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July 27, 1990

To: Members of the Executive Board

From: The Secretary

Subject: Guinea-Bissau - Staff Report for the 1990 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1990 Article IV consultation with Guinea-Bissau, which will be brought to the agenda for discussion on a date to be announced. A draft decision appears on page 23.

Mr. Cronquist (ext. 6932) or Mr. Ordoobadi (ext. 6935) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

GUINEA-BISSAU

Staff Report for the 1990 Article IV Consultation

Prepared by the Staff Representatives
for the 1990 Consultation with Guinea-Bissau

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

Approved by Pierre Dhonte and Anupam Basu

July 26, 1990

<u>Contents</u>	<u>Page</u>
I. Introduction	1
II. Recent Economic and Financial Developments	2
1. Background	2
2. The policy framework for 1989-91	3
3. Developments in 1989	5
III. Report on the Discussions	11
1. Prospects for 1990	11
a. Macroeconomic policies	11
b. External sector	14
c. Structural policies	16
2. Medium-term balance of payments prospects	17
IV. Staff Appraisal	19
Text Tables	
1. Selected Economic and Financial Indicators, 1987-93	4
2. Quantitative and Structural Benchmarks for the Second Annual Arrangement Under the SAF, 1989	6
Appendix I. Relations with the Fund	24
Appendix II. Relations with the World Bank Group	27
Appendix III. Statistical Issues	32

<u>Contents</u>	<u>Page</u>
Appendix IV. Statistical Tables	
I. Central Government Operations, 1987-93	33
II. Monetary Survey, 1988-90	34
III. Balance of Payments, 1987-93	35
IV. External Debt Summary, 1985-89	36
V. Indicators of Fund Credit, 1989-2000	37
VI. Selected Social and Demographic Indicators	38
Appendix V. Status of Implementation at End-1989 of the Policies and Measures Under the Program Supported by the Second Annual Arrangement Under the SAF	39
Charts	
1. Key Indicators of Economic and Financial Policy and Performance, 1987-91	4a
2. Exchange Rate Developments, January 1987-March 1990	10a
3. Currency in Circulation and the Parallel Market Exchange Rate, January 1987-December 1989	10b

I. Introduction

The 1990 Article IV consultation discussions with Guinea-Bissau were held in Bissau during the period April 23-May 8, 1990. The representatives of Guinea-Bissau included Mr. Manuel dos Santos, Minister of State for Economy and Finance, Mr. Pedro Godinho Gomes, Minister-Governor of the Central Bank, and other senior officials concerned with economic and financial matters. The staff team comprised Mr. Cronquist (head), Mr. Adande, Ms. Doizé, Mr. Ordoobadi (all AFR), Mr. Yao (STA), and Mrs. Martinez (assistant-AFR).

A three-year arrangement under the structural adjustment facility (SAF) for the period 1987/88 to 1989/90 and the first annual arrangement thereunder in support of the authorities' program for the period July 1987-June 1988 for the equivalent of SDR 1.5 million (20 percent of quota) were approved by the Executive Board on October 14, 1987 (EBS/87/197). A second annual SAF arrangement in support of a program for calendar year 1989 was approved on July 21, 1989 for the equivalent of SDR 2.25 million (30 percent of quota) (EBS/89/131). As of end-May 1990, Guinea-Bissau's outstanding obligations to the Fund amounted to SDR 3.75 million (50 percent of quota).

On May 19, 1987 the World Bank approved a structural adjustment credit (SAC) for Guinea-Bissau in an amount of about US\$40 million, including cofinancing. A second structural adjustment credit of about US\$50 million, including cofinancing, was approved on May 18, 1989. The disbursement period for the second SAC is July 1989-July 1991. The staffs of the Fund and the World Bank have maintained close collaboration on various aspects of Guinea-Bissau's structural adjustment efforts and financing requirements, as outlined in the updated medium-term policy framework paper (PFP) for 1989-91 (EBD/89/180).

Guinea-Bissau is on the standard 12-month consultation cycle. The 1987 Article IV consultation with Guinea-Bissau was concluded on April 8, 1988. The next Article IV consultation should have been concluded by April 8, 1989, or at the latest by July 8, 1989, allowing for the three-month grace period beyond the end of the specified interval. However, as its conclusion was being delayed, the following notifications have been issued to the Executive Board: EBD/89/253, August 21, 1989; EBD/90/64, February 23, 1990; and EBD/90/64, Sup. 1, June 29, 1990.

During a staff visit to Bissau in January 1990 and a subsequent visit by the Guinea-Bissau authorities to the Fund in early April, the execution of the 1989 program, supported by the second annual SAF arrangement, was reviewed. As there were major deviations from the benchmarks, and because understandings on the requisite corrective measures to be implemented during the remainder of 1990 could not be reached, the Guinea-Bissau authorities recognized that it would not be

possible to negotiate a program that could be supported by a third annual SAF arrangement.

At the time of the conclusion of the last Article IV consultation (SUR/88/30), Executive Directors expressed concern about the rapid growth of domestic liquidity and the resulting acceleration of inflation. They noted the authorities' tightening of fiscal and credit policies and encouraged them to take further steps in that direction, including measures to improve the budget. Directors stressed the importance of sustaining the ongoing adjustment effort and of reinforcing this effort as needed. They also encouraged the authorities to strengthen the Government's ability to monitor economic and financial developments.

Guinea-Bissau continues to avail itself of the transitional arrangements under Article XIV. In addition, Guinea-Bissau maintains a bilateral payments agreement with a Fund member, the restrictive features of which are subject to Fund approval under Article VIII, Section 2(a).

Summaries of Guinea-Bissau's relations with the Fund and with the World Bank Group are provided in Appendices I and II, respectively; statistical issues are discussed in Appendix III; statistical tables are presented in Appendix IV; and the status of implementation at end-1989 of the policies and measures under the program, supported by the second annual SAF arrangement, is shown in Appendix V.

II. Recent Economic and Financial Developments

1. Background

In 1987, the authorities launched a medium-term adjustment program for the three-year period 1987-89, aimed at promoting economic activity, reducing inflationary pressures, and improving the external sector position. A program covering the period July 1987/June 1988 was supported by the first annual SAF arrangement. As economic and financial developments in Guinea-Bissau during the two years 1987-88 were analyzed in the staff report on the request for the second annual arrangement under the SAF (EBS/89/131, 6/28/89), this section provides only a brief summary.

During 1987 and 1988 substantial progress was made in the implementation of economic liberalization measures, and economic growth exceeded the program targets in both years despite a slowdown in the growth of the agricultural sector in 1988 because of adverse weather conditions that affected the harvest of cashew nuts (the principal export). The obstacles to private sector activity were reduced, and the private sector, rather than the state trading enterprises, exported most of the agricultural crops. Nevertheless, marketing and price distortions persisted, as the state monopoly on cereal imports was not

abolished as envisaged, and the retail prices for petroleum products were not adjusted to reflect exchange rate movements and world market petroleum prices. Similarly, the structural benchmarks relating to the completion of a study of the state enterprise sector, including an inventory of the cross-debts between the Government and the state enterprises, were not observed.

There were substantial slippages in the implementation of fiscal and credit policies in 1987-88. The overall government budget deficit, on a commitment basis and excluding grants, rose from 36.7 percent of GDP in 1987 to 38.2 percent of GDP in 1988, compared with program targets of 35.9 percent and 31.8 percent, respectively, because of shortfalls in tax revenue as well as expenditure overruns (Table 1 and Chart 1). Mainly reflecting the growth in bank credit to the nongovernment sector, which exceeded the programmed increase, domestic liquidity expanded by about 73 percent during both years, and the average annual rate of inflation, estimated at 107 percent in 1987 and 66 percent in 1988, also exceeded the program targets. The spread between the official and the parallel market exchange rates for the U.S. dollar narrowed from an average of 68 percent in 1987 to 22 percent in 1988. The trade-weighted nominal effective exchange rate depreciated by 72 percent in 1987 and by 33 percent in 1988. The excess demand pressures, coupled with a worsening of the terms of trade, resulted in a widening of the external current account deficit, excluding official transfers, from 35.5 percent of GDP in 1987 to 47.5 percent in 1988, compared with the 1988 program target of 45.7 percent.

The Paris Club creditors in October 1987 granted Guinea-Bissau a first rescheduling of all principal payments on eligible official debt falling due during the period July 1, 1987 through December 31, 1988 and all payments arrears accumulated through June 30, 1987. As a result, the debt service ratio was reduced from 92.5 percent to 43.8 percent in 1987 and from 100.0 percent to 61.4 percent in 1988.

2. The policy framework for 1989-91

Since the structural benchmarks were not observed and the financial policies were not consistent with the medium-term program for 1987-89, the Guinea-Bissau authorities, in close consultation with the staffs of the Fund and the World Bank, adapted and strengthened their adjustment policies for the period 1989-91. ^{1/} The updated medium-term program was designed to achieve an average annual rate of growth of real GDP of about 4.7 percent over this period, permitting real per capita consumption to rise by at least 1 percent a year. The medium-term objectives also included a progressive reduction in the average annual rate of inflation, from 66 percent in 1988 to about 8 percent in 1991,

^{1/} EBD/89/180, 6/15/89.

Table 1. Guinea-Bissau: Selected Economic and Financial Indicators, 1987-93

(Annual percentage changes, unless otherwise specified)

