.3)	(3.2)	(6.1)	(3.5)	(4.8)
II.	Current expenditure	7.2	8.8	7.4	9.3	7.8	8.8
III.	Capital expenditure	1.9	2.6	2.4	3.8	2.9	2.8
IV.	Transfers to public enterprises	6.2	0.6	0.6	5.5	5.8	5.0
V.	Overall surplus or deficit (-) (I-II-III-IV)	-5.4 2/	-1.7	1.3	-1.6 2/	-6.3	-2.8
VI.	Financing	5.4	1.7	-1.3	1.6	6.3	2.8
	Foreign	1.3	1.2	1.9	1.3	1.2	0.1
	Domestic	4.1	0.5	-3.2	0.3	5.1	2.7
	Of which: banking system	(4.1)	(0.1)	(-0.4)	(1.5)	(2.1)	(...)

Sources: Data provided by the Guinean authorities; and staff estimates and projections.

1/ Expenditure undertaken in 1981-83 in connection with the OAU Conference, which was to be held in Conakry in 1983, is not fully known and probably is only partly included in this table.

2/ Items do not add to totals because of rounding.

Credit developments in 1983 reflected mainly the worsening public finance situation, as net claims on Government rose by GS 2.1 billion to GS 7.2 billion. This explained practically the entire 14 percent increase in domestic credit (Table 2). In 1983 public enterprises had virtually no new recourse to bank borrowing. Lending to the private sector increased fractionally in 1983, but the amount outstanding at year-end was equivalent to only 3 percent of domestic credit. During 1983 money supply, narrowly defined, expanded by 11 percent to GS 16.6 billion. Within this aggregate, however, currency in circulation rose by 47 percent to GS 10.6 billion.

Guinea's already fragile external position came under increased pressure in 1983 (Table 3). The current account deficit fell by 60 percent to SDR 22 million as a result of a sharply higher level of receipts from bauxite,1/ the principal export, attributable to both higher export volume and unit value. Recorded imports 2/ in 1983 recovered slightly to SDR 356 million following a decline of 9 percent in 1982. However, as there appears to have been a net capital outflow of SDR 58 million,3/ an overall balance of payments deficit of SDR 81 million was recorded. About 72 percent of this deficit was financed by a further rise in the net foreign liabilities of the banking system and the remainder by an additional accumulation of arrears, mainly on medium- and long-term foreign debt. At end-1983 total external arrears stood at SDR 200.4 million, or 43 percent of recorded exports in that year; almost two thirds of these arrears were to OECD countries.

With the advent of the Second Republic, IMPORTEX has been abolished, but its functions have been assumed temporarily by the Ministry of Foreign Trade. While no decree has yet been issued, the private sector is free, in practice, to import and export all goods, except for imports of pharmaceuticals and oil products; however, a licensing system remains in effect. A new investment code, which is much more liberal than the previous one,

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1/ During the period 1979-83 bauxite accounted for 96 percent of total recorded export receipts. Guinea was then the world's largest exporter of bauxite.

2/ Recorded imports include imports under the general import program, imports of the mixed enterprises, plan imports, and private sector imports through official channels. Data on the composition of imports are available only in the case of the first category which represents normally about 30 percent of the total.

3/ Net capital movements discussed here include errors and omissions, which, in Guinea, have reached very large proportions in recent years. Thus, for instance, in 1983 errors and omissions (net) were estimated at the equivalent of -SDR 117 million, an amount considerably larger than the overall deficit. While this phenomenon undoubtedly results from underestimates of certain current account transactions, available data do not permit a reduction in the errors and omissions item without recourse to arbitrary imputation.

Table 2. Guinea: Monetary Survey, 1979-83

(In billions of sylis)

	1979	1980	1981	1982	1983 1/ March	June	Sept.	Dec.
Net foreign assets	-3.9	-4.5	-6.1	-6.3	-8.2	-8.0	-9.0	-7.7
Assets	1.2	1.9	1.9	3.0	3.1	2.6	2.3	3.0
Liabilities	5.1	6.4	8.0	9.3	11.3	10.6	11.3	10.7
Domestic credit	10.6	19.7	19.3	16.2	23.1	22.5	18.4	18.4 2/
Claims on Government (net)	3.9	4.0	3.7	5.1	8.8	10.1	5.0	7.2
Claims on public enterprises	5.9	14.5	14.6	10.5	13.5	11.6	12.8	10.6 2/
Claims on private sector	0.8	1.2	1.0	0.6	0.8	0.8	0.6	0.6
Money	5.0	7.0	11.9	14.9	14.7	15.8	14.2	16.6
Currency in circulation	3.2	3.3	6.2	7.2	9.0	9.5	10.2	10.6
Demand deposits	1.8	3.7	5.7	7.7	5.7	6.3	4.0	6.0
Quasi-money	4.0	5.5	5.3	1.2	1.1	1.1	1.6	1.0
Other items (net)	-2.3	2.7	-4.0	-6.2	-0.9	-2.4	-6.4	-6.9 2/

Sources: Data provided by the Guinean authorities; and staff estimates.

1/ Preliminary.
2/ This item has been adjusted by GS 5 billion in an effort to correct an apparent classification error.

