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May 13, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Guinea-Bissau - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Guinea-Bissau. A draft decision appears on page 17. 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. Syvrud (ext. 73162) or Mr. Tandeciarz (ext. 73138).

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INTERNATIONAL MONETARY FUND

GUINEA-BISSAU

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the
1983 Consultation with Guinea-Bissau

Approved by J.B. Zulu and W.A. Beveridge

May 12, 1983

I. Introduction

The 1983 Article IV consultation discussions with Guinea-Bissau were held in Bissau during March 2-16, 1983. These were the first consultation discussions with Guinea-Bissau since December 1978. The Guinea-Bissau representatives included Mr. Victor Saude Maria, Prime Minister; Mr. Victor F. Monteiro, Minister of Finance and Economy; Mr. Luis Sanca, Chief of the Planning Secretariat; Mr. Pedro A. Godinho Gomes, Governor of the National Bank of Guinea-Bissau; and other economic ministers and senior officials of the Guinea-Bissau Government and the directors of the major public enterprises. Staff representatives were Donald E. Syvrud (head-APR), Ignacio Tandeciarz (APR), Ivan Bello (INST), Peter Griffith (FAD), Joseph Perejoan (APR), and Margaret Fisher (secretary-BLS).

Guinea-Bissau continues to avail itself of the transitional arrangements under Article XIV. As of January 31, 1983, the Fund's holdings of the Guinea-Bissau peso amounted to the equivalent of SDR 8.4 million, or 143 per cent of quota. Appendix I contains more specific data on Guinea-Bissau's relations with the Fund. World Bank Group credits to Guinea-Bissau are summarized in Appendix II. Appendix III contains basic data on Guinea-Bissau.

II. Background to the Discussions

Guinea-Bissau has a considerable economic potential. Currently only 40 per cent of usable land is under cultivation. Several projects are under way financed by bilateral and multilateral donors, to expand agricultural production. Moreover, the possibilities of increasing fish output are very good, with a potential catch of 300,000 tons compared with about 12,000 tons, at present. Similarly, forest products could be increased severalfold over the 8,500 tons produced in 1979. Finally, there are prospects for commercial development of bauxite and phosphate resources, and the possibility of exploiting petroleum is being explored with World Bank assistance.

With a traditional pattern of subsistence farming, Guinea-Bissau was almost self sufficient in food products until the 1960s. Although this pattern continued during its post-revolution years, today the country has to import significant amounts of food stuffs. This situation is partly attributable to the destruction of the diking infrastructure (essential for mangrove rice cultivation) during the war for independence and to recurring droughts in the region. However, the main reason for the current economic and financial situation is inadequate economic policies.

Since 1974, when it achieved independence from Portugal, the Government of Guinea-Bissau has been committed to economic development in the context of centralized economic planning. Price controls in the face of rapidly rising money supply (to finance large fiscal deficits) have led to repressed inflation, with inadequate incentives to produce, supply shortages, smuggling, depressed exports, mounting external debt, growing dependence on foreign aid to finance basic essentials, and a parallel market exchange rate several times the official rate.

In view of these results, the authorities have been reassessing their economic strategy and policies. As a result of a study of the economic problems and prospects for the country, the authorities are considering the implementation of a short-term Economic Stabilization Program for 1983-84, and a medium-term economic development plan. The medium-term plan is expected to be completed by October 1983, at which time it will be presented to all of the major donors in a round-table discussion to be held in Bissau.

According to the Economic Stabilization Program, real GDP is projected to grow by 4 per cent in 1983 and by 6 per cent in 1984. Export proceeds, in terms of Guinea-Bissau pesos, are expected to grow at an average annual rate of 60 per cent during the two years. Imports are estimated at US\$97 million in 1983 and US\$107 million in 1984, compared with a level of US\$56 million in 1982. The trade gap, of US\$75.1 million in 1983 and US\$69.5 million in 1984, is expected to be covered with external aid. The Economic Stabilization Program also includes a number of policy measures. With respect to the central government budget, there are proposals to raise revenue, mainly through increased selective excises, and to restrict current expenditure to the level originally adopted in the 1982 budget. There is also a proposal to restructure the commercialization system, providing increased participation to the private sector. In the monetary area the authorities are planning to increase interest rates on loans and offer an interest rate on deposits, as well as to separate the central banking from the commercial banking function of the National Bank of Guinea-Bissau. Regarding the foreign debt the program notes the authorities' intention to request a cancellation or a renegotiation of arrears and of debt service during 1983-84. Finally, with respect to producer prices and the exchange rate, the Economic Stabilization Program notes the need to conduct a study to determine the required degree of adjustment.