	1987		1988		1989		1990		1991	1992	1993
	Prog.	Est.	Proj.	Est.	Prog.	Rev. est.	Orig. proj.	Rev. proj.	Rev.	proj.	Proj.
Real GDP growth ^{1/}	3.5	5.6	3.5	6.8	5.1	5.0	4.5	4.5	4.4	4.5	4.5
Central government operations											
Total revenue and grants	219.1	206.8	70.0	80.9	91.5	131.7	9.3	53.1	7.4	8.0	7.6
Of which: total revenue	(194.6)	(230.9)	(71.6)	(85.3)	(68.7)	(80.9)	(14.2)	(84.2)	(5.1)	(11.4)	(10.7)
Total expenditure	132.1	132.6	67.3	92.3	60.1	121.2	12.1	24.2	15.8	3.2	5.8
Current expenditure	91.4	85.9	66.4	89.6	62.8	143.9	7.7	16.6	17.3	-3.1	3.7
Capital expenditure	163.8	169.0	67.8	93.7	58.6	109.2	14.5	28.9	14.9	6.8	6.8
Overall deficit (commitment basis, in percent of GDP) ^{1/}											
Including grants	-8.3	-12.2	-8.7	-15.4	-3.9	-17.2	-7.0	-2.3	-6.5	-3.6	-2.5
Excluding grants	-35.9	-36.7	-31.8	-38.2	-38.2	-51.5	-37.8	-41.5	-42.3	-37.3	-34.2
Money and credit ^{2/}											
Net domestic credit ^{3/}	2.8	...	-58.2	44.2	0.3	76.7	...	-56.6	...	...	...
Of which:											
Central Government (net)	(-48.9)	(...)	(-71.4)	(-58.5)	(-19.1)	(-42.3)	(...)	(-50.6)	(...)	(...)	(...)
Credit to economy	(51.7)	(...)	(13.2)	(102.7)	(19.4)	(119.0)	(...)	(-6.0)	(...)	(...)	(...)
Broad money supply	12.0	72.5	-15.9	72.8	21.4	42.4	...	15.0	...	...	...
Inflation ^{4/}											
December/December	85.4	149.3	44.0	50.1	20.0	61.2	12.0	20.0	6.0	6.0	6.0
Annual average	77.8	106.7	63.0	66.0	40.0	73.1	14.0	25.0	17.0	6.0	6.0
External sector (in terms of U.S. dollars)											
Exports, f.o.b.	61.8	58.8	40.9	3.2	30.8	-10.7	16.8	72.5	-10.6	26.5	18.8
Imports, f.o.b.	1.0	-12.7	31.8	31.8	6.1	17.0	2.2	2.0	15.8	-2.3	6.3
Export volume	31.0	34.1	24.0	10.1	32.5	-3.0	14.7	82.4	-14.4	20.9	13.0
Import volume	-1.7	-22.4	12.0	21.3	3.5	19.4	2.5	2.3	9.1	-6.9	0.5
Terms of trade (deterioration -)	21.6	5.2	-3.4	-13.6	-4.2	-7.2	2.1	-4.8	-1.2	-0.6	-0.5
Official grants	-1.1	4.8	-4.8	-3.5	18.9	32.3	-5.2	7.6	-1.8	—	—
Nominal official exchange rate (PG/US\$) (depreciation -)	-187.8	-172.7	-73.3	-98.6	-42.7	-63.1	-12.5	-30.8	...	...	...
External current account (in millions of U.S. dollars)											
Including official transfers	-18.8	-12.9	-23.4	-29.0	-23.5	-38.6	-24.0	-8.3	-37.0	-28.0	-28.5
Excluding official transfers	-61.8	-58.5	-66.8	-73.0	-75.8	-96.8	-73.6	-70.9	-98.5	-89.5	-90.0
Excluding official transfers and scheduled interest	-50.6	-50.9	-53.7	-62.4	-62.8	-84.5	-61.4	-58.7	-83.5	-76.9	-78.9
External current account (in percent of GDP) ^{1/}											
Excluding official transfers	-37.5	-35.5	-45.7	-47.5	-49.9	-57.2	-45.8	-45.1	-57.4	-49.1	-46.4
Excluding official transfers and scheduled interest	-30.7	-30.9	-36.7	-40.6	-41.4	-49.9	-38.2	-37.4	-48.6	-42.2	-40.6
Overall balance of payments (in millions of U.S. dollars)	-2.9	2.0	-0.7	-6.7	-10.5	-39.0	-9.4	4.6	-17.1	-13.2	-13.5
Gross official reserves (in weeks of imports, c.i.f.)	3.8	10.5	...	12.3	12.0	15.8	12.0	12.0	12.0	12.0	12.0
External public debt (in millions of U.S. dollars; end of period)											
Medium- and long-term ^{5/}	366.9	369.6	384.6	387.8	398.5	432.2	410.6	440.2	457.5	469.6	481.9
Total outstanding arrears ^{6/}	50.5	32.2	18.2	39.9	19.7	51.1	11.9	17.7	8.1	2.4	—
Debt service ratio ^{7/}											
Before rescheduling	113.2	92.5	95.5	100.0	103.8	155.0	80.6	73.5	111.3	75.6	63.7
After rescheduling ^{8/}	83.9	43.8	49.1	61.4	...	131.3	...	57.3	...	...	...

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

^{1/} Because of the weak data base, figures and ratios related to GDP must be interpreted with caution.

^{2/} The 1988 data on money and credit are not comparable with those for preceding years owing to the extensive revisions of the data base.

^{3/} In percent of initial stock of broad money.

^{4/} Staff estimates, based on movements in the parallel market exchange rate and an assumed weight of 30 percent of the official sector in the economy.

^{5/} Including debt service arrears on medium- and long-term debt; outstanding debt at end-1989 includes US\$24.2 million of previously unreported debt incurred between 1987-89.

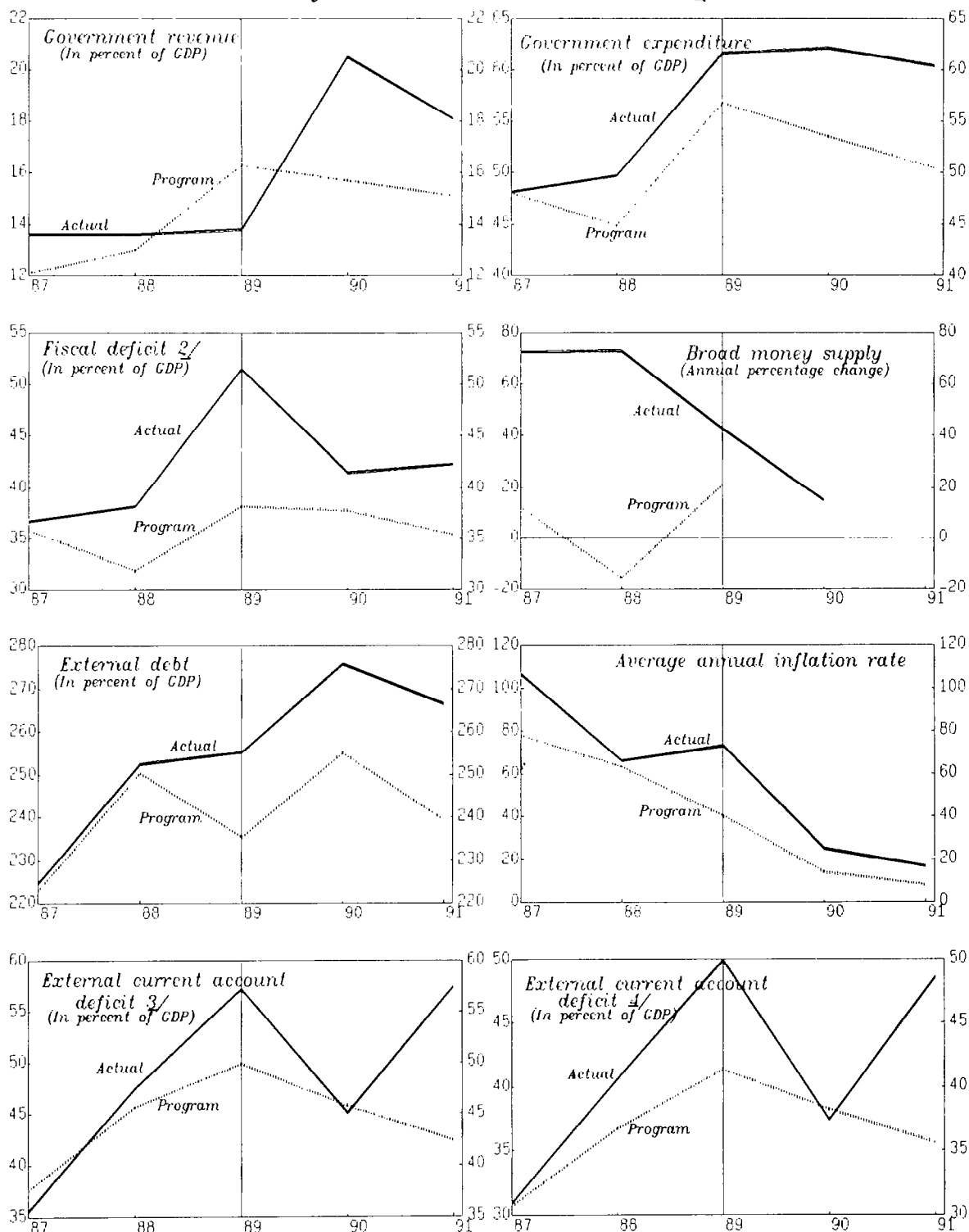
^{6/} Including short-term arrears of the National Bank.

^{7/} In percent of exports of goods and nonfactor services.

^{8/} Rescheduling under the auspices of the Paris Club, and assuming comparability of treatment of other creditors.

CHART 1

GUINEA-BISSAU Key Indicators of Economic and Financial Policy and Performance, 1987-91 ^{1/}



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

^{1/} For 1990 and 1991, the "program" indicators refer to the original projections in the PFP, and "actual" refers to the revised projections in this report.

^{2/} On a commitment basis, excluding official transfers.

^{3/} Excluding official transfers.

^{4/} Excluding official transfers and scheduled interest payments.

and a narrowing of the external current account deficit, excluding official grants, from 47.5 percent of GDP in 1988 to 42.4 percent in 1991.

The thrust of the structural policies was directed toward an expansion of agricultural output and exports, and increased efficiency in the allocation of public resources through a reform of the public enterprise sector, the streamlining of the civil service, the strengthening of the tax system, the restructuring of the banking system, and the continued liberalization of the exchange and trade system.

The authorities' macroeconomic policies were to support and reinforce the structural measures. Fiscal policy aimed at increasing revenue and containing expenditure so as to restrain aggregate demand to a level that would be more in line with available resources. The overall budget deficit, on a commitment basis and excluding grants, was to be reduced from 38.2 percent of GDP in 1988 to 35.4 percent in 1991, and the current budget surplus, excluding scheduled interest payments, to be increased from 1.1 percent of GDP in 1988 to 4.6 percent in 1991. A prudent credit policy would contain aggregate demand pressures while providing financing for production and commerce. The debt management strategy aimed at reducing the heavy external debt service burden, and no new loans with a grant element of less than 50 percent were to be contracted or guaranteed by the Government.

3. Developments in 1989

The adjustment program for 1989, supported by the second annual arrangement under the SAF, incorporated a comprehensive set of structural and demand management measures designed to redress the domestic and external imbalances that had emerged in 1987-88. ^{1/} However, slippages in policy implementation recurred, and there were substantial deviations from the structural and quantitative benchmarks in the second half of the year, reflecting a deterioration in coordination among the agencies involved in economic management (Table 2). While there was progress in the implementation of the measures aimed at economic liberalization, the demand management measures were not implemented as envisaged, resulting in continued high rates of inflation and a further erosion of the value of the currency.

The real rate of GDP growth in 1989 is estimated at 5 percent, in line with the program target, mainly because of strong growth in the agricultural sector, reflecting good weather conditions and the effects of economic liberalization. Increasing monetization of the domestic purchases of the cashew harvest resulted from the competition among

^{1/} The policies and measures under the second annual SAF arrangement are contained in EBS/89/131, 6/28/89. The status of implementation at end-1989 is provided in Appendix V of this report.

Table 2. Guinea-Bissau: Quantitative and Structural Benchmarks for the Second Annual Arrangement Under the SAF, 1989

	1988	1989							
	Dec.	March	June		Sept.		Dec.		
		Act.	Prog.	Act.	Prog.	Act.	Prog.	Adj. prog.	Act.
(In billions of Guinea-Bissau pesos; end of period)									
1. Quantitative benchmarks									
Net domestic assets <u>1/</u>	30.9	30.9	32.2	25.7	31.8	37.9	31.0	27.7	45.5
Net domestic credit <u>1/</u>	33.4	31.8	34.7	27.8	34.3	42.3	33.5	32.2	48.6
Net credit to the Government <u>1/</u>	-11.2	-16.1	-15.1	-18.1	-17.5	-15.0	-18.6	-21.9	-27.6
(In millions of U.S. dollars)									
New foreign borrowing guaranteed by the Government and public entities with any maturity if the grant is less than 50 percent <u>2/</u>	—	—	—	...	—	...	—	—	24.2 <u>3/</u>
Minimum cumulative reduction of external payments arrears through cash payments	—	—	—	...	—	...	7.8	—	-11.0 <u>4/</u>
2. Structural benchmarks									
									Status
- Initiation of reform of the public enterprise sector during the second half of 1989.									Not implemented
- Initiation of a phased elimination of the known cross-debts outstanding at December 31, 1987 between the Government and the public enterprises.									Not implemented
- Quarterly adjustment of gasoline retail prices to reflect exchange rate developments.									Not implemented

1/ To be adjusted if budgetary assistance exceeds the programmed amounts. The end-December 1989 outturn has been adjusted to reflect the higher-than-anticipated budgetary assistance in the amount of PG 3.3 billion.

