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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/126

10:00 a.m., October 14, 1992

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
	L. E. N. Fernando
	Deng H., Temporary
	J. Jamnik, Temporary
	M. E. Hansen, Temporary
	K. M. Heinonen, Temporary
	N. A. Espenilla, Jr., Temporary
	S. Vori, Temporary
	O. A. Himani, Temporary
	A. Törnqvist, Temporary
	T. Kanada, Temporary
	W. Laux, Temporary
	T. Sirivedhin
	M. C. B. Arraes, Temporary
	H. Dognin, Temporary
	H. Golriz, Temporary
	L. J. Mwananshiku
	R. Thorne, Temporary
	R. Meron, Temporary
C. V. Santos	Y.-M. T. Koissy
	R. Marino
	A. G. Zoccali

L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant

Also Present

IBRD: M. R. Iskander, Africa Regional Office. African Department: M. Touré, Counsellor and Director; E. A. Calamitsis, Deputy Director; R. C. Barth, J. P. Briffaux, J. A. Clement, A. Doizé, U. Fasano-Filho, S. J. Minton-Beddoes, S. L. Rothman, A. Tahari. Policy Development and Review Department: A. Basu, A. Ibrahim. Advisor to Executive Director: B. R. Fuleihan. Assistants to Executive Directors: G. M. Blome, S. E. Al-Husseini.

1. GUINEA-BISSAU - 1992 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1992 Article IV consultation with Guinea-Bissau (SM/92/158, 8/7/92). They also had before them a statistical annex (SM/92/159, 8/11/92).

The staff representative from the African Department made the following statement:

> Since the issuance of the staff report (SM/92/158), the staff has received the following information from the Guinea-Bissau authorities regarding recent economic and financial developments.
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> In the first half of 1992, government outlays were kept within target, but there was a shortfall in revenue, due mainly to lower taxable imports, difficulties in tax collection, and less than anticipated receipts from privatization and from collection of outstanding debt-service arrears of public enterprises. Thus, it is now projected that the overall fiscal deficit, excluding grants, will be close to 39 percent of GDP in 1992, instead of the originally anticipated level of 34.4 percent. The deterioration in the fiscal position has resulted in a further accumulation of external payments arrears (including to multilateral creditors), bringing their level to $107.3 million at end-August 1992. During the first eight months of 1992, broad money increased by 74 percent, reflecting the expansion of credit to public enterprises and the improvement in the net foreign assets position. As measured by the consumer price index, the rate of inflation on an annual basis accelerated to 66.6 percent during this period (49.8 percent in the comparable period of 1991).
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> In light of these developments, the Central Bank has recently increased the reserve requirement from 25 percent to 30 percent, decided to avoid granting rediscounts to commercial banks, and raised annual lending interest rates from 47-49 percent to 57-59 percent and deposit rates from 34-38 percent to 45-50 percent. As to exchange rate policy, the authorities continue to apply a multiple rate system, and there has been no progress toward achieving unification.
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> During the 1992 Annual Meetings, the staff urged the authorities to take as soon as possible further measures to address the macroeconomic imbalances. The authorities indicated that they intend to take far-reaching revenue-enhancing and expenditure-containing measures in the context of the 1993 government budget, and it was agreed that the draft budget will be discussed with the staff in early November. In the meantime, the Government implemented in early October 1992 some of the measures recommended by the consultation mission, including the elimination of some customs exemptions; the increase in the rice import tax; the

increase in the domestic selling price of fish received on account of the Government's share in the fish catch by foreign fleets; the improvement in the collection of counterpart funds associated with foreign grants in kind; the reduction in embassy expenditures; and a strict control of gasoline expenditure by the various ministries.

Mr. Santos made the following statement:

The recent efforts of my Guinea-Bissau authorities to stabilize the economy suffered serious setbacks in 1991 and early 1992, as a sharp contraction in exports led to a compression of imports with adverse consequences on domestic economic activity. The resulting decline in fiscal revenue contributed to slippages under their economic and financial program and explains in part the sharp reversal in the inflation performance and the acute payments difficulties facing the country. My authorities recognize that the country's limited administrative capacity also contributed to the delayed policy response. It should be emphasized, however, that following the consultation discussions that took place in May 1992 and more recently during the Annual Meetings, my authorities have introduced measures to strengthen their adjustment efforts in a number of key areas.