Despite a most cooperative attitude on the part of the authorities, the inadequacies in the economic data imposed a severe constraint on the effectiveness of the staff in assessing economic developments and in suggesting remedial actions. The staff emphasized repeatedly the need for improved and more timely economic data to assist the authorities in their formulation of economic policies. At the time of the mission's departure, the latest monetary data available were for June 1982. Moreover, owing to long-standing accounting problems, changes in some monetary statistics, such as foreign assets, were difficult to trace. As a consequence, the reconciliation between monetary developments and those of the rest of the economy was difficult to achieve. Developments described in the following sections, therefore, are largely based on staff estimates.

III. Recent Economic Developments

1. Trends in output and prices

With a traditional agricultural sector that accounts for more than half of real GDP, the Sahelian droughts of 1979 and 1980 were clearly reflected in Guinea-Bissau's drop in total output. During these two years, total value added declined 16 per cent in real terms (Table 1). Adequate rainfall in 1981 and 1982 resulted in a substantial rebound of agricultural output, with the volume of rice and groundnuts almost doubling the level recorded in 1980. Consequently, real GDP more than made up the ground lost in previous years, to reach in 1982 what is estimated to be its highest level in post-independence years.

Nevertheless, the absence of an appropriate producer pricing policy, coupled with an inefficient marketing system, has led to a situation in which only a small proportion of farm production is being commercialized through official channels. Purchases by the state companies SOCOMIN and Armazens do Povo in 1981 and 1982 amounted to less than 3 per cent of rice production (compared with almost 11 per cent in the previous two years), and to 38 per cent of groundnut production (compared with 85 per cent of previous years' output). Most of the official domestic and external trade is dominated by these two enterprises. The same companies also control the processing of groundnuts for export and rice milling, as well as the transportation network serving the rural areas. The shortcomings of the marketing system and pricing policies has resulted in the emergence of parallel markets, supply shortages, and very little, if any, of the imported goods reaching the rural population.

The fisheries sector is the sector that has shown the most dynamic growth during the last five years. It is to be noted that, of the three mixed fishing enterprises created since 1975, only one is still in operation. ^{1/}

^{1/} Estrela do Mar, which was formed with the participation of the U.S.S.R. in 1975. The other two, GUIALP and SEMAPESCA, which were also joint ventures with other countries, no longer operate.

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Table 1. Guinea-Bissau: Indicators of Output and Prices, 1979-82
(In annual percentage change)

	1979	1980	1981	1982
Real gross domestic product	-1.5	-14.8	23.6	5.5
Of which: agriculture	(-6.6)	(-26.0)	(39.4)	(7.0)
fisheries	(39.3)	(-18.0)	(78.1)	(1.8)
manufacturing	(-1.6)	(-8.2)	(-1.8)	(1.8)
GDP deflator	19.2	13.8	2.2	12.5
Producer prices (agriculture)	29.3	7.3	2.0	16.2
Consumer prices	26.0	64.8	45.8	30.0 <u>1/</u>
Unit value of imports (in terms of Guinea-Bissau pesos)	14.6	16.8	17.7	-4.1

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

1/ Estimate. No price survey was conducted in 1982.

In the case of manufacturing, the main characteristics of the sector are the large amount of unutilized capacity (on the average, around 70 per cent) and the apparent misallocation of resources to projects supported by easily available foreign financing. Examples of this are the agro-industrial complex of Cumeré, with a processing capacity twice that of the country's present level of groundnut production, import-substitution projects to produce intermediate chemical products and an automobile assembly plant. Most of these projects face non-competitive costs, location deficiencies, organizational problems, and a need for imported inputs that cannot be satisfied under present balance of payment conditions. As a result, the value added by this sector in 1982 was in real terms about 10 per cent below its 1978 level.

Guinea-Bissau maintains a widespread system of price controls, including producer prices for the main agricultural commodities, consumer prices for basic necessities, and wholesale and retail margins for some specific products. Even though prices of consumer goods are controlled by the Ministry of Commerce and Handicrafts, most of these prices are in fact set by the state-owned retail stores. With respect to producer prices, the limited information available indicates that there were significant upward adjustments

in agricultural prices in 1979 and 1982. However, these adjustments were far too modest to compensate for the sharp increase in consumer prices, thus exacerbating the already existing distortions between producer and consumer prices. 1/

With the rapid growth in domestic prices in recent years, fixed-wage government employees, who account for at least two-thirds of the wage sector, experienced eroding standards of living. Since 1974, when the minimum monthly wage was raised from PG 800 to PG 2,400, government employees have received only one wage increase: in 1980 the minimum monthly wage was raised by 25 per cent and the average wage by 19 per cent.

2. Fiscal performance

From 1978 through 1982 operations of the Central Government have produced overall annual deficits equivalent to approximately 50 per cent of GDP (Table 2 and Appendix III). Central government revenue at no time has been sufficient to cover even current expenditures, with the deficit on current account varying between 11 and 18 per cent of GDP. Net credit from the central bank has financed more than half of the deficit on current account in recent years. Central government capital expenditures (which account directly or indirectly for virtually all public sector investment) have regularly exceeded 30 per cent of GDP and in 1980 reached nearly 50 per cent of GDP. In most cases, the entirety of capital expenditures, including the local currency component, was financed by external assistance.