Table 3. Guinea: Balance of Payments, 1979-84

(In millions of SDRs)

	1979	1980	1981	1982	1983 Prel.	1984 Proj.
Balance of trade	21.1	77.3	40.1	57.6	113.6	133.8
Exports, f.o.b.	280.6	380.2	418.3	402.0	469.2	536.5
Imports, c.i.f.	-259.5	-302.9	-378.2	-344.4	-355.6	-402.7
Services and private transfers (net)	-92.1	-97.5	-134.5	-138.1	-153.1	-165.0
Official transfers	6.9	13.0	13.9	23.7	17.2	38.5
Current account surplus or deficit (-)	-64.1	-7.2	-80.5	-56.8	-22.3	7.3
Capital movements (net)	26.8	15.9	58.3	50.5	58.3	-16.5
Long-term (net)	27.5	15.0	48.6	22.2	60.7	-4.1
Short-term (net)	-0.7	0.9	9.7	28.3	-2.4	-12.4
Errors and omissions (net)	3.2	-57.0	-73.0	-33.5	-116.8	...
SDR allocations	3.1	3.1	3.1	--	--	--
Overall deficit	-31.0	-45.2	-92.1	-39.8	-80.8	-9.2
Reserve movements (net)	22.0	26.2	61.2	10.3	58.0	...
Increase in arrears 1/	9.0	19.0	30.9	29.5	22.8	...

Sources: Data provided by the Guinean authorities; and staff estimates and projections.

1/ Arrears on medium- and long-term debt.

is expected to be approved shortly by the Guinean authorities. The parallel market, while being tolerated, is still illegal, and transactions in foreign exchange outside official channels remain formally prohibited.

Guinea has greatly reduced its reliance on bilateral payments agreements. Since 1975, out of 15 such agreements, 10 have been terminated and 4 are inoperative; only the agreement with the People's Republic of China remains officially operative. At the end of June 1984, the overall liability position in the bilateral accounts was equivalent to SDR 10.4 million.

IV. Report on the Discussions

The Guinean representatives and the staff team agreed that urgent action was required to improve the statistical base, especially in the areas of balance of payments, monetary, and public finance statistics. It was recognized that, without appropriate technical assistance, this would be a very difficult task. Accordingly, the Guinean representatives were hopeful that the short-term technical assistance in balance of payments and monetary statistics to be provided by the Fund 1/ during September 1984 would be a useful first step and that additional assistance would be forthcoming, as required, from the Fund and other sources.

At the outset of the policy discussions, the Guinean representatives emphasized that they were committed to reversing the policies pursued under the former régime. In particular, a major priority was to curtail the extent of government intervention in the economy and foster the growth of private enterprise. To help accelerate this process, internal and external trade would be liberalized and foreign investment encouraged. While recognizing that the large cost/price distortions and related inefficiencies which characterize the economy could not be eliminated satisfactorily on a piecemeal basis, the Guinean representatives noted that they had already taken action in a number of areas. However, it was their intention to undertake a comprehensive adjustment effort, to start at the beginning of 1985, which they hoped would be supported by a stand-by arrangement from the Fund. As is usual under Fund arrangements, this adjustment effort would be framed in a medium-term context. Because Guinea's economic imbalances and poor performance stem significantly from structural rigidities and a misallocation of investment resources in the past, close contacts are also being maintained with the World Bank.

Against this background, the discussions were focused on production, pricing, financial, and external sector policies.

1/ As a result of this assistance, an improved system of compiling monetary statistics has been developed and is expected to be operational by end-1984.

1. Production and pricing policies

In commenting on production trends, the Guinean representatives noted that bauxite mining continued to be the major source of foreign exchange earnings. However, as capacity constraints precluded a major expansion in output, it was hoped that export receipts could be increased through a substantial increase in agricultural production.

The Guinean representatives explained that, until recently, a major impediment to the expansion of agricultural production had been the existence of physical barriers between regions within the country. These barriers have been removed, and persons and goods can now circulate freely. Among the other constraints on agricultural production in the past were the collective farms (FAPAs) and the requirement that farmers sell a specified part of their output to the Government at artificially low official prices. The Guinean representatives stated that the collective farm system has been abolished and that production and marketing in the agricultural sector have been liberalized. Moreover, to encourage agricultural exports, producer prices for all export crops have been raised by an average of 37 percent.

The role of Government in the agricultural sector is being limited to assisting in the distribution of key inputs and providing needed extension services. While it was too early to assess the impact of this new policy orientation, preliminary indications were that farmers had already increased the area under cultivation in the current crop season. The Guinean representatives added, however, that this might not lead to a significant increase in production as rainfall in July and August had been below normal.

In commenting on policies in the agricultural sector, the staff representatives took the position that the initiatives taken so far were positive and should certainly stimulate an expansion in output. However, a sustained rise in agricultural production could only be achieved by establishing a realistic cost/price structure which provided adequate incentives to farmers to sell their output on the domestic market rather than engaging in clandestine border trade. By far the most effective way in which this could be achieved, the mission argued, would be the adoption of a realistic exchange rate policy and appropriate adjustments in domestic prices for inputs and export crops. The Guinean representatives agreed with this approach in principle and indicated that they would give the matter careful consideration.

Regarding pricing policies, the Guinean representatives said that it was their intention to allow prices, in most cases, to reflect the free play of market forces. However, for certain imported products, including rice and pharmaceuticals, supplies would continue to be made available, at least in the near term, through official channels at prices below those prevailing on the parallel market. The mission indicated that a realistic set of prices for imported products would be very difficult to establish as long as their retail prices were based on a cost structure derived from a highly overvalued exchange rate. Thus, for instance, while the sale prices of petroleum products--when converted at the official exchange rate--appeared to be adequate, they were extremely low in terms of the parallel market rate, a phenomenon which encouraged excessive consumption and clandestine exports. Similarly, the tariff structures of the utility companies were constructed on the basis of imported inputs purchased at the official exchange rate and accordingly contained serious distortions. For these reasons, the staff representatives stressed that the authorities' stated objective of allowing prices to be largely market-determined and to increase efficiency and production would be difficult to achieve as long as one key price, the exchange rate, remained seriously out of line.