On the fiscal front, early revenue trends were not in line with budget projections owing to the continued contraction in the tax base and delays in selling public sector assets. In this regard, my authorities further reduced customs duty exemptions, increased the import tax on rice, and improved the collection of tax arrears. They intend to monitor more closely fishing license payments and domestic sales of grants-in-kind in order to improve the collection of nontax revenues. Moreover, it is expected that the recently revamped privatization unit should improve the international bidding procedures so as to accelerate the sale of government assets.

With regard to expenditure, a number of important initiatives have also been taken, which should improve the budgetary position for 1992 and beyond. Between May and July 1992, a high-level expenditure committee was put in place to monitor current spending with a view to curtailing nonpriority expenditure and ensuring that expenditure commitments are in line with the Treasury's cash flow. My authorities have also begun to implement many of the measures recommended by the staff during the last Article IV consultation mission. These include a reduction in embassy expenditures, cash conversion of benefits-in-kind provided tax free to civil servants, and strengthening of the PIP budgeting procedures.

With the implementation of these expenditure control measures, my authorities are of the view that substantial fiscal adjustment can still take place in 1992 despite revenue shortfalls and that the medium-term fiscal consolidation objective remains achievable. In this regard, they have indicated to the staff their intention to hold substantive discussions in early November 1992 on the main elements of the 1993 budget and to reach an understanding on the specific fiscal measures to be introduced to improve the budgetary outlook.

In the monetary sector, my authorities recognize that monetary and credit management was hampered in early 1992 by delays in sterilizing the large inflow of foreign resources and by the lack of effective control over the use of local counterpart funds accumulated under previous balance of payments assistance. Nevertheless, they remain committed to the policy of reducing the expansion of domestic liquidity in order to contain inflationary pressures. In this regard, they have recently tightened monetary conditions, as reserve requirements were increased substantially and both annual lending and deposit rates were raised by some 10 to 12 percentage points. In addition, the continued amelioration of monetary and financial data and the revitalized financial system should enhance the effectiveness of monetary and credit policies.

With regard to the external sector, my authorities are aware of the need to manage external debt in a prudent manner, and they will seek to improve the terms of future borrowings. Pending a permanent solution to their debt difficulties, they have put in place, with the assistance of the UNDP and a bilateral donor, a Debt Management Unit. With regard to the operation of the exchange market, my authorities remain committed to the objective of containing the spread between the parallel and the official markets.

The Guinea-Bissau authorities are continuing their close collaboration with the World Bank on a number of structural issues. On the privatization of parastatals, it is expected that the work of the newly created privatization unit within the Ministry of Finance will accelerate the process. In the areas of forestry and fishery, my authorities intend to continue to address bottlenecks in these sectors and to ensure that prudent and adequate incentives are provided in order to rationalize production and exports.

In conclusion, my authorities are of the view that limited administrative capacity, structural rigidities, and heavy debt burden have constrained the economy's growth prospects. They fully share the staff's call for the provision of technical assistance and debt relief on highly concessional terms. They are concerned that adverse developments have prevented them from building on the early economic and financial achievements. Their resolve to consolidate their adjustment effort has not diminished, as evidenced by the wide-ranging measures implemented. They hope that the policies put in place and those envisaged in the framework of the 1993 budget can form the basis for further discussions on a program to be supported by ESAF resources.

Mrs. Hansen made the following statement:

We welcome the recent measures to contain government expenditure and raise revenues in Guinea-Bissau, because surely finding a solution to the very great fiscal problem is the key to sustainable development and growth in this country. We welcome the fact that some measures have been taken recently, as noted in Mr. Santos's statement, but surely much stronger efforts are needed, particularly to accelerate civil service reforms, sort out the debts of public sector enterprises, and improve the collection of these companies' tax and debt-service arrears.

There is also a need to develop the domestic tax base. I note that revenues from fishing licenses account for a very large part of domestic revenue, and the staff report notes the attendant risk of overfishing in local waters. In this connection, the staff notes in the medium-term outlook that fishing receipts from fishing licenses will continue to increase in 1993 to 1996. I wonder whether this is sustainable in view of the overfishing problem noted earlier in the report.