The central government tax effort has been only slightly lower than the average for similar countries. The most notable difference in revenues is the relatively low contribution of taxes on international trade. A further revenue problem stems from the failure of some state enterprises to pay taxes due (including import duties) and the failure of most state enterprises to generate a significant taxable or transferable surplus. The latter problem became particularly acute in 1982, when transfers from public enterprises (nontax revenue) fell by more than 50 per cent. Overall revenue for 1981 was unusually high, in part because of extraordinary income from foreign grants directly to the central government.

Since independence, Guinea-Bissau has had a formal central government budget for current expenditures only. Most capital expenditures are managed under a capital budget supervised by the Planning Ministry, which combines direct and indirect investment expenditure by the Central Government. Accounting for these expenditures has been lax, in part because of complications introduced by such factors as use of direct aid in kind, use of proceeds from sale of goods donated from abroad to underwrite both

1/ Data on consumer prices were available only with respect to selected commodities for the city of Bissau until 1981. On this basis, the staff prepared estimates of a consumer price index for the period 1978-81. No price survey was made in 1982.

Table 2. Guinea-Bissau: Central Government Operations, 1979-83

(In millions of Guinea-Bissau pesos)

	1979	1980	1981	1982 Budget	1982 1/ Prel.	1983 Budget
Total revenue	747.8	736.9	1,000.3	833.8	828.9	1,020.5
Tax revenue	557.6	568.9	687.8	742.1	736.6	838.1
Taxes on income and property	(94.8)	(99.3)	(117.3)	(173.2)	(102.9)	(111.3)
Taxes on international trade	(204.8)	(213.4)	(244.3)	(235.2)	(298.7)	(227.0)
Taxes on domestic transactions and others	(258.0)	(256.2)	(326.2)	(333.7)	(335.0)	(499.8)
Nontax revenue	151.7	167.4	211.8	91.7	92.3	182.4
Extrabudgetary receipts	38.5	0.6	100.7	--	--	--
Total expenditures	3,123.1	3,862.2	3,555.7	4,509.0	4,320.5	...
Total current budget expenditure	1,297.3	1,567.2	1,720.2	2,029.0	1,840.5	2,111.6
Wages and salaries	722.3	902.5	940.8	1,343.8	995.4	1,382.9
Other goods and services	550.8	639.1	750.1	578.3	807.1	626.4
Interest on public debt	24.2	25.6	29.3	106.9	38.0	102.3
Total capital expenditure	1,825.8	2,295.0	1,835.5	2,480.0	2,480.0	...
Current account surplus or deficit (-)	-549.5	-830.3	-719.9	-1,195.2	-1,011.6	-1,091.1
Overall surplus or deficit (-)	-2,375.3	-3,125.3	-2,555.4	-3,675.0	-3,491.6	...

Sources: Ministry of Finance, Ministry of Planning; and staff estimates.

1/ Actual revenue and current expenditures recorded through December 31, 1982; three-month complementary period in 1983 is excluded; as a result, total revenue and expenditures, including those on wages and salaries, may be substantially underestimated.

current and capital expenditure of government enterprises, and confusion as to legal responsibility (whether Central Government, municipal, or state enterprise) for payment of investment expenses. One of the major technical improvements expected is the development of an integrated (current and capital) budget for 1984.

A high proportion of the current expenditures of the Central Government is devoted to wages and salaries. During the period 1979-81 this averaged 56 per cent of total current expenditure. Preliminary figures for 1982 suggest that this proportion may be somewhat lower. The 1983 current expenditure budget has been set at the same level as the original 1982 budget. There are explicit statements in the budget to the effect that wage and salary expenditures will not be increased, that new hirings and overall salary increases will be banned, and that other nonpriority expenditures will also be held down.

Capital expenditure budgeted for 1982 amounted to about 35 per cent of GDP. Actual expenditure figures were not available and there are no projections of capital expenditure for 1983. Given the recent difficulties in obtaining financing, it is probable that actual expenditures for both years will be lower in terms of GDP than was budgeted for 1982.

3. Monetary developments 1/

Monetary developments are closely related to the financial needs of the Government, as the resources of the National Bank of Guinea-Bissau (BNGB) are actively used to cover budgetary deficits. Net credit to Government has increased sharply since 1977. When measured against the stock of liabilities to the private sector, net claims on Government increased 46 per cent in 1980, 87 per cent in 1981, and 62 per cent during the 12-month period ended June 1982 (Table 3). As shown in Table 3, credit granted to the private sector is a negligible part of the total. The money supply (currency and demand deposits) rose by 19 per cent in 1980, and by about 31 per cent in 1981 as well as in the year ending June 1982. The impact of the huge increases in credit to Government on the money supply has been a major determinant of the persistent decline in net foreign assets.