2/ Excluding debt refinancing and short-term trade credits.

3/ Represents commercial debt, contracted during the period 1987-89, which was not consistent with the authorities' intentions under the SAF arrangement.

4/ Net accumulation of external payments arrears in 1989.

traders and the increased availability of consumer goods in the collection areas. The actual producer price for cashews averaged PG 1,250 per kilogram, compared with the Government's indicative price of PG 450 per kilogram.

With World Bank support, the Government continued to formulate an overall comprehensive strategy for the agricultural sector, aimed at improving production incentives, transport infrastructure, credit, and extension services, so as to remove bottlenecks to the expansion of the area under cultivation. In the forestry sector, the Government strengthened, with World Bank technical assistance, its capacity to manage the exploitation of the abundant forestry resources in an ecologically balanced manner. In the fishing sector, the authorities increased the returns from the sale of fishing licenses by renegotiating fees based on the vessel's tonnage, rather than on the value of the catch.

The process of economic liberalization was deepened as price controls on all goods and services (with the exception of petroleum products) were eliminated, the monopoly on cereals imports was lifted, and the issuance of import licenses was fully liberalized. However, the structural benchmark relating to the quarterly adjustment of the domestic retail price of petroleum products was not observed, resulting in re-exports, a loss of tax revenue, and a further deterioration in the financial performance of the state petroleum monopoly, DICOL.

The reform of the public enterprise sector was not implemented as envisaged. The liquidation of the state trading enterprise (SOCOMIN) was not completed, the structural benchmarks relating to public enterprise reform were not observed, the timetable for the phased elimination of the end-1987 stock of identified public sector cross-debts was not adopted, and the privatization of the second state trading company (ADP) was not begun. However, rehabilitation of the state water and electricity company (EAGB) was initiated, with support of the World Bank. In the context of the reform of the civil service, implemented with World Bank assistance, the number of civil servants was reduced by only 2.5 percent instead of the targeted 10 percent, and the envisaged civil service register was not prepared.

Serious weaknesses arose in public investment programming as a number of projects, which had not been included in the public investment program, were implemented by the Government using foreign commercial financing, thus undermining the objective of containing the recurrent costs, including debt service, of public investment. Only limited progress was made in integrating the public investment program into the budgetary control processes; the monitoring and control of project implementation and investment expenditure remained weak.

There were substantial slippages in the implementation of the financial policies. The overall budget deficit, on a commitment basis and excluding grants, widened from 38.2 percent of GDP in 1988 to

51.5 percent in 1989, against a program target of 38.2 percent, largely owing to overruns in current and capital expenditures (Table 1; Appendix IV, Table I; and Chart 1). Taking into account the accumulation of external payments arrears, equivalent to 6.5 percent of GDP, the overall cash deficit including grants reached 12.5 percent of GDP, compared with the target of 14.4 percent.

Revenue performance fell short of expectations, reflecting the delayed export of the 1989 cashew crop, and the failure to implement the revenue measures envisaged under the 1989 program. Total budgetary revenue reached 13.8 percent of GDP, compared with a program target of 16.3 percent, owing to a substantial shortfall in tax revenue, which was only partially offset by higher-than-anticipated nontax receipts. Little progress was achieved in simplifying customs tariffs and enhancing customs administration (despite the technical assistance provided by the Fund), ad hoc import duty and tax exemptions continued to be granted, and the envisaged strengthening of direct tax administration was not undertaken.

The programmed restraint in expenditures was not realized. Total expenditure reached 61.6 percent of GDP, compared with the target of 56.8 percent, mainly owing to overruns on current outlays, which reached 23.4 percent of GDP, instead of the targeted 19.9 percent. While outlays for wages and salaries were in line with the target, expenditures for other goods and services, and transfers exceeded the target by 4.2 percentage points of GDP. Although the direct subsidies to civil servants for rice and other basic foodstuffs were eliminated, the Government guaranteed external loans to a newly created civil service cooperative for the financing of imports of rice to be sold to the members at below domestic market prices. Reflecting higher-than-anticipated disbursements of project loans and grants, capital expenditure reached 38.2 percent of GDP, compared with the program target of 36.9 percent. ^{1/}

Monetary policy in 1989 was also not consistent with the adjustment strategy. The end-December 1989 benchmarks on net domestic assets and net domestic credit were exceeded by wide margins, because of an expansion of credit to the economy of 119 percent of initial money stock compared with the programmed increase of 19 percent (Table 1; Table 2; Appendix IV, Table II; and Chart 1). The benchmark on net credit to the Government was observed, owing to the accumulation of domestic counterparts of external financial support, which was larger than programmed, mainly because of exchange rate developments. The rate of monetary expansion was 42 percent rather than the target of 21 percent.

^{1/} The Government's capital expenditure classification includes recurrent expenditures for existing projects.

Because of the increase in the level of nonperforming assets, estimated at PG 17.2 billion (44 percent of initial money stock) at end-1989, the authorities set aside PG 14.4 billion of the National Bank's operating surpluses for 1988-89 to write off nonperforming loans, with the result that total outstanding credit, including capitalized overdue interest payments, was reduced by 16 percent to PG 76.2 billion at end-year. Reflecting the slippages in demand management, inflation is estimated to have reached an average annual rate of 73 percent in 1989, instead of the targeted 40 percent. As a result, interest rates turned negative in real terms during the second half of the year.

The failure to restrain aggregate demand resulted in a continuation of the vicious circle of inflation and devaluation. While the official exchange rate (in terms of the U.S. dollar) was devalued by 46 percent in 1989, the parallel market exchange rate depreciated by 59 percent (Chart 2). The spread between the official and the parallel market exchange rates (for the U.S. dollar) averaged 33 percent for the year as a whole. Movements in currency in circulation and fluctuations in the parallel market exchange rate are strongly correlated, as illustrated in Chart 3, which plots the index of the two variables during the period January 1987-December 1989. The trade-weighted nominal effective exchange rate depreciated by 25 percent in 1989, following a depreciation of 33 percent in 1988 (Chart 2).

The external current account deficit, excluding official transfers, is estimated to have reached US\$96.8 million in 1989 (57.2 percent of GDP), compared with a programmed deficit of US\$75.8 million (49.9 percent of GDP) (Table 1; Appendix IV, Table III; and Chart 1). An estimated US\$9.6 million of the deterioration reflected delays in exports of the 1989 cashew harvest and in receipts of fishing licenses. Imports exceeded the program target by 10 percent to reach US\$68.9 million, including US\$11.6 million in rice imports. The overall balance of payments recorded a deficit of US\$39.0 million, compared with a targeted deficit of US\$10.5 million, and external payments arrears in a net amount of US\$11.0 million, equivalent to 6 percent of GDP, were accumulated. Total outstanding debt service arrears are estimated at US\$51.1 million (30 percent of GDP) at the end of 1989.

In October 1989 the participating Paris Club creditors agreed on a concessional restructuring of Guinea-Bissau's debt. 1/ The amount of debt relief obtained from this consolidation for 1989-90 totals US\$21.3 million (US\$13.1 million in 1989 and US\$8.2 million in 1990), comprising debt cancellation of US\$1.4 million and rescheduling of US\$19.9 million. The provisions of the Agreed Minute apply provided that the Government of Guinea-Bissau continues to have an appropriate arrangement from the Fund, and, in particular, will continue to apply from July 31, 1990 through December 31, 1990 provided that an appropriate arrangement

1/ Details on the Paris Club rescheduling are provided in SM/89/261, 12/7/89.

has been approved by the Fund by end-October 1990. Guinea-Bissau's debt service ratio in 1989 is estimated to have declined from 155 percent before the rescheduling to 131 percent afterward, assuming comparability of treatment of other official creditors.

During 1987-89, the Government contracted suppliers' credits on commercial terms for the financing of hotels, schools, hospitals, and facilities for the gas bottling company, as well as equipment for the armed forces, totaling the equivalent of US\$24.2 million (14 percent of 1989 GDP) (Table 1 and Appendix IV, Table IV). ^{1/} The contracting of this debt was not consistent with the benchmarks of the SAF arrangement, which limited new external commitments to loans with a grant element of at least 50 percent. The debt service obligations arising from these loans in 1989, which were equivalent to 98 percent of exports, were not met, and contributed to the accumulation of external payments arrears.