The staff report also notes that timber companies prefer to overlog and pay fines instead of ensuring the appropriate reforestation. I wonder whether this implies that there is not some scope to raise fines and enforcement to ensure that the timber companies are harvesting the proper amounts and providing for the proper reforestation.

I would also be interested in some comment on whether the high level of capital expenditure is appropriate for Guinea-Bissau, given its apparently limited absorptive capacity, not to mention its high debt-service ratio. Perhaps a large part of this is being financed on quite concessional terms, but I note that the staff also feels there is a problem with adhering to the grant element of 50 percent.

Turning to the monetary and interest rate policy and the financial sector in general, we welcome efforts to put the banking system on a more sound footing by closing Banco Nacional de Credito (BCN) and the establishment of new bank branches in Guinea Bissau. However, we also see a need to raise domestic interest rates to levels that are positive in real terms so as to encourage further domestic savings and investment. At the same time, there is a strong need to contain the growth in domestic liquidity. As for the external sector, it is worrying that the authorities balance of payments projections diverge so markedly from those of the staff. It is also notable that the authorities' budgetary and balance of payments projections do not appear to be entirely consistent. I wonder whether there is a means to provide further technical assistance to the authorities so as to improve their own analytical ability; perhaps the Institute or technical assistance missions from the Fund and the Bank could help.

Turning to the medium-term outlook, clearly Guinea-Bissau's prospects are very difficult, even if they do follow the improved policies recommended by the Fund. But I thought that, for illustrative purposes, it would have been helpful to show a scenario based on current policies. I think that, on the basis of the adjustment we have seen so far, it is not entirely clear that the authorities will be able to tighten policies according to the Fund's recommendations, and I think that it would be interesting for the authorities to see just how much worse their situation could become without substantial policy improvements.

With these remarks, we hope that the authorities will be successful in improving policies in the run-up to their elections, and that we can look forward to substantially better policies in the period to come.

Mr. Dognin made the following statement:

In the absence of a credible medium-term macroeconomic framework, no real progress towards sustainable growth has been made in Guinea-Bissau since the last Article IV consultation, two years ago.

Beyond the worrisome deterioration of all the macroeconomic indicators, confirmed by the most recent indications given in the staff's buff statement, the course of action followed by the authorities gives cause for concern in three particular areas. First, as is rightly pointed out in the staff report, the recourse to short-term and costly expedient to overcome the present financial difficulties is leading the external debt situation to unmanageable levels. Second, despite a very high level of investment and large external financing, GDP growth has been steadily declining since 1988. Third, without any real adjustment in the economy, successive exchange rate adjustments will only contribute to fueling inflation.

In early October, the authorities took fiscal measures that are, of course, steps in the right direction, but the situation clearly requires much more strenuous efforts and a decisive turnaround from present policies in macroeconomic, structural, and external sectors.

To begin with fiscal policy, I agree with the staff that restoring the primary balance of the budget is the most urgent priority. Given the rapid decline in tax revenue, most of the effort should first be on the revenue side, but I would like to make two preliminary remarks in this regard. The authorities seem to place too much emphasis on nontax revenue, and particularly on receipts from public enterprises and proceeds from privatization, which, by nature, are not recurrent resources. In the same vein, the rapid growth over the past three years of fishing license fees appears to have bolstered a somewhat more lax tax collection effort. As rightly emphasized by the staff, the risk of overfishing may lead to an almost as rapid decline in fishing receipts. I would therefore join the staff in urging the authorities to embark on comprehensive tax and tariff reforms, which have already been drafted with Fund and World Bank assistance.

On the expenditure side, I welcome recent electricity and telecommunications outlays. This is a first step in the right direction to prevent the accumulation of new arrears vis-à-vis public enterprises, but more clearly needs to be done to bring current expenditures in line with government revenue. As a case in point, the authorities should not further delay designing a comprehensive civil service reform both to reduce the wage bill and to improve administrative capacity, which remains a major constraint to adjustment in Guinea-Bissau.