2. Financial policies

It was agreed that urgent action was needed to establish an improved Treasury accounting system which covered the totality of government operations so that the financial transactions of the central administration could be more effectively monitored. In essence, this would involve the integration of transactions which are now divided between the Ministry of Finance and the Ministry of the Plan.

Regarding the fiscal situation in 1984, the Guinean representatives stated that indications, based on data for the first half of the year, were that revenue collections were recovering from the very low level recorded in 1983 and that it was expected that receipts would rise by 35 percent to some GS 13.8 billion (Table 1). The projected sharp increase in receipts in 1984 was partly due to the fact that revenue from taxes on international trade was returning to a more normal level, having been unusually low in 1983 as a result of the prepayment of certain obligations in 1982. On the expenditure side, it was intended to maintain a strict limit on the growth of current outlays. Accordingly, recruitment into the civil service would be tightly controlled, and pressures for wage increases in the current year would be resisted, even though real salaries have declined considerably in recent years. Moreover, outlays on materials and supplies would be subject to strict scrutiny. In this way, it was hoped that current expenditure could be limited to GS 8.8 billion in 1984, compared with GS 7.8 billion in 1983.

As to capital expenditure, the Guinean representatives explained that a decision had been taken to avoid embarking on any major new investment projects in the period ahead. This policy reflected the authorities' concern that the relatively high level of public investment in Guinea in recent years had not contributed to any significant increase in output but had seriously aggravated the debt service burden. Therefore, it was felt that a pause was warranted and for the next few years capital expenditure would be largely confined to maintenance and rehabilitation, pending the elaboration of a new development plan which would take effect in 1988. For 1984, capital outlays would be limited to GS 2.8 billion, slightly below the 1983 level.

The Guinean authorities recognized that, in connection with the elaboration of a future development plan, it would be necessary to devote attention to strengthening the process of investment selection and implementation and in this regard they were hopeful that the proposed technical assistance project in planning and statistics being discussed with the World Bank would play a useful role. Assistance was currently being received from the World Bank, mainly in the energy sector, and the possibility of a Rehabilitation Imports Credit from the same source was under consideration. Among other priority sectors in which additional assistance from the Bank was being sought were agriculture, industry, and the public enterprises. It was expected that, with assistance from the UNDP and the World Bank, a donors' conference would be organized during 1985 at which time the authorities' objectives in the area of development policy would be fully articulated.

The Guinean representatives agreed that transfers to public enterprises had been the major cause of the deterioration in public finances in the past few years. These transfers had been necessary, it was explained, to discharge some of the accumulated debts of the sectoral holding companies which were liquidated in 1981 and to provide needed new capital to units which were considered viable. It was stressed that it was the authorities' policy to discontinue transfers to cover operating losses, except in special cases. Moreover, a detailed study of the overall operations of the public enterprises was nearing completion, and it was stated that decisive action would soon be taken to close nonviable units and to strengthen the financial position of those enterprises which would continue their operations. During the first half of 1984, however, government transfers to the public enterprises had already reached GS 3 billion, reflecting the ongoing process of liquidating debts of the former sectoral holding companies. It was possible that additional transfers of about GS 2 billion would be required before the end of the year as a result of the abolition of IMPORTEX. It was hoped that total transfers for the year could be limited to GS 5 billion and, in that way, the overall fiscal deficit would not exceed GS 2.8 billion, compared with GS 6.3 billion in 1983.

As regards the prospects for strengthening fiscal performance over the medium term, the Guinean representatives shared the mission's view that a major reform of the taxation system was required to integrate progressively the transactions of the parallel economy. This would involve not merely a strengthening of tax administration but also a fundamental review of the tax structure. In particular, a complete review of the customs administration would be needed. It was recognized that, while such an ambitious undertaking would require considerable technical assistance and would take a number of years to complete, it was important that the process be initiated without delay.

Concerning expenditure, it was agreed that cautious policies were certainly required, given the weak state of public finances. The staff team pointed out that, while both current and capital outlays have been generally under control in recent years, transfers to the public enterprises have been allowed to expand rapidly. Unless such transfers can be effectively controlled, the staff team argued, prospects for a significant improvement in the overall public finance situation were not bright. This, in turn, presupposed the establishment of realistic cost/price relationships in the public enterprise sector, which could not be done without the adoption of an appropriate exchange rate policy. Moreover, it would be vital to strengthen the financial performance of those enterprises which would continue their operations; this would require adjustments in tariff structures, improved management procedures, and intensified efforts to collect accounts receivable.

In the area of credit policy, the Guinean representatives acknowledged that the private sector was still virtually outside the banking system and that credit expansion was essentially related to the needs of the public enterprises and the financing of the fiscal deficit. It was their intention, however, to gradually absorb the private sector into the banking system, and, to this end, a review of the existing institutional structures would be required. The staff representatives stated that it would also be important that interest rate policy, which hitherto had been relatively passive, be re-examined.

To facilitate the expansion of international trade and to promote increased foreign investment in Guinea, consideration was being given to permitting foreign banks to establish branches. Although the necessary legislation has not yet been approved, a number of such banks have already shown an interest in this possibility, provided that appropriate guarantees would be given concerning the transfer of funds.