The BNGB does not pay any interest on savings deposits, while it charges 6.5 per cent on loans. No interest is charged on credit to Government. The CCG lends at 8 per cent, mostly to public enterprises, from funds rediscounted at the BNGB. The fact that no interest is paid on time and savings deposits explains in part the poor performance of private savings in the financial system. At end-June 1982 quasi-money accounted for only 1.7 per cent of total liabilities to the private sector.

1/ The financial system consists of the Banco Nacional da Guiné-Bissau (BNGB) and two minor financial institutions, the Caixa da Credito da Guiné (CCG), and the Caixa Economica Postal (CEP). All monetary authority operations and most of the banking operations are performed by the BNGB.

Table 3. Guinea-Bissau: Summary Accounts of the National Bank of Guinea-Bissau, 1979-June 1982

(In millions of Guinea-Bissau pesos)

End of Period	1979	1980	1981	June	
				1981	1982
Net foreign assets	-61.9	-365.7	-703.3	-785.3	-975.5
Net domestic assets	1,243.7	1,776.9	2,554.2	2,385.3	3,088.3
Public sector	1,595.2	2,149.8	3,264.2	2,803.0	3,875.2
Central government (net)	(1,333.1)	(1,869.4)	(3,093.7)	(2,518.8)	(3,511.0)
Public enterprises (net)	(262.1)	(280.4)	(170.5)	(284.2)	(364.2)
Private sector	90.6	138.0	166.4	191.5	175.0
Medium- and long-term foreign liabilities	...	-8.0	-122.4	-76.5	-138.5
Other assets (net)	-442.1	-502.9	-754.0	-532.7	-831.6
Liabilities to private sector	1,181.8	1,411.2	1,850.9	1,600.0	2,112.8
Currency in circulation	828.8	1,016.6	1,282.7	1,146.1	1,440.8
Demand deposits	326.2	362.8	529.9	414.4	636.5
Quasi-money	26.8	31.8	38.3	39.5	35.5

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

The authorities are studying a proposal to raise the interest rates charged on loans to a range of 9-3/4 per cent to 14-1/2 per cent, depending on the maturity of the loans. Regarding interest rates on deposits, the proposal introduces a rather complicated system of rates depending on the amount, the maturity, type of deposit, and the institution where it is made. It would offer a maximum rate of 4 per cent for deposits up to six months, and a maximum of 8 per cent for deposits with a maturity of more than one year. Regarding the separation of the commercial activities of the BNGB from its central banking functions, the authorities are currently considering the implementation of a law which would effectively accomplish this objective.

4. External sector

Guinea-Bissau experienced large and persistent trade deficits, averaging about 30 per cent of GDP, in the period 1979-82 (Table 4).

Table 4. Guinea-Bissau: Balance of Payments, 1979-82

(In millions of U.S. dollars)

	1979	1980	1981	1982
A. Current account	-39.4	-41.9	-29.8	-31.6
Trade balance	-45.5	-49.8	-43.0	-41.9
Exports, f.o.b.	(14.1)	(11.3)	(14.1)	(14.6)
Imports, f.o.b.	(-59.6)	(-61.1)	(-57.1)	(-56.5)
Net services	-11.1	-10.6	-1.9	-7.5
Transfers	17.2	18.5	15.1	17.8
B. Capital	14.7	11.9	26.0	9.3
Long-term	15.0	9.5	17.1	12.0
Short-term, official	-0.3	2.4	8.9	-2.7
C. SDR allocation	0.5	0.5	0.5	--
D. Errors and omissions	31.5	16.9	-5.7	...
E. Overall balance (A + B + C + D)	7.3	-12.6	-9.1	-22.3
F. Net foreign assets ^{1/}	-8.9	7.2	0.2	15.3
Use of Fund credit	1.4	-0.7	2.8	-0.3
Payments arrears (on official short-term capital)	-4.8	0.8	0.5	...
Bilateral balances	0.6	0.6	--	...
Changes in other official international reserves ^{2/}	-6.1	6.5	-3.1	...
G. Payments arrears (on medium- and long-term capital)	1.6	5.4	8.9	7.0

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

^{1/} Excludes official short-term capital flows and SDR allocations.

^{2/} Includes SDR drawings.

These trade deficits are probably much larger than shown owing to the difficulties in obtaining adequate data on imports of goods and services financed with foreign aid. The decrease in the trade deficits of 1981 and 1982 is probably related to a slowdown in foreign aid and external financing. Grant aid has been Guinea-Bissau's main source of external financing since independence in 1974. In the mid-1970s, several donor countries viewed Guinea-Bissau as a special case of economic reconstruction and granted substantial aid to the country in the form of unrequited transfers. Starting in 1980, some of these donor countries considered that the reconstruction period had come to an end and began to reduce the level of grant aid. Consequently, in the past few years the external deficits have been financed increasingly by foreign borrowing. As a result, medium- and long-term external debt has increased sharply, and the associated debt service payments have considerably worsened Guinea-Bissau's external imbalance.