Turning now to capital expenditures, I, like Mrs. Hansen, would like to place particular emphasis on the public investment program, which, in my view, has various important consequences for macroeconomic policies that stem from the level of expenditures involved in the program and its direction and financing. First, given the limited absorptive capacity in Guinea-Bissau, I cannot help thinking that such a high level of capital expenditures, around 30 percent of GDP, has a direct and detrimental impact on the level and control of current government outlays. This is partly reflected in the difficulties encountered by the authorities in accounting and studying counterpart funds of external growth. Second, the steady decline in GDP growth since 1988 points to the need for a reorientation of public investment toward the productive sector. In this regard, I noted with satisfaction the measures taken recently, with the assistance of the World Bank, to change the structure of the PIP in favor of priority sectors. Third, in view of the decline in grants, the authorities have decided to progressively shift to less concessional financing to sustain such a high level of investments. My conclusion on this point is that, in addition to the need to restore a primary balance in the fiscal position, it is also urgent to better monitor the investment process.

I would appreciate the staff or Bank representative's comments on these various points. In any case, the current situation clearly calls for better coordination among donors and for more emphasis on technical assistance to increase Guinea-Bissau's implementation capacity.

On monetary policy, I can concur with the thrust of the staff report on the use of interest rates and reserve requirements to reduce credit expansion, but recent developments point to the need for more determined efforts in two directions. First, a comprehensive public enterprise reform, including the early settlement of cross-payment arrears, would be critical to progressively increasing their efficiency and reducing their demand for credit. Second, beyond the elimination of the dual exchange rate system, I would recommend that the authorities adopt a more stable exchange rate policy that will provide an anchor against inflationary expectations and a framework for financial and monetary discipline.

To conclude, recent measures and Mr. Santos's indications for next November's discussions with the staff are encouraging signs of the authorities' commitment to gain momentum in the adjustment effort. However, given the wide range and intricate nature of the macroeconomic and structural problems facing Guinea-Bissau, I cannot but urge the authorities to embark at an early stage on a comprehensive medium-term adjustment program that could pave the way for both stabilization of the economy and normalization of their relations with creditors.

Mr. Mwananshiku made the following statement:

Guinea-Bissau has shown a relatively good rate of economic growth, averaging some 4.8 percent annually over the past five years, but the country is burdened by fundamental structural problems. The most obvious one is the fiscal imbalance. The large budget deficit relative to GDP, and the limited tax effort, speak to the need for strong fiscal action. This is important to help reduce inflation and the pressure on the country's external payments position. All told, I would emphasize that steps aimed at improving public sector finances should be the centerpiece of the Government's adjustment program.

In the present circumstances, expenditure cuts could be important. It would also appear that, in light of the low percentage of tax receipts in relation to GDP, there is room for improving revenue. Technical assistance in this area could be very useful. A cursory view of the situation suggests the need to deal with the problem of ad hoc tax exemptions and the practice of collecting revenue through autonomous special funds. Privatization of public enterprises would also be a step in the right direction. However, we must be realistic and accept that such a move must be seen as part of a longer-term solution, capital is scarce and the current economic climate does not seem to be attractive to foreign private investors.

The authorities would be well advised to go beyond the immediate needs of financial stabilization and promptly implement fundamental reforms in the real sector of the economy. Two points might be stressed in this context. One is that the efficiency of investment should be improved. The economy could have benefited more from the high level of investment--some 32.7 percent relative to GDP over the past five years--if resources had been used more efficiently. The second point is the need to expand the money economy. A significant portion of total production is in the nonmonetized sector. In 1991, exports amounted to only $20 million. This puts in perspective the country's high reliance on foreign financial assistance, as well as its inability to meet its debt-service payments.

Continued assistance on highly concessional terms, as well as debt relief, with emphasis on debt cancellation, must be part of a comprehensive package to address Guinea-Bissau's economic problems. The authorities, for their part, have to move quickly to develop a realistic program of economic reform that can be supported by the Fund, through its concessional window, and by the international community in general. Time is of the essence, because further delays could only mean a further buildup of external arrears and the slow disbursement of much-needed foreign aid.