3. External sector policies

a. Balance of payments prospects

The Guinean representatives and the staff team agreed that, in view of the very weak state of balance of payments data and the significant policy changes which were being contemplated, it was not possible to make meaningful balance of payments projections beyond 1984 at the present time. For 1984, it was expected that the trade surplus would increase further to SDR 134 million (Table 3), as exports would reach SDR 537 million, reflecting an increase in the volume and unit value of bauxite and an almost ten-fold increase in diamond exports to SDR 40 million attributable to the start of operations by AREDOR.1/ This would more

1/ AREDOR-Guinée (Association pour la Recherche et l'Exploitation des Diamants et de l'Or) is the first company to mine diamonds on a commercial scale in Guinea since the nationalized diamond mines ceased production in 1973. The equity capital of the company is US$20 million, of which one half was acquired by the Government in exchange for prospecting and mining rights, tax exemptions, and other advantages. The other half of the shares is held by Aredor Holdings, Ltd. of Australia, in which IFC holds an 11.3 percent share. Production, which commenced in April of this year, is expected to reach 128,000 carats in 1984.

than offset an increase in imports of 13 percent to SDR 403 million. While the deficit on services and private transfers was expected to increase by a further SDR 12 million to SDR 165 million, the net inflow reflecting exceptional assistance related to the earthquake of December 1983 and other increased assistance from a number of countries. Thus, a modest current account surplus of SDR 7 million was in prospect. Indications were that there would be a net outflow of SDR 16 million on the capital account, as higher scheduled amortization obligations on public debt were to be coupled with a sharply reduced inflow of private capital. Consequently, a small balance of payments deficit of SDR 9 million was projected. However, it was agreed that the actual deficit would in all likelihood be much larger than this, as the official ex ante balance of payments projections fail to capture significant outflows which ex post are recorded as negative errors and omissions; in the period 1981-83 such errors and omissions averaged minus SDR 74 million. Therefore, it was expected that in 1984 there would be, in fact, another large overall balance of payments deficit, which, given the very tight foreign exchange situation, would inevitably lead to a further accumulation of external arrears.

b. Policy orientation

Guinea faces a very weak balance of payments situation. Despite the existence of a highly restrictive exchange and trade system, great difficulties are still being encountered in financing imports, and external arrears, principally on medium- and long-term debt, continue to accumulate. The Guinean representatives agreed that these problems were merely symptoms of the more deep-rooted imbalances in the economy and that their solution lay in the adoption of a comprehensive adjustment program which would restore balance of payments viability in the medium term.

As the most fundamental distortion lay in the area of the exchange rate, it was acknowledged by the authorities that a major adjustment in this area was urgently needed.1/ Moreover, it was accepted that following an initial adjustment it would be essential that a flexible exchange rate policy be pursued so as to ensure that the Guinean economy would maintain its competitiveness, once this were re-established. In view of the far-reaching implications of a major exchange rate adjustment, the Guinean representatives, while agreeing in principle, explained that it would be important to defer action until a comprehensive adjustment program could be formulated and adequate external financing mobilized. Furthermore, it was recognized that, to be effective, the exchange rate

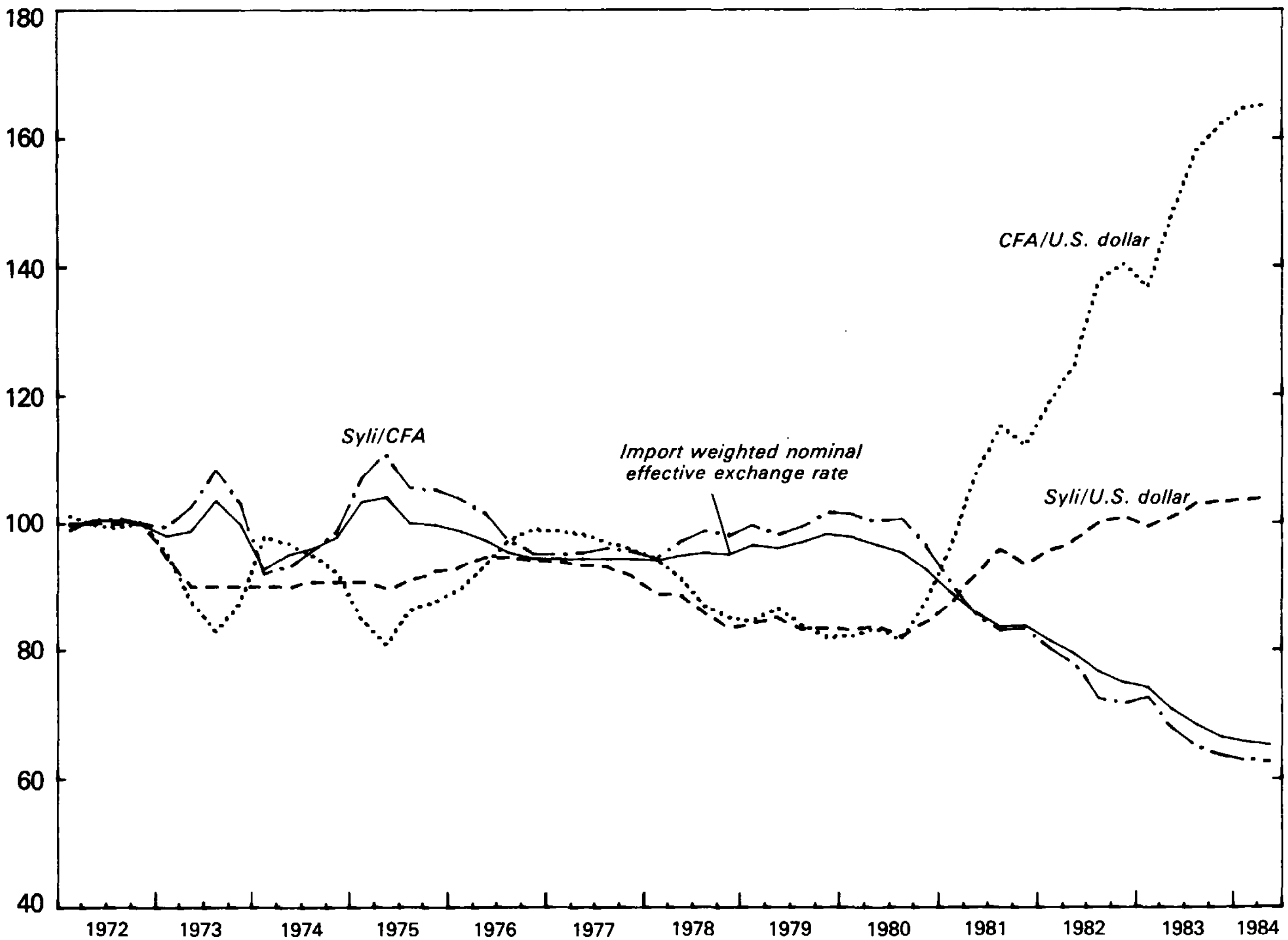
1/ In this connection, it was noted that the period average exchange rate of the syli depreciated vis-à-vis the U.S. dollar, from GS 19.11 = US$1 to GS 23.60 = US$1 between 1979 and the second quarter of 1984, or by 23 percent; in the same interval the CFA franc depreciated vis-à-vis the U.S. dollar from CFAF 212.72 = US$1 to CFAF 416.59 = US$1, or by 96 percent (see Chart). Available data suggest that more than 50 percent of Guinea's imports originate in the franc zone.