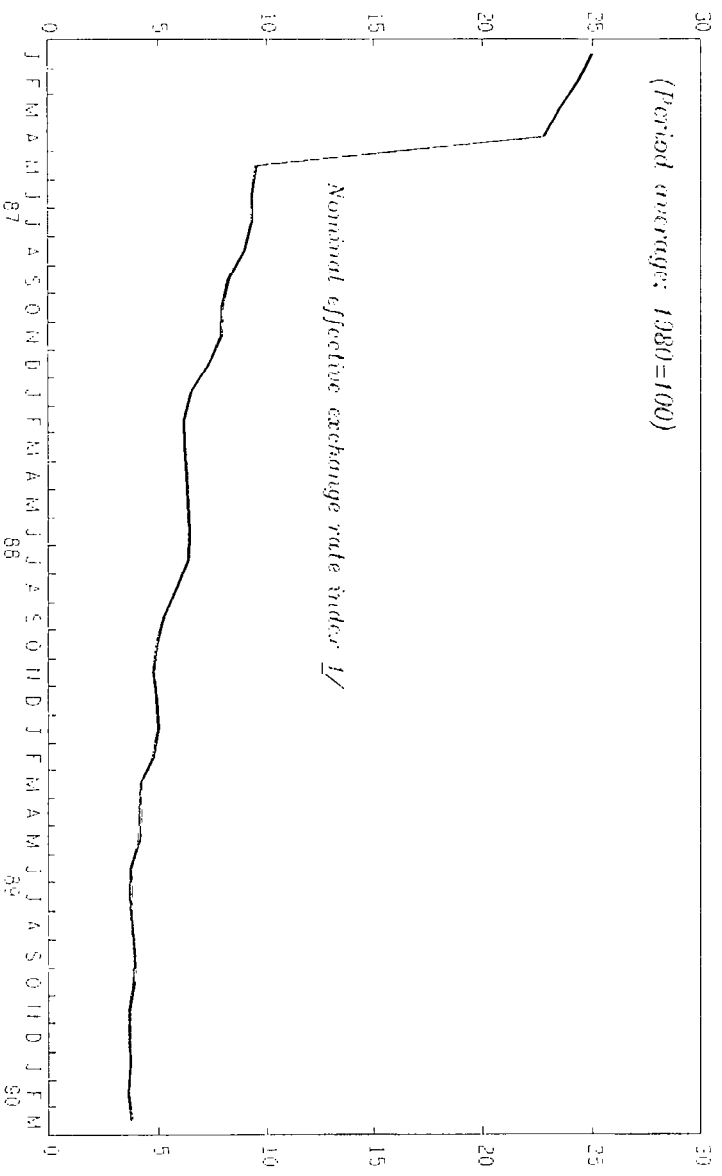
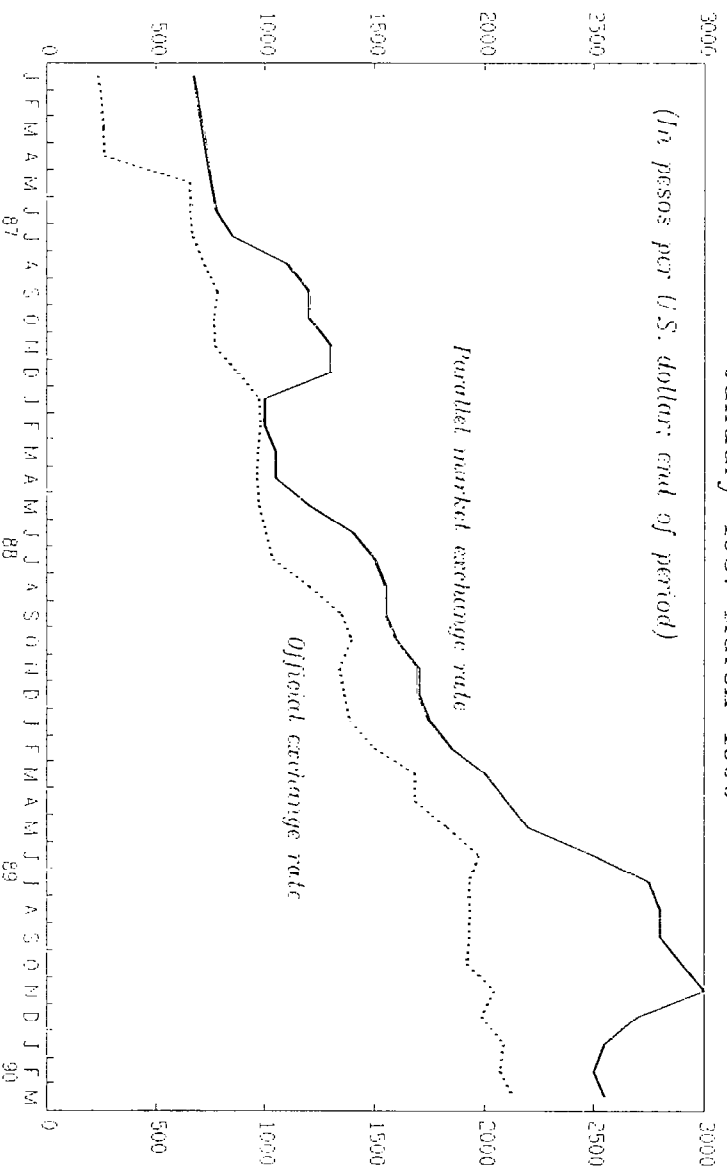
Guinea-Bissau continues to maintain restrictions on the making of payments and transfers for current international transactions. Import licenses are automatically issued to licensed traders upon request, after verification of the invoiced prices, except for imports on a short negative list, and petroleum products, which are imported by the state petroleum distribution company. Private sector importers with valid import licenses may provide their own foreign exchange to finance the imports. Exporters are allowed to retain up to 50 percent of proceeds to pay for merchandise imports. All payments for invisible transactions require prior approval of the Central Bank and are granted on the basis of a weekly ceiling. Foreign exchange allowances for business travel are limited to the equivalent of Esc. 50,000 a trip. For study abroad, foreign exchange is granted up to the equivalent of Esc. 17,100 each month. Guinea-Bissau maintains a bilateral payments agreement with Algeria, under which there are unsettled balances on the part of Guinea-Bissau; the payments agreement has been inactive since 1981.

On March 1, 1989 the Guinea-Bissau Government reached an agreement with Portugal on the principle of linking Guinea-Bissau's currency to the Portuguese escudo. In this context, the Portuguese Treasury would provide a line of credit to reinforce Guinea-Bissau's exchange reserves in case of need. Although the arrangement has not yet been approved by the Portuguese Parliament, the Portuguese authorities have been providing technical assistance since November 1989 to assist the Guinea-Bissau authorities in the preparations for the implementation of such an arrangement. An analysis of the arrangement will be undertaken when the operational details become available.

^{1/} The Paris Club cutoff date is end-1986; these obligations were first reported at end-1989.

CHART 2

GUINEA-BISSAU
Exchange Rate Developments
January 1987-March 1990

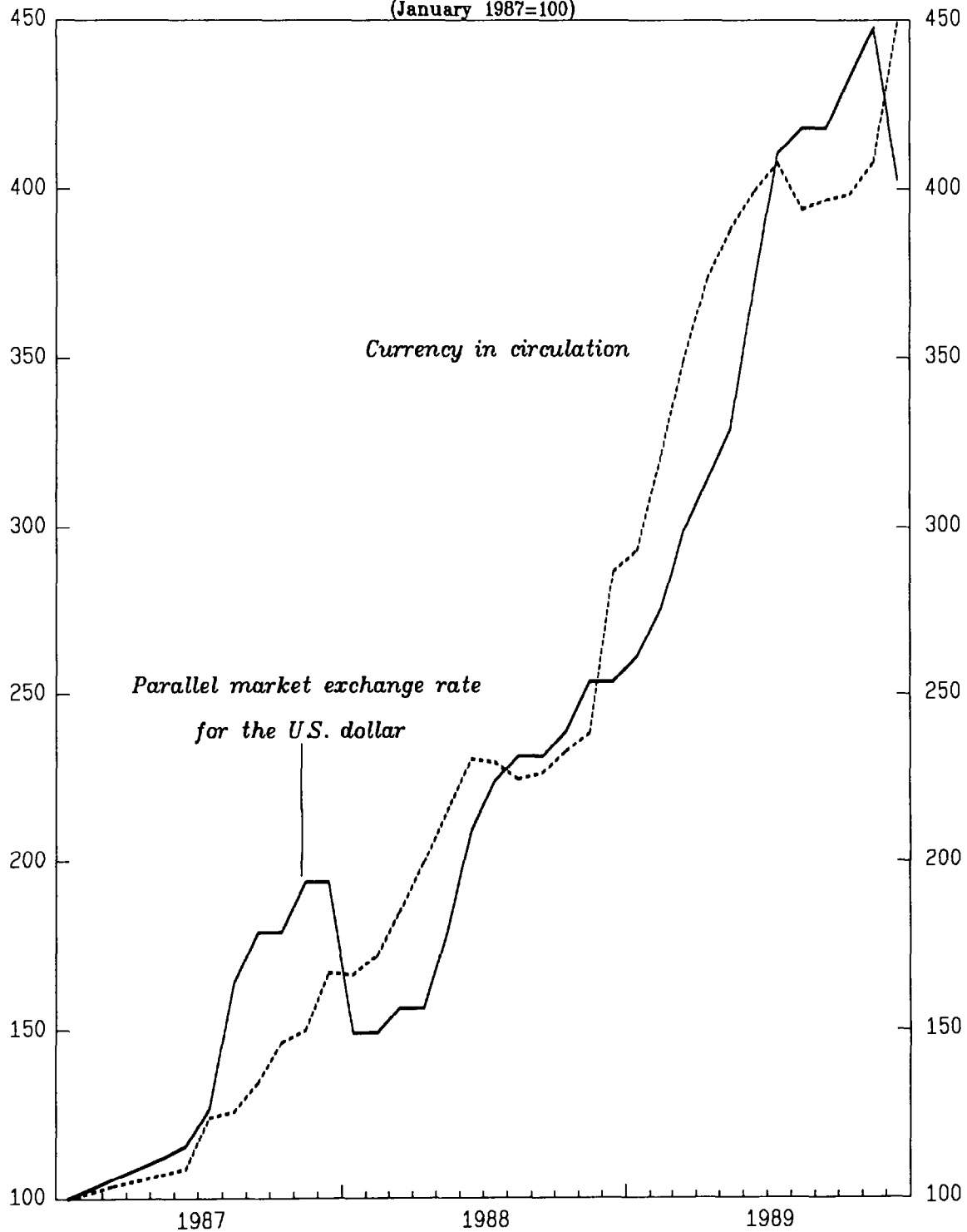


Sources: Data provided by the Guinea-Bissau authorities; and staff estimates.

1/ Information Notice System; a decline in the index reflects depreciation.

CHART 3

GUINEA-BISSAU
Currency in Circulation and the Parallel
Market Exchange Rate, January 1987-December 1989
(January 1987=100)



Source: Data provided by the Guinea-Bissau authorities.

III. Report on the Discussions

The consultation discussions covered the economic and financial prospects for 1990 and the medium term, against the backdrop of the slippages in policy implementation under the 1989 program, supported by the second annual SAF arrangement. The authorities' objectives for 1990 are to achieve growth in real GDP of 4.5 percent, reduce the average annual rate of inflation to 25 percent, and narrow the external current account deficit, excluding official transfers, from 57.2 percent of GDP in 1989 to 45.1 percent. Consequently, the discussions with the authorities focused on the Government's proposed policies for achieving these objectives.

During these discussions, the staff expressed concern about the adequacy of the Government's policies for achieving a sharp reduction in the inflation rate and resuming progress toward the original adjustment path, and emphasized that additional corrective measures should be effected promptly to stem the deterioration in the economic and financial situation. ^{1/} In the absence of these additional measures, the budgetary situation in 1990 would be much weaker than projected by the authorities, the inflation rate would remain high, and, as illustrated under the alternative scenario for the balance of payments (Appendix IV, Table III), the external current account deficit, excluding grants, would be some 2.3 percentage points of GDP higher than indicated by the baseline scenario, which is based on the prompt introduction of the requisite actions. Consequently, the overall balance of payments deficit would be higher, giving rise to a much larger financing gap.

1. Prospects for 1990

a. Macroeconomic policies

The Government's budget for 1990 is based on a projected increase in budgetary revenue that would permit increases in expenditure in real terms. The overall deficit, on a commitment basis and excluding grants, is foreseen to be reduced to 36.6 percent of GDP, compared with the staff's original projection of a deficit of 37.8 percent of GDP. Total revenues are expected to increase by 149 percent to 27.8 percent of GDP, compared with 13.8 percent of GDP in 1989, largely owing to an anticipated quadrupling of tax revenue from 4.8 percent of GDP in 1989 to 17.2 percent. The projected increase in tax receipts is essentially based on delayed receipts from the 1989 cashew exports and on improvements in tax administration; no new taxes or increased rates are envisaged, while the tax rate on cashew exports has been reduced, from 34 percent in 1989 to 28 percent in 1990. On the other hand, current and capital expenditures are budgeted to increase to 64.4 percent of

^{1/} In the first quarter of 1990, the spread between the exchange rates in the parallel and official markets averaged about 24 percent.

GDP, mainly reflecting the Government's intention to phase in a 44 percent increase in salaries, while increasing investment outlays to 39.9 percent of GDP.

While concurring with the authorities that a substantial strengthening of tax administration is essential, the staff representatives were of the view that the government budget was based on optimistic assumptions of the revenue impact in 1990 of the proposed improvements in tax administration. On the basis of budgeted expenditures, and in the absence of additional tax measures, the staff projected that the overall deficit, on a commitment basis and excluding grants, could reach nearly 44 percent of GDP. Consequently, the staff representatives emphasized the importance of introducing additional revenue-enhancing and expenditure-containing measures, and reviewed with the authorities the measures that would be needed to reduce the prospective higher deficit. The revenue measures would include those that had been programmed in 1989, including the effective elimination of exemptions from import duties and taxes, the acceleration of the sale of government-owned assets, the quarterly adjustment of prices for petroleum products, the enhanced collection of taxes on rental income, and the pursuit of tariff reform, as recommended by Fund technical assistance missions in 1988 and 1989. On the expenditure side, the increase in the wage bill would need to be limited to 20 percent; outlays on other goods and services would have to be curtailed through a limit on travel and unclassified expenditures; and the government-controlled rice imports would need to be eliminated. On the basis of the first quarter outturn, and the immediate introduction of the above measures, the staff projected that the overall fiscal deficit, on a commitment basis and excluding grants, could be contained at 41.5 percent of GDP in 1990.