Mr. Törnqvist made the following statement:

I agree with the staff report and previous speakers in that the developments in Guinea-Bissau give rise to great concern. Since the last Article IV consultation, slippages have continued in the areas of fiscal policy, monetary policy, and structural reform. Inflation has increased from an already high level, fiscal policy has weakened, and monetary growth has accelerated. The current account deficit has increased, and external arrears have accumulated further.

As to structural reforms, there has been some progress. There has been a welcome strengthening of the financial system.

Some privatization has taken place, albeit limited. On the other hand, not much has happened as to civil service reform. The long-recommended unification of the exchange system has not taken place. On the whole, also the structural developments have been disappointing.

What gives some hope is that the authorities recognize the problems and are expressing their intentions to solve them. The authorities still seem to be aiming at an ESAF program, and it is clearly in the best interests of Guinea-Bissau to return to such a program. Thus, even if there have been serious setbacks, the authorities must be encouraged to try to work their way back to a situation where it can be meaningful to resume discussions about an ESAF program. In this work, they should give the highest priority to getting the budget under control. There seems to be ample room both for cutting expenditures and increasing revenues, as has been observed by several speakers.

In the meantime, it is very important that the Fund and the World Bank continue to extend all the support they can give to the authorities of Guinea-Bissau, including, not least, various kinds of technical assistance that is crucial in order to strengthen the administrative capacity of the authorities.

Mr. Kanada made the following statement:

I welcome this opportunity to review the economic situation of Guinea-Bissau. Looking at the overall economy of Guinea-Bissau, it is a matter of great concern that the situation has not improved since the 1990 Article IV consultation, because of the setbacks in 1991 and early 1992; in fact, the situation has deteriorated in some areas.

I would like to point out that Guinea-Bissau is suffering from chronic insolvency in conjunction with the overall deficit and the current sizable and increasing external debt burden. In this regard, it is welcome that the Government implemented earlier this month some of the measures on both the revenue and the expenditure sides that were recommended by the consultation mission. However, it is absolutely necessary for the authorities to take further revenue-enhancing and expenditure-containing measures without delay, as indicated by the staff, in order to correct the deteriorating fiscal and debt situations.

It is a matter of concern that broad money increased by 74 percent in the first eight months of 1992, reflecting the expansion of credit to public enterprises, and the rate of inflation on an annual basis accelerated to 66.6 percent during this period. In this regard, it is welcome that the Central Bank has recently taken some measures, such as increasing the reserve requirement and raising the annual lending interest rates by about 10 percent.

However, the authorities should take further measures to adjust the lending and deposit rates in order to establish positive real interest rates. This will contain excessive credit expansion and help achieve a permanent reduction in the inflation rate.

Lastly, as Mr. Santos mentioned in his statement, the policies envisaged in the framework of the 1993 budget can form the basis for further discussions on a program to be supported by ESAF resources. I would like to emphasize that the authorities should take the requisite corrective measures to regain adjustment momentum. In my view, it is essential that the authorities achieve a credible adjustment record prior to any new Fund arrangement.

With these remarks, I support the proposed decision.

Mr. Al-Tuwaijri made the following statement:

Since the SAF program went off track, Guinea-Bissau's economic position has continued to deteriorate. The central government deficit widened to the extraordinary level of 39 percent of GDP, inflation accelerated further, and the external position weakened sharply. Clearly, there is a need for appropriately restrictive fiscal and credit policies in order to curtail the excess demand pressures that contributed to this state of affairs.

It is beyond doubt that any country confronting such an economic situation is in need of a substantial and sustained improvement of the fiscal position. In view of the size of the public sector deficit and the recent decline in revenues, fiscal adjustment should be given the highest priority. Despite the recent and welcome revenue measures, the authorities appear reluctant to tackle aggressively the fiscal deficit, and they are relying largely on improvements in the collection of tax and debt-service arrears from public enterprises. Consequently, as the staff paper indicates, the overall fiscal position may actually deteriorate, thereby leading to sizable additional payments arrears. Therefore, I join the staff in urging the authorities to implement promptly additional revenue-enhancing and expenditure-containing measures, including the long-delayed civil service reform. Indeed, given the low revenue elasticity, the authorities should intensify efforts to reform the tax system, broaden the tax base, and adjust fees and charges for inflation. In this connection, it is crucial that the budget provide for the scheduled debt service to multilateral institutions.