CHART

GUINEA

EXCHANGE RATE INDICES, 1972-84

(1972=100)[1]



[1] A decrease in the indices implies an appreciation.

action would have to be accompanied by a major liberalization of the trade and payments system and by the creation of mechanisms to ensure that the private sector was able to conduct its external transactions without cumbersome administrative procedures. In this regard, the staff team, while welcoming the abolition of the state trading enterprise, IMPORTEX, cautioned that no real benefit would be derived from this decision unless the private sector were quickly given an opportunity to perform the former functions of IMPORTEX, which have now been assumed temporarily by the Ministry of Foreign Trade. In agreeing to study the matter, the Guinean representatives reaffirmed their commitment to a market-oriented economy.

The Guinean representatives indicated that a new and liberal investment code was at an advanced stage of discussion within the Cabinet. This investment code was expected to foster a major expansion of foreign investment in Guinea in the coming years, which was viewed as a sine qua non for the effective development of the country's vast resources.

c. External debt

Regarding the external debt burden, the Guinean representatives stated that a debt rescheduling exercise was urgently required and that, in contrast to the approach of the former régime, they strongly favored a multilateral approach. They added that it would also be vital to ensure that prudent debt policies be followed in the future; for that reason, they were determined to avoid contracting any major additional external liabilities on nonconcessional terms until they were sure that they would be for sound investments which would, as a minimum, generate adequate foreign exchange to service the associated debt obligations.

The Guinean representatives explained that during the three years ended 1983 the amount of outstanding disbursed medium- and long-term public debt had remained largely unchanged at around SDR 1.2 billion (Table 4). Moreover, it was expected that, in the absence of substantial new borrowing in the period ahead, the outstanding debt would decline steadily in the coming years and by 1987 would amount to SDR 1 billion. Although the average terms on which debt has been contracted are rather favorable,1/ Guinea continues to experience great difficulties in servicing external debt obligations, which in recent years have averaged the equivalent of 23 percent of exports of goods. In view of these difficulties, the authorities intend to seek multilateral debt relief for 1985 in the context of a comprehensive adjustment program. While only about one third of debt service obligations for 1985 is susceptible to multilateral rescheduling, the Guinean representatives were hopeful that if such relief were to be obtained, other bilateral creditors would also be willing to reschedule.

1/ Available data indicate that at end-1983 about two thirds of Guinea's outstanding public debt carried an interest rate of less than 4.25 percent, had an average maturity of more than 21 years, and contained a grant element of 40 percent.