Commenting on the staff's projections, the authorities indicated that the effective elimination of the import duty and tax exemptions would unduly increase the cost of private investment in the economy, and complicate the budgeting of government imports. The authorities stated that, henceforth, the Minister of Economy and Finance would permit either full or partial duty and tax exemptions in the case of capital goods imports for investment purposes, and that imports by the Government would be subject to a flat rate of 5 percent, to be deducted from the importing ministry's annual budget allocation. In this context, and referring to the importance of maintaining adequate supplies of rice at an affordable price, the authorities noted that the newly established civil service rice cooperative would continue to obtain foreign short-term loans, guaranteed by the Government, to finance rice imports in 1990, despite the implications of this policy for the marketing of domestically produced rice and the contingent debt service liability. Furthermore, the authorities pointed out that the recommended containment of the wage bill was not politically feasible, since the Government was committed to a 44 percent salary increase and a policy of hiring all returning graduates possessing adequate qualifications.

With regard to credit policy in 1990, the authorities were aware that the control and proper allocation of credit is essential to stem the inflationary pressures, to prevent a continued depreciation of the parallel market exchange rate, and to provide the financial environment that would be conducive to sustained economic growth. During the first quarter of 1990, total domestic liquidity expanded by 10.6 percent, reflecting the improvement in the net foreign asset position that resulted from the repatriation of delayed export receipts. Total domestic credit was reduced by 59 percent in terms of beginning broad money supply because of a 30 percent reduction in credit to the nongovernment sector, resulting from the unwinding of trade credits, and a further improvement in the Government's net creditor position, largely owing to an increase in tax receipts from the delayed 1989 exports.

To reduce excess real monetary balances, the staff representatives indicated that it would be essential to limit the rate of monetary expansion to 15 percent in 1990. Following the drop in credit to the nongovernment sector in the first quarter, the growth of such credit during the remaining three quarters of the year would need to be held to 21 percent of beginning broad money stock. On this basis, total domestic credit for the year as a whole would have to be reduced by 57 percent in terms of beginning money stock. Since the statutes for the new Central Bank require that the advances to the Government be repaid by the end of the fiscal year, and in view of the projected availability of external aid, the Government's net creditor position is projected to improve by 51 percent. Consequently, credit to the nongovernment sector during 1990 would need to be reduced by 6 percent of beginning money stock. In this context, the staff representatives expressed concern about the Government's intention to use part of the local counterparts of external balance of payments assistance, which are deposited in a blocked treasury account with the Central Bank, for the financing of the local cost of development projects. The staff emphasized that the authorities should continue to ensure that these counterparts remain blocked to contain liquidity expansion.

To strengthen financial intermediation, the Government--with technical assistance from the Fund, the World Bank, and bilateral creditors--has established a two-tier banking system. The new system consists of a Central Bank, a joint-venture commercial bank, the Banco Internacional da Guiné-Bissau (BIGB), ^{1/} and a temporary financial institution, the Banco do Credito Nacional (BCN), which has taken over the medium- and long-term portfolio of the former National Bank. Indirect financial control instruments have been introduced, including obligatory reserve requirements and rediscount facilities, in addition

^{1/} The BIGB started operations on March 1, with a capital of PG 3.0 billion, subscribed by Portuguese banks (49 percent), local private interests (25 percent), and the Guinea-Bissau Government (26 percent). At the end of March 1990, its deposits amounted to PG 3.9 billion and its outstanding loan portfolio, to PG 1.0 billion.

to the credit ceilings and other measures having a more selective impact on the capacity to extend credit. The obligatory reserves are calculated on a weekly basis against demand deposits in national and foreign currency. Rediscount facilities are being provided, initially for crop credit at an interest rate of 32 percent for maturities of less than 90 days and at 36 percent for maturities of 90 days to 180 days. These rates are consistent with the present interest rate structure and will be adjusted in line with changes in that structure.

The average rate of inflation abated during the first quarter of 1990 to about 3 percent, equivalent to 12.6 percent at an annual rate. Since the lending and deposit rates, which were established in 1989 as a prior measure, had become positive in real terms, the authorities intended to introduce a new structure of interest rates that would reflect the abatement of inflation. The staff representatives, although agreeing with the authorities' intention of pursuing a flexible interest rate policy in 1990, cautioned against a downward revision at this time since the lower rate of inflation during the first three months of the year reflected special circumstances, including the availability of substantial stocks of imported rice. The staff stressed the need to maintain the present level of positive real interest rates to help achieve a sharp, permanent drop in the inflation rate. Moreover, there was a need for a further simplification of the existing structure of lending rates, which would eliminate the remaining interest rate concessions and make all lending rates uniform within three broad maturity profiles. At the same time, a strong signal should be given to the commercial bank to continue to increase its deposit base rather than having recourse to the rediscount facilities of the Central Bank and thus, the rediscount rates should be established accordingly. Concerning the BCN, the staff representatives emphasized that the primary objective of this institution was loan recovery, and, consequently, the BCN should not have access to the rediscount facilities. Furthermore, it should extend new credits only to the extent that outstanding loans in its portfolio were being repaid, while ensuring that such credits had an appropriate maturity profile in view of the targeted liquidation date for this institution at end-1991.

b. External sector

Based on the macroeconomic policies and measures proposed by the staff in the discussions with the authorities, the external current account deficit, excluding official transfers, could be contained in 1990 at US\$70.9 million, equivalent to 45.1 percent of GDP, compared with a deficit of 47.4 percent of GDP in the absence of the requisite corrective measures. Export receipts, including some US\$4 million in receipts from the 1989 cashew exports, are projected to increase by 72.5 percent to US\$24.5 million, because of an anticipated strong expansion in the volume of agricultural crops, which would offset the foreseen decline or stagnation in export unit prices. The projected volume growth reflects the cumulative impact of the liberalization measures, the reduction of the export tax (on cashews), and the ample

supply of consumer goods in the economy. Import growth could be limited to 2.0 percent in 1990, because of the anticipated decline in imports of rice and of capital goods (in U.S. dollar terms). On the basis of the projected increase in official grants and an inflow in private short-term capital, partly reflecting the repayment of trade credits outstanding at end-1989, the overall balance of payments would record a surplus, excluding arrears, of US\$4.6 million in 1990. However, in view of the need to reduce the Central Bank's outstanding short-term payments arrears and to eliminate the Government's debt service arrears, there would be a financing gap of US\$24.8 million, which would need to be filled through further exceptional financing, including debt relief beyond that obtained under the auspices of the Paris Club.

Additional measures were taken in the first months of 1990 to adapt the exchange system to the restructured banking system. The commercial bank was authorized to accept foreign exchange deposits from nonresidents as well as from Guinea-Bissau nationals residing abroad. These deposits, which may be freely used and transferred abroad, are remunerated in foreign exchange, at the rate of 4 percent a year for demand deposits and at freely negotiated rates for time deposits. Transfers abroad for the payment of invisible transactions are being authorized within a weekly ceiling set by the Central Bank.

In the area of exchange rate policy, the authorities stated their continued commitment to the objective of containing the spread between the official and parallel market exchange rates to less than 20 percent. Prior to moving to a unified fixed peg regime (such as the proposed link to the Portuguese escudo), the authorities intend to adopt a dual system, under which the commercial bank would be authorized to buy and sell foreign notes and coins at freely determined rates within 15 percent on either side of the central bank exchange rate. Under this scheme, whenever the bank's holdings of foreign notes and coins exceed the equivalent of US\$150,000, the surplus must be sold to the Central Bank at the official central bank rate. The staff explained that under either exchange regime, tighter financial policies would be critically important for achieving price and exchange rate stability. The staff representatives also noted that in addition to the parallel exchange market, this dual system would introduce two official exchange rates, consisting of the central bank rate, and the commercial bank rate; it would thus increase the scope for distortions in the economy. Furthermore, the incentives that the proposed system would offer to the commercial bank and to the users of the parallel market to participate in the system are not evident. For the commercial bank, the requirement to sell holdings in excess of the stipulated limit at the central bank rate would serve as a disincentive to comply with that requirement. For those who sell foreign exchange in the parallel market, the proposed spread between the commercial bank and central bank rates may not be sufficient in view of the frequency of much larger spreads between the parallel and the central bank rates. Consequently, should the authorities want to establish a market-based exchange rate system, the margin limits of 15 percent that can be offered by the commercial bank

should be eliminated, the limit on the bank's holdings of foreign notes and coins should be abolished, and most importantly, much tighter financial policies should be implemented to stabilize the exchange rate in the commercial bank market. Moreover, consideration should be given to allowing the commercial bank to purchase and sell all instruments of foreign exchange in the market (not only notes and coins), and all its transactions with the Central Bank should be effected at market-determined rates; also, transactions should be progressively shifted from the Central Bank to the commercial bank. Such a broadening of the authorities' proposal would be a step toward a unified and market-based exchange system. The staff representatives encouraged the authorities to consider moving expeditiously to pegging the exchange rate at a realistic market-based level and supporting it with tight financial policies.

With respect to external debt management, four bilateral agreements with Paris Club creditors are still under negotiation. The authorities had not completed the necessary steps to negotiate a rescheduling on concessional terms of the commercial debt, incurred during 1987-89 despite the Government's intentions under the program supported by the SAF arrangement. Since the obligations that are due in 1990 and 1991 are incompatible with Guinea-Bissau's debt-servicing capacity, the authorities would need to secure debt relief for these obligations with a degree of concessionality that is consistent with this capacity. Moreover, despite the Government's inability to service the current level of external debt, the authorities stated that the intention expressed in the PFP to limit the contracting or guaranteeing of new loans by the Government to those with a grant element of at least 50 percent was too restrictive, and that they intended to waive this limit for government guarantees of external borrowing for investment purposes.

c. Structural policies

On the structural front, the discussions focused on the need to effect those measures that had been included in the 1989 program but not implemented. In the area of public enterprise reform, no timetable for the privatization and liquidation program, undertaken in consultation with the World Bank, had yet been established, although the authorities expressed the intention to initiate the liquidation of ADP by end-September 1990. Moreover, the authorities plan to complete the identification of the end-1989 stock of public sector cross payments arrears and to establish, by end-September 1990, a timetable for their phased elimination. However, they did not expect to begin eliminating these arrears during 1990. To prevent the further accumulation of domestic payments arrears vis-à-vis the public utility company (EAGB), the Government had negotiated a flat fee and a monthly schedule of payments, based on past levels of central government consumption, which would thus permit timely payments by EAGB to the state petroleum distribution company (DICOL).

With respect to the adjustment of the retail prices for petroleum products, the authorities indicated that, henceforth, these prices would be adjusted quarterly with a view to improving the financial position of DICOL and increasing tax revenue. The adjustments are to be based on a formula related to DICOL's cost structure; changes of more than 5 percent stemming from exchange rate or world market price fluctuations would trigger an adjustment in retail prices. However, no adjustments have taken place since January 1990.