Exports cover only a fraction of Guinea-Bissau's import needs. Insufficient supplies of consumer goods in rural areas combined with inadequate producer prices have distorted the commercial trading system. Smuggling is widespread. Legal exports of some traditional products have declined, and, in the case of palm oil, have practically ceased to exist. In 1977-81 groundnuts, palm kernels, and fish products accounted for 85 per cent of all exports. During that period exports of fish products increased by 250 per cent in nominal terms, becoming the major and most dynamic export commodity, while exports of groundnuts, previously the major export commodity, fell by 70 per cent. About 70 per cent of total exports goes to Europe, almost half to Portugal, and more than a quarter to Spain. Most of the remaining exports go to African countries, particularly Senegal and The Gambia.

Guinea-Bissau's demand for imports far exceeds available financing. Import control and allocation, both to the public and to the private sector, is effected by means of a quarterly import program. Often, and specially in recent times, the targets of the import program have not been met, and parts of the program have been carried over to the next quarter. In 1977-81 imports of food products accounted for 21 per cent of all imports and there are indications that food imports, which are generally financed with foreign aid, may have been substantially underestimated. Imports of petroleum products accounted for 10 per cent of all imports during this period. Unlike other imports that are often financed with foreign aid or some other type of concessionary element, Guinea-Bissau has to buy oil products in the spot market on commercial terms. Since electricity is generated entirely with oil in Guinea-Bissau, and the country's stocks of oil products are normally low, a temporary shortage of foreign reserves tends to have disruptive effects on the generation of electricity and, therefore, on the economy. In 1977-81 about 79 per cent of all Guinea-Bissau's imports originated in Europe, almost two fifths of them in Portugal. At the same time, Senegal's share of imports has increased steadily, becoming Guinea-Bissau's second most important supplier.

As already mentioned, grant aid has been the major form of foreign financing for Guinea-Bissau since independence. Major items financed with this type of aid include food imports, productive and infrastructure projects (often with payment of local costs), and balance of payments support. Control of disbursements usually resides in the donor countries. In the late 1970s, Guinea-Bissau embarked on a few major investment projects, financed with foreign borrowing, which led to sharp increases in the external debt. At end-1982 total external debt amounted to US\$218 million, of which US\$142 million was disbursed (Table 5). Debt service has risen sharply in the last four years, approaching 40 per cent of exports of goods and services. Since most of this debt service has not been paid, arrears on external debt service have risen to about US\$53 million at the end of 1982. The short-term debt of Guinea-Bissau results from special credit lines extended by a few foreign banks.

Table 5. Guinea-Bissau: External Debt and Payment Arrears, End-1982

	End-1982
	(in US\$ millions)
External debt <u>1/</u>	
Total debt outstanding	218.5
Medium- and long-term	176.4
Short-term	42.1
Disbursed debt outstanding	142.5
Medium- and long-term	100.4
Short-term	42.1
Payment arrears	
Arrears on debt outstanding	53.4
Medium- and long-term	25.3
Short-term	28.1
	(in per cent of GDP)
Total external debt outstanding	123.4
Disbursed external debt outstanding	80.5
Of which: total payment arrears outstanding	30.2

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

1/ Includes payment arrears.

The Guinea-Bissau peso, created in 1976, was pegged to the Portuguese escudo until 1978, when the peg was shifted to the SDR at the rate of SDR 1 = PG 44. The rigidity of the exchange rate in the context of the high rate of inflation prevailing in Guinea-Bissau has resulted in a sharp overvaluation of the currency in both nominal and in real terms. Staff estimates indicate that the effective nominal exchange rate of the Guinea-Bissau peso appreciated by about 40 per cent from 1978 to 1982. During the same period, the real effective exchange rate appreciation ranged up to 200 per cent, depending on the price indices used in the calculation. The overvaluation of the currency has resulted in excess demand for imports and increased incentives to export outside the legal channels in order to acquire essential consumer goods that are not available in the official market. According to the authorities, the peso is quoted in the illegal market at four times its official exchange rate.

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. Another bilateral payments agreement that existed with Cape Verde has been discontinued. No other major changes have taken place since the last consultation discussions.