Table 4. Guinea: External Public Debt Indicators, 1979-87

	1979	1980	1981	1982	1983	1984	1985	1986	1987
					Prel.	Proj.			
					(In millions of SDRs)				
Medium- and long-term public debt (excluding use of Fund credit)									
Disbursed and outstanding (end of period)	749.8	799.5	1,073.0	1,116.0	1,161.0	1,145.6	1,145.1	1,081.0	990.7
Of which: arrears on principal	(72.5)	(89.0)	(115.6)	(140.0)	(157.2)	(...)	(...)	(...)	(...)
Disbursements	97.8	17.6	115.6	78.2	74.1	74.1	99.2	56.7	25.8
Debt service due	78.7	91.9	101.0	101.2	85.9	114.3	123.3	143.0	136.2
Principal	61.0	71.7	78.2	73.7	60.1	89.5	99.7	120.8	116.1
Interest	17.7	20.2	22.8	27.5	25.8	24.8	23.6	22.2	20.1
Debt service paid	69.9	72.9	70.1	71.7	63.1	...	...	...	...
Principal	51.0	55.2	51.6	49.3	42.9	...	...	...	...
Interest	18.9	17.7	18.5	22.4	20.2	...	...	...	...
Arrears (changes)	9.0	19.0	30.9	29.5	22.8	...	...	...	...
Principal	10.2	16.5	26.6	24.4	17.2	...	...	...	...
Interest	-1.2	2.5	4.3	5.1	5.6				
Cumulative arrears (end of period)	89.9	108.9	139.8	169.3	192.1	...	...	...	...
Principal	65.4	81.9	108.5	132.9	150.1	...	...	...	...
Interest	24.5	27.0	31.3	36.4	42.0	...	...	...	...
Short-term public debt arrears (end of period)	...	6.7	16.0	9.2	8.3	...	...	...	...
Use of Fund credit									
Outstanding (end of period)	3.0	3.0	—	11.5	11.5	11.5	...	...	...
Drawings	3.0	—	—	11.5	—	—	...	...	...
Repurchases	—	—	3.0	—	—	—	—	5.75	5.75
					(In percent of exports)				
Medium- and long-term public debt (excluding use of Fund credit)									
Debt service due	28.1	24.2	24.1	25.2	18.3	21.3	...	...	...
Debt service paid	24.9	19.2	16.8	17.8	13.4	...	...	...	...
Cumulative arrears (principal and interest; end of period)	32.0	28.6	33.4	42.1	40.9	...	...	...	...
Arrears on short-term debt	...	1.8	3.8	2.3	1.8	...	...	...	...

Sources: Data provided by the Guinean authorities; the World Bank; and staff estimates and projections.

4. Exchange and trade system

Guinea has not made any significant changes in its highly restrictive exchange and trade system since the last consultation. Bilateral payments agreements continue to be maintained with five countries, including one operative agreement with a Fund member; these agreements, however, were concluded prior to Guinea's membership in the Fund. Restrictions on current transfers also exist as a result of the accumulation of external arrears and these are subject to Fund approval.

The Guinean representatives shared the staff team's view that a major liberalization of the exchange and trade system would be a central element of the forthcoming adjustment program. They were hopeful that the problem of external arrears, which, they recognized, seriously constrained Guinea's access to new external borrowing, would be largely resolved in the context of the prospective debt rescheduling exercise. Finally, they explained that they were prepared to examine, on a case-by-case basis, the possibility of terminating the existing bilateral payments agreements.

V. Staff Appraisal

The Guinean economy continues to face large internal and external imbalances which prevent it from realizing its full potential. As a result of the pursuit of inappropriate policies over a long period, agricultural production is now a fraction of potential; a large and very inefficient public enterprise sector controls most manufacturing and commercial activities; and real per capita income continues to decline.

In an attempt to tackle the country's serious economic and financial difficulties, the new authorities have taken a number of corrective measures aimed at allowing market forces to play a greater role in economic decision-making. These include the removal of the physical barriers to the free circulation of goods and persons, the liberalization of agricultural production and marketing, the formulation of a new investment code, and the elimination of IMPORTEX. While these measures are clearly a step in the right direction, they need to be reinforced by a comprehensive adjustment program designed to achieve balance of payments viability over the medium term, while allowing the economy to realize a satisfactory rate of growth.

The preparation of such a program will require the establishment of an adequate statistical base. This in turn will imply that appropriate foreign technical assistance be provided in the near future. Particular importance needs to be attached to making available rapidly reliable statistics in the case of money and credit, public finance, and the balance of payments.

The centerpiece of an adequate adjustment effort would need to be a major exchange rate action which reflects market realities. Without such action and appropriate complementary measures, especially in the area of pricing policy, the desired improvement in economic and financial performance will be very difficult, if not impossible, to achieve. It would also be important to take early action to identify and correct physical obstacles to increased production, which might otherwise impede the desired supply response that would arise from a more appropriate price structure.

In the fiscal area, the adoption of a consolidated government budget is imperative in order to make it possible to properly analyze developments. A fundamental revision of the tax system is required to integrate progressively the transactions of the parallel economy, and, in this connection, a strengthening of the customs administration should be given high priority. At the same time, the growth of current outlays should continue to be restrained, while increased efforts need to be made to limit government transfers to public enterprises. Unless these transfers can be effectively controlled, the prospects for a lasting improvement in public finances are rather dim.

A strengthening of the financial situation of the public enterprise sector will certainly require the establishment of a realistic set of cost/price relationships which in turn presuppose the existence of an appropriate exchange rate. Moreover, vigorous action will be needed to close units which are nonviable and to improve the performance of the remaining enterprises. The latter will require adjustments in tariff structures, better management and accounting, and intensified efforts to collect accounts receivable.

In the external sector, a major exchange rate action should be accompanied by a liberalization of the exchange and trade system. Given the very tight foreign exchange situation, exceptional balance of payments assistance, including debt relief, will be required in support of the adoption of a comprehensive adjustment program.

While the immediate stabilization issues discussed above are being addressed, it would be important for the authorities to begin elaborating a coherent development strategy to permit the effective exploitation of the country's considerable resources. Among the priority sectors in any future plan should be agriculture and industry. In the elaboration of such a plan it would be essential that the authorities maintain close contacts with the World Bank so as to ensure that the investment priorities retained are fully in harmony with the country's needs and absorptive capacity.

The staff is encouraged by the initiatives taken by the authorities so far and the welcome change in policy-direction in Guinea. The new approach, which relies essentially on a market-oriented philosophy, seems well suited to address Guinea's serious economic and financial difficulties. However, there is a need to translate this philosophy into a concrete program of action in a number of spheres, and in this regard early action is clearly warranted. The staff recommends that appropriate technical assistance be made available rapidly to the Guinean authorities to help in the design and implementation of the comprehensive adjustment program which they intend to undertake in the near future.