Concerning civil service reform, the authorities stated that the achievement of a net reduction of 1,500 civil servants (10 percent) was not feasible in 1990. The Government's policy was to seek to strengthen the civil service by hiring all returning graduates possessing adequate qualifications, while reducing existing staff by some 1,500, mainly from the lower salary grades. No timetable was available for the completion of the civil service register, which had been programmed for 1989.

The recent merger of the Ministry of Plan with the Ministry of Finance was seen by the authorities as a step toward improving public investment programming and strengthening the monitoring of project implementation. Nevertheless, the authorities believed that because of existing institutional weaknesses and the difficulties in coordinating with donors, the current deficiencies in investment programming were likely to persist over the medium term. A revised investment code has been approved by the Council of Ministers, which, in the opinion of the staff representatives, is excessively complex and contains distortionary features, including in particular provisions for the subsidization of local labor costs and interest payments; moreover, it does not include a mechanism for the settlement of investment disputes.

In the agricultural sector, the authorities, in collaboration with the World Bank, are pursuing efforts to expand the area under cultivation and improve land resource management with a view to increasing the diversity and yield of agricultural crops. In the forestry sector, the Government plans to introduce, with technical assistance from the World Bank, a forestry resource management plan aimed at achieving a sustainable rate of exploitation of Guinea-Bissau's forests. In the fishing sector, the Government's long-term strategy is to develop an indigenous artisanal and industrial fishing capacity through a combination of public investment and joint ventures with foreign partners.

2. Medium-term balance of payments prospects

The medium-term baseline scenario for Guinea-Bissau's balance of payments has been revised and extended to 1993, taking into account developments in 1989 as well as the latest forecasts of international prices (Appendix IV, Table III). ^{1/} This scenario is based on the

^{1/} The medium-term projections for the period 1989-92 were provided in EBS/89/131 (6/28/89).

assumed introduction of the adjustment policies that were discussed with the authorities. The alternative scenario for the period 1990-93 illustrates the sensitivity of the baseline scenario to delays in the introduction of the corrective measures.

The revised projections are premised on continued favorable weather conditions and a continued decline in the prices for Guinea-Bissau's cashew exports. Compared with the previous medium-term projections, the revised scenario includes higher annual fishing license receipts; a more rapid expansion in the volume of fish and shrimp exports, as two industrial joint ventures are expected to begin operations in 1991; less favorable prospects for the expansion of exports of cashews, palm kernels, and wood products owing to lower prices in the case of cashews and a lower-than-previously-projected expansion in the production of palm kernels and wood products; a higher base level of imports reflecting the slippages in 1989 and the slower path of adjustment currently being pursued; higher levels of capital goods imports, linked to anticipated development project assistance; higher fuel imports, mainly because of the expansion of the fishing activities; and higher debt service payments, arising, in part, from the improved coverage of the debt statistics. In view of the slippages experienced in 1989 and the worsening in Guinea-Bissau's external trade prospects, the mediumterm outlook for Guinea-Bissau's balance of payments has deteriorated further. Under the baseline scenario, substantially larger annual financing gaps are projected, indicating Guinea-Bissau's continued dependence on external financing, and underscoring the need to pursue additional adjustment efforts in 1991-93 aimed at containing aggregate demand, and to reduce the impact of a worsening external debt service burden.

In 1990, the external current account deficit, including official transfers, is projected at US\$8.3 million because of the delayed receipts from the 1989 cashew exports and fishing licenses, compared with the originally projected deficit of US\$24.0 million. Thereafter, regular seasonality of export and service receipts is assumed. By 1993, the external current account, including official transfers, is expected to record a deficit of US\$28.5 million; excluding official transfers, that deficit would reach US\$90 million in 1993, against US\$96.8 million in 1989.

The trade deficit is projected to decline from US\$54.9 million in 1989 to US\$51.6 million in 1993. Export earnings would increase at an average annual rate of about 10 percent during the period 1991-93, because of a large increase in fish and shrimp exports. As a result, by 1992 fish and shrimp are projected to surpass cashews as the largest individual export item, and reach 34 percent of total merchandise exports. Imports are foreseen to increase at an average annual rate of about 6 percent during 1991-93, largely owing to higher capital goods imports for externally financed development projects and fuel imports linked to the fishing activities. Thus, while food imports as a share of total imports would decline from 26 percent in 1990 to 13 percent in

1993, petroleum imports are expected to increase from 14 percent in 1990 to 17 percent in 1993. Guinea-Bissau's terms of trade during 1991-93 are anticipated to worsen at an average annual rate of 0.8 percent, mainly because of continued stagnation of cashew export prices. The deficit in the services account in the period 1991-93 is projected at an average annual level of about US\$40 million, compared with US\$43.3 million in 1989.

Net inflows of official capital are expected to increase from US\$9.3 million in 1989 to US\$12.3 million in 1993, largely because of a decline in scheduled amortization payments for the recently incurred commercial debt. The disbursements of medium- and long-term loans in 1992 and 1993 are foreseen to return to their 1989 levels following the substantially larger disbursements of project loans in 1991 for the purchase of equipment for the fishing sector, totaling US\$17 million.

An alternative scenario for the period 1990-93 has been prepared to illustrate the likely impact of continued expansionary fiscal and credit policies on the balance of payments. Under this scenario, imports and service payments, particularly for travel and freight, would be higher, reflecting the increased aggregate demand pressures. As a result, the external current account deficit, excluding official transfers, is projected to average US\$96 million during this period, compared with an average of US\$87 million under the baseline scenario. The anticipated financing gaps would be substantially larger, exceeding the gap in the baseline scenario by 19 percent in 1990, 29 percent in 1991, 45 percent in 1992, and 85 percent in 1993. On this basis, additional external payments arrears are likely to develop, implying that the prospects for reaching external viability over the medium term would recede.

IV. Staff Appraisal

During the three-year period 1987-89, the Government of Guinea-Bissau adopted adjustment programs, in support of which the first and second annual SAF arrangements were approved by the Fund. The implementation of economic liberalization measures, together with favorable weather conditions, contributed to a marked expansion in Guinea-Bissau's agricultural output and exports. However, there were substantial deviations during this period from the adjustment path because of slippages in the implementation of the macroeconomic and structural policies. Thus, even though economic growth exceeded the targeted level of the programs, the other medium-term objectives--including the reduction in the rate of inflation, the improvement in the balance of payments position, the containment of the external debt burden, and the stabilization of the exchange rate--were not attained.

The staff is concerned that the weakening in the momentum of structural reform, together with the fundamental setback on the financial front, which has fueled rapid inflation and a depreciation of the currency, will jeopardize the earlier achievements from the adoption

of economic liberalization measures. Furthermore, the continued widening of the domestic and external imbalances has lessened the likelihood that Guinea-Bissau can resume early progress toward the original medium-term objectives, particularly since the recovery from the setback would require the introduction of politically sensitive measures within a shorter timespan. While the authorities have stated their continued commitment to the adjustment process, they have also acknowledged that it would not be possible to take the requisite additional measures before the end of the commitment period under the SAF for Guinea-Bissau.

Although the authorities are improving the institutional coordination among the agencies involved in economic management, strengthening tax administration and increasing the effectiveness of the monitoring of budgetary outlays and the loan recovery performance, the staff believes that substantial additional measures are required to prevent a further deterioration in the prospects for the medium term. Particular attention will need to be devoted to six key areas.

First, progress toward the fiscal targets of the medium-term adjustment program will require a combination of revenue-enhancing and expenditure-containing measures. The proposed strengthening of tax administration will not, in the opinion of the staff, be sufficient to redress the severe fiscal imbalances unless it is accompanied by the introduction of the revenue measures envisaged under the 1989 program, including, in particular, the effective elimination of import duty and tax exemptions, and the launching of tariff reform. Concrete and effective steps should be taken urgently to simplify the tax system and broaden the tax base. At the same time, there is a need for expenditure-containing measures: the share of the wage bill in total current outlays should be reduced through the decisive implementation of the authorities' originally envisaged civil service reform, and expenditures for other goods and services must be strictly contained.

Second, the external debt management policies should be reassessed, since both the government budget and the balance of payments are overburdened by debt that has been accumulated at too high a cost to the economy, as evidenced by worsening debt indicators and the increase in outstanding debt service arrears. The revised projections for the medium-term balance of payments indicate that the external current account position has weakened further, in part because of higher debt service payments obligations, and that the external financing gaps will be substantially larger than earlier envisaged. The staff would urge the authorities to avoid continued recourse to short-term borrowing to finance long-term activities, to take the necessary steps to negotiate the rescheduling on concessional terms of the recently incurred commercial debt, and to eliminate the external payments arrears. The staff also believes that the authorities should strictly adhere to the policy of not contracting or guaranteeing any external debt that does not meet the concessionality requirement as outlined in Guinea-Bissau's policy framework paper.

Third, the recent restructuring of the banking system is an important step forward in the development of financial intermediation, and should help the authorities to reinforce credit control. However, a restrictive credit policy is crucial for achieving a much needed sharp reduction in the rate of inflation and ensuring a stable exchange rate system. To help control growth in domestic liquidity, the Government needs to continue to sterilize the local counterpart funds generated by external budgetary assistance. Particular attention should also be directed to the ongoing efforts to recover nonperforming loans. In this context, the staff believes that the financial institution that has taken over the medium- and long-term loan portfolio of the former National Bank should emphasize loan recovery and should be authorized to extend new credit only to the extent that outstanding loans have been recovered, with due regard given to the targeted liquidation date for this institution. The staff believes that at this time, before there is a sharp and permanent drop in the inflation rate, a downward revision in interest rates would be premature. A further simplification of the existing structure of lending rates to remove distortions would enhance the functioning of the credit market and facilitate the operations of the new commercial bank.

Fourth, the momentum of structural reform needs to be strengthened through the acceleration of public enterprise reform, aimed at enhancing the efficiency of public resource management and at promoting further increases in private sector economic activity. The newly revised investment code is excessively complex and contains distortionary features that should be corrected. The public investment program must be carefully designed in order to support the directly productive sectors. The agricultural and fishing sectors will remain the main sources of growth in Guinea-Bissau and the continued development of these sectors will depend on adequate incentives and as well as appropriate investment projects. However, it will be important to ensure that the total investment program is compatible with the country's absorptive capacity, the future debt servicing capacity, and the ability to cover the related recurrent outlays within the framework of a sustainable overall fiscal position.

Fifth, the continuing excessive spread between the official and parallel market exchange rates will need to be addressed through the implementation of much tighter financial policies aimed at sharply reducing the inflation rate and achieving stability in the exchange market. In this regard, the staff believes that the authorities' proposal to introduce a two-tier official exchange market introduces new distortions in the pricing of foreign exchange and defines the coverage of transactions rather narrowly; thus, it carries the risk of not reflecting market forces adequately. The staff encourages the authorities to consider moving expeditiously to pegging the exchange rate at a realistic market-based level and supporting it with tight financial policies.

Finally, the implementation of appropriate policies will have to be supported by the continued strengthening of the institutions involved in economic policy formulation and implementation and a reinforcement of the Government's ability to monitor economic and financial developments. Critical areas for additional technical assistance include the newly established two-tier banking system, the management of the foreign exchange reserve and the external debt, the tax system, and the budgeting and control of government expenditure.

Guinea-Bissau maintains exchange restrictions subject to Fund approval under Article VIII, Section 2(a), arising from the restrictive features of a bilateral payments agreement with a Fund member, and evidenced by some commercial external payments arrears. No approval for the retention of these exchange restrictions by Guinea-Bissau is being proposed, because of the absence of a timetable for their elimination and the lack of comprehensive adjustment policies to facilitate their removal.