IV. Report on the Discussions

After years of inaction, the authorities are considering the implementation of a series of policy measures to redress present problems. Most of these measures are contained in the short term Economic Stabilization Program described above. 1/

One of the main issues discussed with the authorities relates to the proposed reform of the commercialization system. Under the new system, SOCOMIN and Armazens do Povo, the state trading companies, will no longer engage in the same type of operations. Armazens do Povo will become a major wholesaler while retaining the retail activity in remote rural areas where the private sector would not participate. SOCOMIN will become an import-export agency and will retain the export monopoly on groundnuts and cotton. The private sector will be given a more prominent role in the

1/ It should be noted that the Development Plan for 1983-86, currently under preparation, has as its main objective the development of the agricultural sector. Particular attention will be paid to the production of basic foodstuffs with a view to achieving self-sufficiency. Among the export crops, production of groundnuts and cotton will be encouraged. Sectors that could provide substantial foreign currency earnings will also be considered as priority, especially the timber and fishing sectors.

commercialization of agricultural products and the distribution of imports at the retail level. Special consideration will be given to the development of the commercial, transport, and public works sectors with a view to improving the collection of crops and the distribution of consumption goods in rural areas. A new transportation enterprise will be set up to transport crops from the collection centers in the provincial capitals to Bissau. In addition, the fluvial transport system will be upgraded with external aid.

To limit the central government deficit, the authorities have announced a series of fiscal measures for 1983-84. These include restrictions on central government and non priority expenditure, and the establishment of a ceiling for total 1983 current expenditure at the same level originally budgeted for 1982. Increased supervision is also to be exercised over capital expenditure. Some increases in excise taxes are scheduled, and better tax enforcement in general is planned. Finally, the authorities expect to renegotiate the external public debt. On the technical side, a major improvement will take place with the development of an integrated (current and capital) budget for 1984.

The authorities have stated their intention to decrease their recourse to credit from the National Bank of Guinea-Bissau to finance the Central Government deficit. They have proposed the use of resources from the National Investment Fund (constituted primarily of Guinea-Bissau peso counterparts of imports financed by donations, earmarked for domestic costs associated with investment projects) to finance the central government current account deficit. A plea will be made to donors to increase aid in order to cover the unfinanced domestic investment projects. The mission pointed out that if the resources used to finance the Central Government deficit were those currently frozen in deposit accounts at the National Bank of Guinea Bissau, the inflationary effect would be the same as if the central bank would grant additional credit to the Government.

Regarding interest rate policy, the authorities recognize that both the present and the expected rate of inflation should be considered in determining the new rate structure, with the expected inflation rate assumed to be substantially lower after the measures contained in the Economic Stabilization Program are implemented. The relatively low rates on deposits are based on the assumption of the existence of a high degree of "monetary illusion." The mission suggested that the proposed system should be simplified, that the spread on the basis of maturity should be narrowed, that as a first step rates should be set on the upper bound of the proposed scheme, and that the authorities should adopt a more flexible approach in the determination of interest rates.

Most of the reforms that the authorities intend to implement require increased amounts of foreign aid. In order to stimulate agricultural production, large increases in imports will be necessary to supply basic essentials to rural areas where, in the last few years, supply of goods had been obtained basically through smuggling. The authorities have planned large

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increases in exports for 1983-84. The mission pointed out that, apart from other reasons mentioned below, targets for the increase in exports cannot be met unless reforms in the commercialization system have been carried out to a satisfactory degree. The high level of external arrears and of debt service payments for 1983-84, and the increased import bill, imply the need for a rather large volume of external resources. The authorities have stated their intention to request a cancellation or a renegotiation of all existing external arrears and debt service maturing in 1983-84.

The mission pointed out that the major shortcoming of the reform package was the inadequate treatment of the adjustment required in producer prices to increase agricultural output. Within this context, changes in the exchange rate were essential to make the increase in producer prices possible.

The staff noted that the measures included in the Economic Stabilization Program, with the reservations made above, were generally on the right track and that, if they were implemented vigorously, they would be helpful to the Guinea-Bissau economy. Some elements of the program could be implemented immediately; others could be implemented as part of a more integrated program. Measures that could be implemented immediately include: (a) improvement in the structure of the marketing system; (b) the restrictive budget measures--particularly the restraints on personnel hiring and personnel costs; and (c) the establishment of an adequate interest rate structure, offering interest on deposits and increasing interest rates on loans, with an adequate spread to cover operational costs. The authorities agreed that major changes in the exchange rate and other pricing policies were needed, but felt they needed technical assistance and were particularly concerned about the political reactions when these measures were implemented. In this area, timing of implementation should be considered carefully. The response of farmers to pricing and exchange rate actions would be thwarted if they found no outlet on which to spend their increased revenues. Hence additional external resources had to be found to cushion the period immediately following the pricing actions.

V. Staff Appraisal

Guinea-Bissau has considerable economic potential. However, in recent years, real economic growth has been unsteady, depending heavily on the vagaries of the weather. Dependence on dwindling foreign aid, price distortions, and lack of an adequate commercialization system have limited the expansion of real output. In addition, investment projects, mainly in the manufacturing sector, have not contributed significantly to the development of the country. Instead, they have unduly increased external indebtedness and, by their heavy reliance on imported inputs, have added pressures to an already weak balance of payments position. Therefore, the staff welcomes the authorities' intention to concentrate their efforts in promoting the expansion of agricultural output.