It is recommended that the next Article IV consultation with Guinea take place on the standard 12-month cycle.

VI. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Guinea in the light of the 1984 Article IV consultation with Guinea conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Guinea continues to maintain a number of restrictive exchange practices as described in SM/84/226. While welcoming the progress made in Guinea in the pursuit of a liberalization policy, the Fund urges the authorities to take early comprehensive action to correct the distortions in costs and prices in the Guinean economy and to accelerate progress in eliminating restrictive practices, including the external payments arrears and the bilateral payments agreements with Fund members.

Guinea - Relations with the Fund

(As of August 31, 1984)

I. Membership Status

Date of membership	September 28, 1963
Status	Article XIV

A. Financial Relations

II. *General Department (General Resources Account)*

Quota	SDR 57.90 million
Fund holdings of sylis	
Amount	SDR 64.48 million
In percent of quota	119.86
Fund credit	
Credit tranche	
Amount	SDR 11.50 million
In percent of quota	19.86
Reserve tranche position	--

III. Stand-By Arrangements

On December 1, 1982, the Fund approved a one-year stand-by arrangement in an amount equivalent to SDR 25 million, representing 55.6 percent of the then existing quota. Only the initial purchase of SDR 11.5 million was made under this arrangement.

IV. SDR Department

Net cumulative allocations	SDR 17.60 million
Holdings	
Amount	--
In percent of net cumulative allocations	--

Guinea - Relations with the Fund (continued)

V. Administered Accounts

Trust Fund Loans

Disbursed	SDR 23.45 million
Outstanding	SDR 22.18 million

VI. Overdue Obligations to the Fund

General Department:	Repurchases	--
	Charges	--
SDR Department:	Charges	--

B. Nonfinancial Relations

VII. Exchange System

The syli has been pegged to the SDR since June 11, 1975, at a rate of GS 24.6853 = SDR 1.

VIII. Last Article IV Consultation

The last Article IV consultation discussions were held in Conakry during the period April 3-20, 1983 and were concluded by the Executive Board on August 5, 1983.

The decision was:

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

2. While generally continuing the trend toward liberalization, Guinea maintains a number of restrictive exchange practices as described in EBS/83/148. The Fund welcomes the progress made in Guinea in the pursuit of liberalization policy, but would urge the authorities to take early comprehensive action to correct the maladjustment in costs and prices in the Guinean economy and to accelerate progress in eliminating restrictive practices, including the external payments arrears and the bilateral payments arrangements with Fund members.

Guinea: Relations with the World Bank Group

(As of August 31, 1984)

	IBRD 1/	IDA	Total
	(In millions of U.S. dollars)		
A. Financial relations with IBRD and IDA			
1. Disbursements during fiscal years			
1976	--	0.4	0.4
1977	--	3.4	3.4
1978	--	8.3	8.3
1979	--	6.8	6.8
1980	--	7.4	7.4
1981	--	12.3	12.3
1982	--	11.4	11.4
1983	--	24.0	24.0
1984	--	17.6	17.6
2. Commitments for fiscal years			
1985	--	14.3	14.3
1986	--	33.0	33.0

B. Financial relations with IFC

In December 1982 the IFC approved investment financing amounting to US$15.31 million, consisting of a US$13.9 million equivalent loan to Société Mixte Arédor-Guinée and US$1.41 million equivalent equity participation in Arédor Holdings Ltd. for the development and operation of a surface diamond mine. The loan has been disbursed.

C. Other

1. On September 12, 1983, the IBRD cancelled a livestock development project, for failure of the Government of Guinea to comply with conditions agreed at negotiations concerning the dismantling of the state marketing system and the increase of the official price of meat.

2. During November 29-December 4, 1983, a World Bank mission visited Guinea to discuss with Guinean officials two reports recently prepared by the World Bank, namely a Country Economic Memorandum and an Agricultural Sector Review.

Source: IBRD.

1/ IBRD gross disbursements in the years through 1975 amounted to US$73.5 million, which was used to finance infrastructure for the Boké bauxite development project.

Guinea: Selected Economic and Financial Indicators, 1980-84 1/

	1980	1981	1982	1983	1984
	Estimated			Prel.	Proj.
	(Annual percent changes)				
National income					
GDP at constant prices	2.6	0.6	1.8	1.3	...
External sector (in SDR terms; total recorded) 2/					
Exports, f.o.b.	35.5	10.0	-3.9	16.7	14.3
Imports, c.i.f.	16.7	24.9	-8.9	3.3	13.2
Non-oil imports, c.i.f.	13.0	24.7	-9.0	1.9	14.8
Export volume	12.9	-12.2	-2.6	7.4	8.2
Import volume	-6.8	27.3	-11.2	-1.1	7.8
Terms of trade (deterioration -)	-4.2	28.0 3/	-3.8	-4.0	0.6
Nominal import-weighted effective exchange rate (depreciation -)	1.4	10.3	8.7	10.3	...
Public finance					
Revenue	4.5	14.2	45.7	-40.1	35.3
Expenditure	-21.3	-13.3	79.0	-11.5	1.0
Money and credit					
Domestic credit	86.4	-2.1	-16.2	13.8	...
Central Government (net)	2.4	-8.9	40.9	40.9	...
Public enterprises	145.3	1.0	-28.5	0.9	...
Private sector	60.4	-16.0	-42.2	7.7	...
Money supply (M_2)	38.7	37.6	-6.0	8.6	...
	(In percent of exports)				
Debt service ratio					
Scheduled	24.2	24.1	25.2	18.3	21.3
Actual	19.2	16.8	17.0	13.4	...
	(In millions of SDRs)				
Overall balance of payments (recorded sector)	-45.2	-92.1	-39.8	-80.8	-9.2
Gross official reserves (in months of imports)	3.1	2.5	4.2	4.1	...
External payments arrears 4/ outstanding (end of year)	115.6	155.8	176.5	200.4	...