Strong fiscal deficit reduction measures need to be coupled with a tight credit and monetary stance, in order to curb aggregate demand. Here I agree with the staff that the Government should forgo the use of the local counterpart funds accumulated from past external balance of payments assistance. Moreover, the maintenance of positive real interest rates, along with periodic adjustments of indirect financial control instruments, are also needed.

Reflecting the continuing large domestic imbalances, the current account deficit in 1991 exceeded 36 percent of GDP. In addition, since exports consist of only a few agricultural products, and given that Guinea-Bissau is heavily dependent on grants and concessional loans from donors and creditors, the balance of payments position will continue to be extremely precarious in the future. This unsustainable external position underscores the crucial importance of ambitious and bold stabilization policies. Indeed, the absence of such policies is likely to adversely affect the flow of external exceptional assistance, including debt relief. Finally, I welcome the authorities' intention to adopt a market-based unified exchange rate. However a unified market exchange rate will not provide a solution to the economies' problem unless accompanied by much tighter financial policies.

With these comments, I wish the authorities well and support the proposed decision.

The staff representative from the African Department said that the limitations on both the quality and consistency of the data for Guinea-Bissau added to the difficulty in not only formulating and implementing needed policies, but also in assessing the current situation. Technical assistance had been provided and would continue to be provided by the Fund, the World Bank, UNDP, and bilateral sources. In that connection, however, it was important to bear in mind the limited absorptive capacity of the authorities to take advantage of the technical assistance.

Capital expenditure was one of the data issues, the staff representative continued. The ratio of that expenditure to GDP was relatively high, at 30-35 percent. However, that mainly reflected two factors. First the figure for capital outlays, which was used by the staff of the Fund and the Bank, was an estimate, based on disbursements of loans and grants, to which the domestic counterpart was added. In that connection, the important question to ask was whether all the loans and grants actually used for capital outlays. Gaining a better idea of the actual volume of capital expenditure should be one of the goals of the technical assistance provided to the authorities. A second aspect of the high capital/GDP ratio was the exchange rate impact (in terms of dollars, capital expenditure over the past few years has been about $50 million per year).

The provision of fishing licenses was reflected in the medium-term projections in the staff report, the staff representative commented. The projections--an increase from $13 million to $17 million--were based on very moderate assumptions about the number of fishing licenses that would be provided, given the importance of using the country's natural resources in a rational manner. Under current arrangements, the recent decision to increase the domestic selling prices of fish received on account of the government's share in the fish catch by foreign fleets would increase the contribution to the budget.

There appeared to be scope to raise the fines in the forestry and timber sector to help reduce the overutilization of forestry resources, the staff representative remarked. That issue would be raised with the authorities.

The staff had not prepared a scenario based on the continuation of current policies, the staff representative stated. The staff felt that Guinea-Bissau was at a stage at which it had no alternative but to implement the adjustment policies recommended in the staff report, rather than maintain the current policies. The authorities fully agreed with that assessment. In that connection, the main issue was the degree of policy adjustment that would be undertaken; the 1993 budget would provide an important opportunity to introduce the needed measures. Without such measures, the authorities would clearly have major difficulty in servicing the foreign debt, without accumulating additional arrears, including to multilateral creditors.

The staff agreed with Directors' comments on the exchange rate policy, the staff representative from the African Department said. The staff would continue to urge the authorities to unify the exchange rate system and to implement appropriate monetary and fiscal policies.

Mr. Thorne said that he agreed with earlier speakers on the analysis of the general situation and wished to raise several questions. The first concerned the Central Bank and the Banco Nacional de Credito (BCN); he was puzzled by the various factors at work in respect of those institutions. He wondered why domestic counterpart funds had been released by the Central Bank and short-term credits had been granted by BCN. Second, arrears on civil service wage payments seem to have developed, but no reference to them was made in the staff report. Third, he wondered whether, in the circumstances, the staff felt that the crawling exchange rate peg had been beneficial. Fourth, given the high and variable inflation rate in the country, the budget tables were not easy to interpret: the peso was devaluing so quickly that it was difficult to determine the real rates of growth from the tables provided. Notwithstanding the statistical difficulties with GDP, it might have been easier for readers to have been presented with fiscal tables either in real terms or ratios to GDP. Indeed, Chart 3, on the exchange rate, showed such a rapid rate of decline that logarithmic scales might have been helpful.