In view of the unfavorable economic developments, the Guinea-Bissau authorities have reassessed their economic policies and have prepared an Economic Stabilization Program for 1983-84, the main elements of which are described in Chapter II. While there are some shortcomings in the measures proposed by the authorities, the program is essentially on the right track and should be implemented quickly and vigorously.

Containment of central government current expenditures, whose financing has been the main determinant of monetary expansion, is a key element in the adjustment effort. Strict limits on the wage bill, which is unduly high, will be necessary to contain government expenditures. It is also important that revenues be increased further, particularly from the foreign trade sector, which is currently distorted due to an overvaluation of the currency. Measures to contain central government expenditures and increase revenues should be undertaken as soon as is practicable. Improvement in the efficiency of the public enterprises is the major focus for the medium term. More efficient management of these enterprises would improve the allocation of resources and decrease pressure on the budget, monetary expansion and the balance of payments.

Monetary and credit policy in Guinea-Bissau has been expansionary, with the National Bank of Guinea-Bissau satisfying the credit needs of the public sector without limit. The staff welcomes the authorities' intention to separate the central banking and commercial banking functions of the National Bank as soon as practicable, as this would make the task of the National Bank as a monetary authority more manageable. The staff also believes that the proposed increase in interest rates on loans, as well as on deposits, is overdue, and in light of the current rate of inflation, is insufficient. A higher rate structure would be more conducive to improving the savings performance and the allocation of financial resources.

The restructuring and liberalization of the commercial marketing system is a vital element of the adjustment effort. The changes in the marketing structure proposed in the stabilization program are an improvement over the existing structure. The staff believes that the proposed reforms should be implemented as soon as possible and suggests that greater private sector involvement in the transport and distribution systems would be useful.

The major weakness in present policies and in the Economic Stabilization Program for 1983-84 is exchange rate and producer pricing policies. The exchange rate has remained unchanged in SDR terms since 1978, while the parallel market rate is four times the official rate. Inadequate pricing and commercialization systems have led to widespread smuggling in both imports and exports. Farmers have been reluctant to market their produce through domestic channels because there has been nothing to buy in the domestic market. Upward adjustments in both producer prices and exchange rates, integrated with liberalization of the commercial structure, are essential to an effective adjustment effort.

Guinea-Bissau continues to maintain comprehensive restrictions on payments and transfers for current international transactions. The staff notes that Guinea-Bissau's external payments arrears have increased since the last Article IV consultation, and that Guinea-Bissau continues to operate a bilateral payments agreement with a Fund member. The staff regrets the adverse effect these restrictions have on the allocation of resources and urges that policies be adopted that would permit their elimination as part of a comprehensive adjustment process. In the meantime, the staff does not recommend that the Executive Board approve the restrictions.

The authorities have stated their intention to approach creditor countries, with a view to finding a solution to the high levels of external payment arrears and debt service payments. The staff considers that it would be wise for the authorities to put their stabilization program into effect before initiating their approach to the creditor countries.

The measures contained in the Economic Stabilization Program were designed to be fully operative in 1983; their implementation, however, has been delayed. It is the staff's impression that the adoption of significant measures will be further delayed by the authorities' need to reach political consensus on the degree of adjustment, particularly regarding pricing and exchange rate policies.

It is recommended that the next Article IV consultation with Guinea-Bissau be held on the standard 12-month cycle.

VI. Proposed 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/. 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.

GUINEA-BISSAU--Relations with the Fund
(As of March 31, 1983)

Date of membership:	March 1977
Status:	Article XIV
Quota:	SDR 5.9 million
Fund holdings of Guinea-Bissau pesos:	Total currency holdings: SDR 8.44 million, (143 per cent of quota); Holdings from purchases under CFF: SDR 2.54 million (43 per cent of quota)
SDR Department:	Holdings: SDR 9,408 (0.8 per cent of net cumulative allocation)
Trust Fund, gold distribution, and profits from gold sales:	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
Exchange rate:	Pegged to the SDR at the rate of PG 44 = SDR 1 since May 1978. The intervention currency is the U.S. dollar. On December 31, 1982 the exchange rate was PG 40.605 = US\$1 (selling).
Exchange and trade restrictions:	Guinea-Bissau maintains tight restrictions on trade and payments. Guinea-Bissau has a bilateral payments arrangement with Algeria.
Last Article IV consultation:	Discussions were held in December 1978; the consultation was completed by the Executive Board on April 23, 1979 (SM/79/67, 3/1/79; and Sup. 1, 4/20/79; and SM/79/76, 3/22/79).