Sources: Data provided by the Guinean authorities; and staff estimates and projections.

1/ In view of serious weaknesses in the statistical base in Guinea, the data in this table should be interpreted with caution.

2/ Consists of the external transactions of the public sector and the mixed enterprises, plus the recorded transactions of the private sector, and excludes parallel market transactions.

3/ Mainly reflects an increase in the contract price for bauxite and alumina.

4/ Includes short-term arrears.

Guinea - Statistical Issues

1. Coverage, currentness, and reporting of data in IFS

   There is no country page for Guinea in *IFS*.

2. Outstanding statistical issues

   Prices

   No price statistics are presently available.

   Government finance

   The statistical presentation for Guinea in the 1983 *GFS Yearbook* contains only the institutional tables.

   Monetary accounts

   The balance sheets of the Central Bank of Guinea and the specialized banks are produced with considerable delay. There is a need to improve both their currentness and quality.

   Merchandise trade

   Only annual trade data are available through 1978.

   Balance of payments

   Official balance of payments data for 1972 through 1974 and for 1979 and 1980 were provided, on a confidential basis, during two balance of payments technical assistance missions to Guinea (January 1980 and March 1982).

3. Technical Assistance

   A technical assistance mission in the area of monetary and balance of payments statistics of approximately three weeks took place in August/September 1984. As a result of this visit, compilation methods for both monetary and balance of payments statistics have been improved and it is expected that future data will be available with much shorter time lags.

Guinea - Basic Data

Area and population

Area	95,000 square miles
Population (1983)	5.7 million
Population growth rate	2.9 percent

Central government finance

Central government finance	1979	1980	1981	1982	1983 Prel.	1984 Proj.
			(In millions of sylis)			
Revenue	9,836	10,274	11,731	17,086	10,232	13,846
Tax	6,051	7,018	8,507	11,018	6,746	9,031
Nontax	3,785	3,256	3,224	6,068	3,486	4,815
Current expenditure	7,206	8,813	7,447	9,332	7,796	8,789
Capital expenditure	1,858	2,650	2,370	3,776	2,933	2,830
Transfers to public enterprises	6,200	550	600	5,540	5,780	5,046
Overall surplus or deficit (-)	-5,428	-1,739	1,314	-1,562	-6,277	-2,819
Financing	5,428	1,739	-1,314	1,562	6,277	2,819
Foreign	1,325	1,163	1,924	1,297	1,181	70
Domestic	4,103	576	-3,238	265	5,096	2,749
Of which: banking system	(4,117)	(94)	(-356)	(1,489)	(2,100)	(...)

Money and banking

Money and banking	1979	1980	1981	1982	1983 Prel.
	(In millions of sylis; end of period)				
Foreign assets (net)	-3,900	-4,547	-6,057	-6,311	-7,743
Domestic credit	10,570	19,707	19,297	16,179	18,417
Government (net)	3,905	3,999	3,643	5,132	7,232
Public enterprises	5,910	14,497	14,673	10,459	10,552
Private sector	755	1,211	1,017	588	633
Money and quasi-money	9,015	12,500	17,196	16,158	17,555
Money	4,963	7,049	11,925	14,947	16,592
Of which: currency in circulation	(3,174)	(3,269)	(6,176)	(7,242)	(10,559)
Quasi-money	4,052	5,451	5,271	1,211	963
Other items (net)	-2,345	2,660	-3,974	-6,290	-6,881

Guinea - Basic Data (concluded)

	1979	1980	1981	1982	1983 Prel.	1984 Proj.
			(In millions of SDRs)			
Balance of payments						
Balance of trade	21.1	77.3	40.1	57.6	113.6	133.8
Exports, f.o.b.	280.6	380.2	418.3	402.0	469.2	536.5
Imports, c.i.f.	-259.5	-302.9	-378.2	-344.4	-355.6	-402.7
Services and private transfers (net)	-92.1	-97.5	-134.5	-138.1	-153.1	-165.0
Official transfers	6.9	13.0	13.9	23.7	17.2	38.5
Current account surplus or deficit (-)	-64.1	-7.2	-80.5	-56.8	-22.3	7.3
Capital movements including errors and omissions (net)	30.0	-41.1	-14.7	17.0	-58.5	-16.5
SDR allocations	3.1	3.1	3.1	--	--	--
Overall deficit (-)	-31.0	-45.2	-92.1	-39.8	-80.8	-9.2
Reserve movements (net)	22.0	26.2	61.2	10.3	58.0	...
Increase in arrears	9.0	19.0	30.9	29.5	22.8	...
Official reserves (end of period)						
Gross official reserves	50.4	77.5	78.3	120.2	120.4	...
Net official reserves	-158.0	-184.2	-245.4	-255.7	-313.7	...
External public debt 1/ (end of period)						
Disbursed and outstanding	749.8	799.5	1,073.0	1,116.0	1,161.0	1,145.6
Cumulative arrears	89.9	108.9	139.8	169.3	192.1	...
Nominal effective exchange rate (Import-weighted; 1972 = 100) 2/	96.9	95.5	85.7	78.2	70.1	65.4 3/

1/ Medium- and long-term debt.
2/ Values below 100 indicate an appreciation.
3/ Second quarter.