The staff representative from the African Department responded that, despite the Fund's repeated advice to the authorities, they had decided to use the domestic counterpart funds. The staff, too, had wondered why the authorities had permitted the BCN to go ahead with the short-term loans mentioned in the staff report, but the authorities had recognized their mistake and were making an efforts to resolve the issue. It was the staff's understanding that there had been delays in salary payments to civil servants, but the staff was not aware of any arrears in recent months.

The staff could take up the questions on statistics on a bilateral basis, the staff representative from the African Department said.

The staff representative from the Policy Development and Review Department recalled that the question had been raised whether the move to a crawling peg exchange regime had proved beneficial. No exchange rate regime could be expected to function well in the absence of supportive fiscal and monetary policies; in that connection, in Guinea-Bissau there had not been a level playing field, and, therefore, comparing the gains from the crawling peg regime with possible gains from another regime was difficult.

As to Mrs. Hansen's question concerning medium-term scenarios, in general, in cases in which the underlying fiscal and monetary policy framework was as weak as it was in Guinea-Bissau, and the exchange system was open and flexible, the imbalance in the economy showed up either in movement in the exchange rate that was faster than expected in the scenario, or in the accumulation of arrears. With those two variables moving by large amounts, depending on how the authorities conducted domestic policies, it was difficult to construct medium-term scenarios. The scenario in the present staff report on Guinea-Bissau was meant to show the basic benefits in the medium term of a stability-oriented scenario.

Mr. Santos commented that his authorities agreed with the assessment by the staff and Directors of the overall economic and financial situation in Guinea-Bissau, and of the priority issues in particular. The authorities' record of performance was not strong, but since the 1992 Annual Meetings they had clearly made a firm commitment to implement serious measures to address the crucial issues, especially in the budgetary field. They recognized that the absence of a credible medium-term macroeconomic framework could hamper their efforts to create an environment conducive to sustainable growth. At the time of the 1992 Annual Meetings they had requested the staff's assistance in putting such a framework in place, which could contribute to the successful transition to democratic institutions by imposing discipline and establishing a firm foundation for stable and sustainable growth. The authorities hoped to hold further discussions with the staff in early November 1992. They recognized that, while the African Department faced a serious human resources constraint, the staff was strongly committed to continuing to assist the authorities, whose success would depend importantly on the help provided by the Fund and the World Bank. Guinea-Bissau was greatly dependent on concessional external financing; without it, the Government's adjustment efforts were disrupted by a lack of revenues, which derailed the fiscal efforts and led to an increase in monetary financing that was reflected in the exchange rate--a vicious circle from which the authorities were anxious to escape. In 1989-91, the difficulty in managing the economy had stemmed in part from the actions of the Central Bank, whose high-level management had recently been replaced. He was confident that the bank's management would continued to move in the right direction in the future.

In the process of reallocating staff resources under the temporary procedures for conducting Article IV consultations, it had been agreed that translations of staff papers would no longer be provided, Mr. Santos noted. In the absence of translations into French, the Central Bank authorities in Guinea-Bissau had not been able to respond in any detail to the staff papers under discussion.

The Acting Chairman made the following summing up:

Directors generally concurred with the thrust of the staff appraisal. They expressed deep concern that Guinea-Bissau's economic situation had deteriorated further as a result of the slippages in policy implementation and of external borrowing on terms that had not been in line with the country's debt-servicing capacity. Directors thus urged the authorities to take all necessary measures to correct the internal and external imbalances with a view to resuming progress toward the country's medium-term objectives. While welcoming the most recent corrective actions taken by the Government, they emphasized the need for a substantial and lasting improvement in the fiscal position through the introduction of more far-reaching measures to raise revenue and contain expenditure. In this respect, Directors stressed in particular the importance of broadening the tax base, enhancing collection of import and consumer taxes on petroleum products, reducing nonpriority government outlays, and effectively implementing the long-delayed civil service reform. Directors were also concerned that the public investment outlays were unsustainably high in relation to the size of the economy and urged that such outlays focus on directly productive projects.