There are currently three Fund experts giving technical assistance in Guinea-Bissau. A CBD expert (Mr. Cuadros-Sanchez) is serving as Advisor to the Governor of the Central Bank. One fiscal panel expert (Mr. Gouveia) is advising the Government on the implementation of tax reform proposals made by a FAD technical assistance mission in 1979. A second fiscal panel expert (Mrs. Wood-Sanchez) is serving as Advisor to the Ministry of Economy and Finance on government budgeting and financial management. In addition, an Advisor on Agricultural Credit has been requested and CBD is trying to locate a suitable candidate.

GUINEA-BISSAU--World Bank Group Lending Operations

(In millions of U.S. dollars)

A. IDA Operations (as of February 28, 1983)

	Total (including undisbursed)	Disbursed
Roads	9.0	8.1
Petroleum exploration	6.8	4.5
Total	<u>15.8</u>	<u>12.6</u>
Repaid		--
Outstanding		12.6

B. Projected IDA Loan Disbursements

1983	6.9 <u>1/</u>
1984	10.7 <u>2/</u>

Source: IBRD.

1/ Includes disbursements of US\$4.5 million from two new project loans: US\$14 million for developing port facilities; and US\$12.6 million for a second petroleum exploration and promotion project.

2/ Includes disbursements of US\$9.7 million from the project loans mentioned in footnote 1.

Guinea-Bissau--Basic Data

Area, population, and GDP per capita

Area	36,125 sq. kilometers
Population (est. 1982)	808,850
Population growth rate	2.2 per cent
GDP per capita (1982)	SDR 198

Origin of GDP in 1982 (at 1979 prices) (Per Cent)

Agriculture	55.2
Fisheries	5.4
Manufacturing	5.2
Commerce and transport	12.7
Public administration	16.2
Other	5.3

Annual changes in selected economic and financial indicators

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Gross domestic product and prices				
GDP at constant prices	-1.5	-14.8	23.6	5.5
GDP deflator	19.2	13.8	2.2	12.5
Consumer prices (average)	26.0	64.8	45.8	30.0
External sector (in terms of U.S. dollars)				
Exports, f.o.b.	16.5	-19.9	24.8	3.5
Imports, c.i.f.	12.9	2.9	-6.6	-0.8
Non-oil imports, c.i.f.	7.2	-2.0	-5.0	-4.3
Export volume	-11.6	-23.4	52.6	20.8
Import volume	-4.3	-12.4	-12.6	10.7
Terms of trade (deterioration -)	12.1	-10.9	-23.6	-4.1
Government operations				
Revenue and grants	51.2	-1.5	35.7	-17.1
Current expenditures	35.6	20.8	9.8	7.0
Capital expenditures	13.6	25.7	-20.0	35.1
Money and credit (NBGB)				
Net domestic assets <u>1/</u>	-14.4	45.1	55.1	43.9 <u>2/</u>
Central Government <u>1/</u>	17.3	45.4	86.8	62.0 <u>2/</u>
Private sector <u>1/</u>	4.3	4.0	2.0	-1.0 <u>2/</u>
Liabilities to private sector (M ₃)	18.7	19.4	31.2	32.0 <u>2/</u>

<u>Ratios to gross domestic product</u> <u>(in per cent)</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Central government current account deficit	11.3	17.7	12.1	14.4
Central government overall deficit	49.0	66.5	43.1	49.6
Domestic financing	(3.6)	(11.4)	(20.6)	(10.0)
Other <u>3/</u>	(45.4)	(55.1)	(22.5)	(39.6)
Trade balance <u>4/</u>	-32.0	-36.1	-25.3	-23.7
Current account deficit <u>4/</u>	-27.6	-30.1	-18.7	-17.9
External debt, including arrears <u>4/5/</u>	33.2	45.0	54.2	56.7
External payments arrears <u>4/5/</u>	2.3	6.3	11.1	14.3
<u>International reserve position</u> <u>of the NBGB (in millions of U.S.</u> <u>dollars at the end of the period)</u>				
Gross official foreign reserves	17.8	12.1	15.0	15.1 <u>6/</u>
Net official foreign reserves	-1.8	-10.6	-18.6	-24.2 <u>6/</u>
Gross official reserves (months of imports)	3.2	2.1	2.8	2.9 <u>6/</u>

Sources: National Bank of Guinea-Bissau; Ministry of Finance; Planning Secretariat; and Fund staff estimates.

1/ Against the stock of liabilities to the private sector, including liabilities to the nonbank financial intermediaries, at the beginning of the period.

2/ For the 12-month period ending June 1982.

3/ Includes foreign financing, arrears, and differences between accrual and cash basis.

4/ GDP in U.S. dollars calculated on the basis of the official exchange rate.

5/ Excludes arrears on short-term foreign debt.

6/ As of June 1982.