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

V. Proposed Decision

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

1. The Fund takes this decision relating to Guinea-Bissau's exchange measures subject to Article VIII, Section 2(a), and in concluding the 1990 Article XIV consultation with Guinea-Bissau, in the light of the 1990 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/90/148, Guinea-Bissau maintains 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 and the exchange restrictions evidenced by certain external payments arrears are subject to Fund approval under Article VIII, Section 2(a). The Fund encourages Guinea-Bissau to continue reducing its reliance on exchange restrictions, and to eliminate those subject to Fund approval.

Guinea-Bissau - Relations with the Fund
(As of June 30, 1990)

I. Membership Status

Date of membership	March 24, 1977
Status	Article XIV

A. Financial Relations

II. General Department

General Resources Account

a. Quota	SDR 7.50 million
b. Total Fund holdings of Guinea-Bissau pesos	SDR 7.50 million (100.00 percent of quota)
c. Fund credit	--
d. Reserve tranche position	--

Special Disbursement Account

Structural adjustment facility	SDR 3.75 million
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III. SDR Department

Net cumulative allocation	SDR 1.21 million
Holdings	SDR 0.01 million (0.4 percent of net cumulative allocations)

IV. Administered Accounts

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

Guinea-Bissau - Relations with the Fund (continued)

B. Nonfinancial Relations

V. Exchange System

On May 4, 1987 the exchange rate of the Guinea-Bissau peso was devalued against the U.S. dollar, the intervention currency, from PG 269 = US\$1 to PG 650 = US\$1. A flexible exchange rate policy has since been maintained. The exchange rate at end-May 1990 was PG 2,026.02 = US\$1.

VI. Latest Article IV Consultation

Guinea-Bissau is on the standard 12-month consultation cycle. The latest Article IV consultation discussions were held during the period December 5-21, 1987; the consultation was completed by the Executive Board on April 8, 1988. The following decisions were taken on the consultation and the first annual SAF arrangement:

a. 1988 Article XIV Consultation

1. The Fund takes this decision relating to Guinea-Bissau's exchange measures subject to Article VIII, Section 2, and in concluding the 1988 Article XIV consultation with Guinea-Bissau, in the light of the 1987 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/88/65, Guinea-Bissau maintains 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 are subject to Fund approval under Article VIII, Section 2(a). The Fund encourages Guinea-Bissau to continue reducing its reliance on exchange restrictions and to terminate the restrictive features of the bilateral payments agreement with a Fund member.

b. First Annual Arrangement Under the SAF

1. The Government of Guinea-Bissau has established revised program targets for end-March and end-June 1988 with respect to net credit to the Government and total domestic credit, as specified in the letter of December 21, 1987 from the Minister of Commerce of Guinea-Bissau, and requests that they be considered as benchmarks under the first annual arrangement under the structural adjustment facility.

2. The Fund takes note of the benchmarks for economic and financial performance as set out in the table to the attachment of SM/88/58.

Guinea-Bissau - Relations with the Fund (concluded)

VII. Second Annual Arrangement Under the SAF

Guinea-Bissau's request for a second annual arrangement under the SAF was considered by the Executive Board on July 21, 1989. The following decision was taken:

1. The Government of Guinea-Bissau has requested the second annual arrangement under the structural adjustment facility.

2. The Fund has appraised the progress of Guinea-Bissau in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, and notes the updated policy framework paper (EBD/89/180).

3. The Fund approves the arrangement set forth in EBS/89/131.

VIII. Technical Assistance

A CBD expert served as Advisor to the Governor of the National Bank for a three-year period, which ended on September 30, 1986. In addition, during October 1984-April 1985, CBD provided technical assistance to the National Bank on accounting procedures. A new CBD expert served as Advisor to the Governor of the National Bank for a one-year period, which ended on April 30, 1988. A CBD technical assistance mission visited Bissau in November 1988 to advise on the restructuring of the banking system and the implications of entering into monetary arrangements with Portugal or alternatively with the West African Monetary Union. A follow-up CBD technical assistance mission visited Bissau in December 1989 to assist the authorities in the transition to a two-tier banking system. In connection with this transition, two CBD experts have been assigned effective February 1990 to advise the Governor of the central bank on monetary policy and to strengthen the accounting system at the central bank. Two fiscal panel experts served in the Ministry of Finance through early 1986. One was involved in advising on the implementation of tax reform proposals made by an FAD technical assistance mission in 1979, and the other was advising on government budgeting and financial management. An FAD technical assistance mission in February 1988 advised the Government on a general revision of the import tax system. An FAD expert visited Bissau in October-November 1989 to assist the authorities in implementing the proposed reform of the import tax system. Staff members from the Bureau of Statistics visited Bissau in 1984 to familiarize officials of the National Bank with an analytical framework for financial statistics. Technical assistance was provided by the Bureau of Statistics in 1987-88 to revise the accounting framework of the National Bank. Further assistance in the area of monetary statistics was provided by the Bureau during a technical assistance mission in August 1989.

Guinea-Bissau - Relations with the World Bank Group
(As of June 30, 1990)

IDA has made 18 credits to Guinea-Bissau totaling US\$162.8 million equivalent. ^{1/} Five have been in the transport sector, two for petroleum exploration, three for strengthening the country's management capability, five for financing urgently needed imports in support of the Government's economic recovery program, one for population, health and nutrition, one for basic education services and one to address the social costs of adjustment. As of April 30, 1990 total disbursements under these credits amounted to the equivalent of US\$114.1 million.

Transport

IDA's assistance has focused on urgently needed rehabilitation and maintenance of roads under the First Roads Project for US\$9.0 million (FY 1979), and the Second Roads Project for US\$8.0 million (FY 1984). These projects are strengthening the local maintenance capacity by training road maintenance brigades. Further assistance in the transport sector is being provided under the Bissau Port Project for US\$16 million (FY 1983), which involves the rehabilitation of the port of Bissau and small river ports throughout the country. In December 1989, IDA approved an Infrastructure Rehabilitation Credit for US\$23.6 million equivalent designed to strengthen transport institutions and to finance part of the public transportation expenditures.

Petroleum

The two credits in the petroleum sector (US\$6.8 million in FY 1981 and US\$13.1 million in FY 1983) are helping the Government to carry out offshore oil exploration through the collection, processing, and evaluation of seismic data, provision of training and physical facilities, and assistance in establishing a sound legal framework for negotiating exploration contracts. The first Oil Exploration Project led to the identification of six offshore lots, and drilling by a consortium headed by ELF/Aquitaine. Surveys under the Second Project are progressing satisfactorily. In June 1987, Shell/Pecten signed an exploration contract with the Government and exploration work was started in October/November 1989. This project is supported by an IFC equity investment of US\$5.85 million.

Technical Assistance

Technical assistance has played an important role in the above projects. In FY 1985, IDA approved a US\$6.0 million Technical Assistance Credit to assist the Government in strengthening the macro-

^{1/} The U.S. dollar equivalent is calculated using the SDR/U.S. dollar rate at the date of each credit approval.

Guinea-Bissau - Relations with the World Bank Group (continued)

economic management capability of key economic institutions and in developing a sound institutional framework in newly created ministries and agencies. Its objective is to provide the Government with the technical and managerial expertise necessary to support economic recovery. The project also financed a survey of the state enterprises. In FY 1988, a second technical assistance credit for US\$9.7 million was approved to continue assistance to improve the efficiency of key economic ministries.

Agriculture

In 1987, IDA approved a US\$3.7 million credit to strengthen the capacity of the Ministry of Rural Development and Fisheries to manage its human resources, with particular attention to technical assistance; to plan activities in the agricultural sector and to coordinate external aid; to fulfill its technical role in the different agricultural subsectors; and to ensure monitoring of sectoral implementation and impact of the Government's Structural Adjustment Program. Additional financing for the project was provided as a grant by the Netherlands in an amount of US\$2.5 million equivalent.

Import Credits

In FY 1985, IDA approved a US\$10.0 million Reconstruction Import Credit to assist in providing urgently needed agricultural, transport, energy, and other essential imports to support the economic recovery program and ensure economic activity during the design and implementation of reform measures. A supplementary credit of US\$5.0 million from the Special Facility for Africa (SFA) was approved in April 1986 to ensure needed imports for 1986 and the continuation of the policy reform program.

Structural Adjustment Credits

In May 1987, IDA approved a US\$10 million credit and a US\$5 million SFA credit to support the Government's economic recovery program and allow economic activity to expand while current and future reform measures are implemented. The adjustment program focusses on economic liberalization measures and the reform of public administration and public enterprises. Special Joint Financing from Switzerland of US\$5.2 million equivalent and US\$3.2 million equivalent from the Saudi Fund were provided in collaboration with the SFA. Furthermore, the International Fund for Agricultural Development (IFAD) provided US\$5.3 million equivalent, and the African Development Fund, US\$11.3 million equivalent. Additional financing of US\$2.5 million equivalent was provided by the Netherlands. In May 1989, IDA approved a second structural adjustment credit for US\$23.4 million equivalent to support

Guinea-Bissau - Relations with the World Bank Group (continued)

the second phase of the Government's economic recovery program; this credit includes a technical assistance component in support of the Public Enterprise Reform Program. Cofinancing from AFDB, US\$12.0 million equivalent, US\$5.0 million equivalent from the Netherlands, US\$4.5 million from USAID and US\$2.0 million equivalent from Japan has been provided.

Population, Health and Nutrition

In 1987, IDA approved a credit of US\$4.2 million equivalent to improve the institutional capabilities of the Ministry of Public Health and to strengthen the delivery of health and family planning services, *particularly in the rural sectors.*

Education

In 1988, IDA approved a credit of US\$4.3 million equivalent to strengthen the institutional capabilities of the Ministry of Education and to improve the quality and access to basic education.

Social Dimensions of Adjustment

In May 1989, IDA approved a credit of US\$5.0 million equivalent to help increase income and employment opportunities among low income and unemployed urban and rural workers through activities in the infrastructure sector; this credit also assists the education sector through provision of basic equipment and teaching aids, and the health sector through the provision of emergency medical supplies and support to the National Aids Campaign. Cofinancing of about US\$11.0 million is expected, including about US\$3.0 million equivalent from Sweden, US\$1.5 million equivalent from Portugal, and US\$0.7 million equivalent from the World Food Program.

Guinea-Bissau - Relations with the World Bank Group (continued)

Summary of IDA Operations
(In millions of U.S. dollars, as of June 30, 1990)

<u>Projects</u>	<u>Credits 1/</u>	<u>Disbursements 2/</u>
Roads I	9.0	9.0
Petroleum I	6.8	6.1
Petroleum II	13.1	12.0
Bissau Port	16.0	16.2
Roads II (2 credits)	8.0	9.4
Technical Assistance	6.0	7.2
Reconstruction Import Credit (2 credits)	15.0	16.8
SAC I (2 credits) 3/	15.0	15.6
Agricultural Services	3.7	1.4
Population, Health, and Nutrition	4.2	4.1
Education	4.3	1.3
Technical Assistance II	9.7	3.3
SAC II 4/	23.4	9.7
Social and Infrastructure Relief	5.0	2.0
Infrastructure Rehabilitation	<u>23.6</u>	<u>--</u>
Total (18 credits)	162.8	114.1

Source: Statements of Development Credits, World Bank.

1/ IDA credits after 1980 and Special Fund credits are denominated in special drawing rights. U.S. dollar amounts are calculated using the exchange rate prevailing at time of credit negotiation.

