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SM/83/81
Correction 1

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INFORMATION

June 6, 1983

To: Members of the Executive Board
From: The Secretary
Subject: Guinea-Bissau - Staff Report for the 1983 Article IV Consultation

The following corrections have been made in SM/83/81 (5/13/83):

Page 4, Table 1, column 1, line 1: for "1.5" read "-1.5"

column 2, line 1: for "14.8" read "-14.8"

Page 5, 2nd full para., line 10: for "In all cases," read "In most cases,"

Page 14, 2nd full para., line 10: for "interest or deposits"
read "interest on deposits"

Corrected pages are attached.

Att: (3)

Other Distribution:
Department Heads

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.

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 | <u>747.8</u> | <u>736.9</u> | <u>1,000.3</u> | <u>833.8</u> | <u>828.9</u> | <u>1,020.5</u> |
| Tax revenue | <u>557.6</u> | <u>568.9</u> | <u>687.8</u> | <u>742.1</u> | <u>736.6</u> | <u>838.1</u> |
| 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 | <u>3,123.1</u> | <u>3,862.2</u> | <u>3,555.7</u> | <u>4,509.0</u> | <u>4,320.5</u> | ... |
| Total current budget expenditure | <u>1,297.3</u> | <u>1,567.2</u> | <u>1,720.2</u> | <u>2,029.0</u> | <u>1,840.5</u> | <u>2,111.6</u> |
| 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 | <u>1,825.8</u> | <u>2,295.0</u> | <u>1,835.5</u> | <u>2,480.0</u> | <u>2,480.0</u> | ... |
| Current account surplus or deficit (-) | <u>-549.5</u> | <u>-830.3</u> | <u>-719.9</u> | <u>-1,195.2</u> | <u>-1,011.6</u> | <u>-1,091.1</u> |
| Overall surplus or deficit (-) | <u>-2,375.3</u> | <u>-3,125.3</u> | <u>-2,555.4</u> | <u>-3,675.0</u> | <u>-3,491.6</u> | ... |

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.

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

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.