Directors noted the closing of the Banco Nacional de Credito (BCN) and welcomed the establishment of new commercial bank branches as important steps toward the development and strengthening of an orderly banking system. However, they also emphasized the importance of implementing a prudent credit policy, adjusting lending and deposit rates further to achieve positive real interest rates, and speeding up the recovery of the nonperforming loans to the BCN. The need to bring inflation under control and establish the basis for a unified exchange rate and exchange rate stability underscored the importance of tight fiscal and credit policies.

Given the heavy external debt burden and its impact on the budget and the balance of payments, Directors stressed the urgent need to adopt a comprehensive medium-term adjustment program and restore orderly debt management policies and relations vis-à-vis external creditors. They recommended avoiding further recourse to short-term external borrowing and adhering strictly to a policy of not contracting or guaranteeing external debt except on very concessional terms and for productive purposes.

Directors urged the authorities to strengthen the momentum of structural reforms in order to avoid jeopardizing past achievements in this area. In particular, it was felt that emphasis should be placed on the acceleration of public enterprise and civil service reforms, a careful design and implementation of an efficient and productive public investment program that would be in line with the country's absorptive and debt-servicing capacities, and the formulation of tax measures or tax adjustments that would be consistent with the preservation of Guinea-Bissau's natural resources in the fishing and forestry sectors.

Directors noted the progress achieved since the last consultation in improving the economic and financial data base, but encouraged the authorities to continue with their efforts to strengthen the statistical system, with particular emphasis on information on external transactions, consumer prices, and the balance of payments. Directors encouraged the provision of technical assistance to this end.

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

The Acting Chairman commented that the question of the translation of documents would have to be raised with the Bureau of Language Services. However, the Bureau clearly had a large volume of papers to translate and had to do this work with the resources that were available to it.

The Executive Board approved the following decision:

1. The Fund takes this decision relating to Guinea-Bissau's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1992 Article XIV consultation with Guinea-Bissau, in the light of the 1992 Article IV consultation with Guinea-Bissau conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. As described in SM/91/255, Guinea-Bissau continues to maintain restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV, Section 2. In addition, the restrictive features of a bilateral payments agreement with a Fund member, the exchange restrictions evidenced by certain external payments arrears, and a multiple currency practice are subject to Fund approval under Article VIII, Sections 2(a) and 3. The Fund encourages Guinea-Bissau to continue reducing its reliance on exchange restrictions and urges the authorities to eliminate the restrictions that are subject to Fund approval, including the multiple currency practice.

Decision No. 10164-(92/126), adopted
October 14, 1992

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/92/125 (10/9/92) and EBM/92/126 (10/14/92).

2. REPUBLIC OF LITHUANIA - REPRESENTATIVE RATE FOR LITHUANIAN TALONA

The Fund finds, after consultation with the Lithuanian authorities, that the representative exchange rate for the talona under Rule 0-2(b)(i) against the U.S. dollar is the midpoint between spot buying and selling rates for the U.S. dollar in the foreign exchange market, as determined by the Bank of Lithuania. (EBD/92/239, 10/7/92)

Decision No. 10165-(92/126), G/S adopted
October 9, 199

3. STAFF RETIREMENT PLAN - WORKERS' COMPENSATION POLICY

The Executive Board approves the recommendations of the Committee on Administrative Policies concerning modifications to the Fund's workers' compensation policy as set forth in EBAP/92/146 (10/7/92).

Decision No. 10166-(92/126), adopted
October 13, 1992

4. OFFICE SPACE - PHASE III - FUND INTERVENTION IN LANDMARK DESIGNATION CASE

The Managing Director is authorized to initiate legal proceedings to challenge the decision of the D.C. Historic Preservation Board to reconsider HPRB Case No. 91-10 concerning landmark designation of the Western Presbyterian Church and to take all necessary actions relating thereto. (EBAP/92/145, 10/7/92)

Adopted October 13, 1992

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 92/36 through 92/39 are approved.

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Advisor to Executive Director as set forth in EBAM/92/95 (10/9/92) is approved.

APPROVED: April 21, 1993

LEO VAN HOUTVEN
Secretary