2/ Disbursed amounts may exceed the credit amounts because of changes in the SDR/U.S. dollar exchange rate.

3/ Including Special Facility for Africa (SFA) but excluding co-financing.

4/ Does not include co-financing.

Guinea-Bissau - Relations with the World Bank Group (concluded)

Guinea-Bissau: IDA Credits and Debt Service, 1982-93

(In millions of U.S. dollars)

	Actuals								Projections			
	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
Disbursements <u>1/</u>	2.9	10.7	4.7	14.6	10.1	18.6	17.8	22.2	15.6	17.0	18.0	18.0
Amortization	—	—	—	—	—	—	—	0.1	0.1	0.1	0.1	0.1
Net disbursements	2.9	10.7	4.7	14.6	10.1	18.6	17.8	22.1	15.5	16.9	17.9	17.9
Service charges	—	—	0.1	0.4	0.5	0.7	0.7	0.7	0.7	0.8	0.8	0.8

Source: World Bank.

1/ Including Special Facility for Africa.

Guinea-Bissau - Statistical Issues

1. Outstanding statistical issues

The country has no page in IFS and the statistical system remains weak.

a. Government finance

Annual data for period 1983 through 1988 (provisional data for years 1986 onwards) have been reported to the Bureau of Statistics. These data have been published in the Government Finance Statistics Yearbook.

b. Monetary accounts

The authorities have made some progress in implementing the recommendations of recent technical assistance missions in money and banking statistics, but now need to modify their statistical reporting system following institutional changes that included a change in the role of the National Bank of Guinea-Bissau, which had been the only financial institution.

Table I. Guinea-Bissau: Central Government Operations, 1987-93 1/

	1987	1988		1989		1990			1991	1992	1993
	Act.	Prog.	Act.	Prog.	Est.	Orig. proj.	Govt. budget	Rev. proj.	Rev. proj.	proj.	Proj.
(In billions of Guinea-Bissau pesos)											
Total revenue and grants	35.21	59.86	63.69	121.93	147.57	133.28	253.21	225.88	242.62	262.02	281.97
Budgetary revenue	12.58	21.59	23.30	39.32	42.16	44.89	104.98	77.64	81.57	90.83	100.51
Tax revenue	7.90	15.12	14.54	25.23	14.79	28.88	65.11	38.34	38.49	45.17	52.22
Income taxes	0.91	1.50	1.38	3.62	3.09	4.56	9.41	5.19	5.79	6.80	7.78
Consumption tax	0.83	2.12	2.12	4.37	2.23	5.03	13.28	8.06	9.50	11.40	13.40
Taxes on international trade	5.41	10.52	9.97	15.47	7.77	17.26	39.55	22.80	20.68	24.20	27.99
Of which: on imports	(1.44)	(2.88)	(3.55)	(7.04)	(5.31)	(8.09)	(13.36)	(6.90)	(8.29)	(9.94)	(11.93)
on exports	(3.39)	(5.12)	(4.88)	(5.52)	(0.02)	(5.88)	(14.25)	(10.20)	(6.12)	(6.73)	(7.41)
Nontax revenue	4.68	6.47	8.76	14.09	27.37	16.02	39.86	39.30	43.08	45.66	48.29
Of which: fishing licenses	(3.71)	(5.43)	(6.32)	(9.51)	(24.35)	(10.87)	(33.94)	(33.63)	(37.19)	(39.53)	(41.90)
Grants	22.63	38.28	40.38	82.61	105.41	88.39	148.24	148.24	161.06	171.91	181.46
Food aid and balance of payments support	4.25	8.24	4.25	24.32	30.19	23.17	46.18	46.18	45.83	48.71	51.64
Project aid	18.38	30.04	36.13	58.29	75.22	65.22	102.06	102.06	115.23	122.48	129.83
Total expenditure and net lending	46.48	74.31	88.89	131.20	200.17	153.23	243.31	234.64	271.66	280.38	296.51
Current expenditure	15.54	25.86	29.47	47.98	71.87	51.66	92.46	83.80	98.29	95.27	98.82
Wages and salaries	5.40	8.06	8.71	14.25	17.82	15.82	24.98	21.39	23.52	25.41	27.44
Other goods and services	4.96	6.19	10.70	10.60	25.49	12.00	31.18	28.06	30.53	32.63	34.89
Transfers	1.59	1.92	2.01	4.29	6.48	4.06	7.89	5.94	6.27	6.62	6.98
Scheduled interest 2/	3.59	9.69	8.05	18.85	22.08	19.78	28.42	28.42	37.97	30.62	29.51
Capital expenditure	28.87	48.45	55.92	88.70	117.00	101.57	150.84	150.84	173.36	185.11	197.69
Net lending	2.06	—	3.50	-5.48	11.30	—	—	—	—	—	—
Overall balance (commitment basis, deficit -)	-11.27	-14.45	-25.21	-9.28	-52.59	-19.95	9.91	-8.76	-29.03	-18.36	-14.53
External payments arrears (reduction -)	-12.34	-0.12	5.25	-25.34	19.98	—	-70.09	-70.09	—	—	—
Float, errors and omissions (net)	-0.36	—	-1.05	—	-4.58	—	—	—	—	—	—
Overall deficit (cash basis)	-23.97	-14.58	-21.00	-34.62	-37.19	-19.95	-60.18	-78.86	-29.03	-18.36	-14.53
Financing	23.97	14.58	21.00	34.62	37.19	19.95	60.18	78.86	29.03	18.36	14.53
Domestic (Central Bank) 3/	-9.54	-16.33	-13.17	-7.40	-16.35	...	-27.86	-27.86	-30.33	-32.70	-34.67
Foreign (net)	18.02	17.35	22.22	13.16	16.81	21.56	22.97	22.97	11.26	33.68	36.29
Drawings 4/	24.70	34.88	37.20	45.95	66.97	54.89	82.17	82.17	95.85	103.27	109.47
Balance of payments loans	10.81	18.41	23.00	19.65	28.42	24.06	38.12	38.12	46.09	50.38	53.41
Project loans	13.89	16.47	14.20	26.29	38.55	30.83	44.04	44.04	49.76	52.89	56.06
Amortization 2/	-6.67	-17.54	-14.98	-32.79	-50.16	-33.32	-59.20	-59.20	-84.59	-69.59	-73.18
Debt relief	15.48	13.57	11.96	...	36.72	...	19.44	19.44	—	—	—
Current obligations	5.44	11.63	11.96	...	11.04	...	19.44	19.44	—	—	—
Payments arrears	10.04	1.94	—	...	25.68	...	—	—	—	—	—
Financing gap	—	—	—	28.87	—	...	45.64	64.31	48.10	17.38	12.91
Memorandum items:											
Import-related taxes	5.91	12.08	11.51	19.01	9.62	21.30	52.26	30.40	29.62	34.93	40.61
Current budget (deficit -)	-2.96	-4.28	-6.17	-8.66	-29.71	-6.76	9.91	-6.16	-16.73	-4.45	1.69
Current budget, excluding interest (deficit -)	0.63	5.41	1.88	10.19	-7.63	13.02	38.32	22.26	21.25	26.17	31.20
Overall deficit, excluding grants	-33.90	-52.73	-65.59	-91.88	-158.01	-108.34	-138.33	-157.00	-190.09	-189.55	-196.00
Commitment basis	-33.90	-52.73	-65.59	-91.88	-158.01	-108.34	-138.33	-157.00	-190.09	-189.55	-196.00
Cash basis	-46.60	-52.85	-61.39	-117.23	-143.58	-108.34	-208.42	-227.09	-190.09	-189.55	-196.00
(In percent of GDP)											
Overall deficit (commitment basis, excluding grants)	-36.7	-31.8	-38.2	-38.2	-51.5	-37.8	-36.6	-41.5	-42.3	-37.3	-34.2
Overall deficit (commitment basis, excluding grants and interest)	-32.8	-26.0	-33.5	-30.4	-44.3	-30.9	-29.1	-34.0	-33.8	-31.3	-29.1
Overall deficit (cash basis, including grants)	-26.0	-8.8	-12.2	-14.4	-12.5	-7.0	-15.9	-20.9	-6.5	-3.6	-2.5

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

1/ Data may not add because of rounding.

2/ The data for 1989-93 include debt service payments on the consolidated medium- and long-term debt of the National Bank.

3/ The accumulation of government deposits is linked to the sterilization of local counterpart funds generated by external budgetary assistance.

4/ Excluding disbursements under the SAF.

Table II. Guinea-Bissau: Monetary Survey, 1988-90

(In billions of Guinea-Bissau pesos; end of period)

	1988	1989								1990	
	Dec.	March	June		Sept.		Dec.		March	Dec.	
	Act.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Act.	Proj.	
Foreign sector	7.8	10.8	13.4	19.4	15.6	7.7	16.0	9.6	47.6	49.0	
Net foreign assets	-20.2	-28.8	-16.0	-28.5	-15.7	-37.3	-17.2	-44.8	-10.3	-25.9	
Medium- and long-term liabilities	-86.8	-100.9	-101.6	-2.7	-105.7	-2.7	-109.9	-2.7	-2.7	-2.7	
Valuation adjustments	114.8	140.5	131.0	50.6	137.0	47.7	143.1	57.1	60.7	77.6	
Domestic assets (net)	30.9	30.9	32.2	25.7	31.8	37.9	31.0	45.5	13.2	14.3	
Domestic credit (net)	33.4	31.8	34.7	27.8	34.3	42.3	33.5	48.6	16.1	17.4	
Central Government (net)	-11.2	-16.1	-15.1	-18.1	-17.5	-15.0	-18.6	-27.6	-43.8	-55.4	
Central Government, excluding counterpart deposits (net)	14.1	20.3	...	23.8	...	29.8	...	45.0	28.0	45.0	
Counterpart deposits 1/	-25.3	-36.4	...	-41.9	...	-44.8	...	-72.6	-71.8	-100.4	
Credit to the economy	44.6	47.9	49.8	45.9	51.8	57.3	52.1	76.2	59.9	72.8	
Credit to the economy, excluding write-off	44.6	47.9	49.8	45.9	51.8	57.3	52.1	90.6	74.3	...	
Private sector	30.9	35.9	...	39.5	...	49.1	...	68.1	59.4	...	
State enterprises	13.7	12.0	...	6.4	...	8.2	...	22.5	14.9	...	
Write-off 2/	—	—	—	—	—	—	—	-14.4	-14.4	...	
Other items (net)	-2.5	-0.9	-2.5	-2.1	-2.5	-4.4	-2.5	-3.1	-2.9	-3.1	
Broad money supply	38.7	41.7	45.6	45.1	47.4	45.6	47.0	55.0	60.9	63.3	
Money	30.9	34.5	...	35.7	...	36.5	...	42.1	46.3	...	
Currency in circulation	16.0	19.4	...	22.2	...	22.1	...	25.0	28.3	...	
Deposits	14.9	15.0	...	13.5	...	14.4	...	17.1	18.0	...	
Quasi-money	7.8	7.2	...	9.4	...	9.0	...	13.0	14.6	...	
Memorandum item:											
Exchange rate (Guinea-Bissau pesos per U.S dollar; end of period)	1,360	1,695	...	1,993	...	1,930	...	1,986	2,132	2,699	

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

1/ Counterparts of external balance of payments assistance.

2/ Outstanding interest arrears and nonperforming assets.

Table III. Guinea-Bissau: Balance of Payments, 1986-93

(In millions of U.S. dollars)

	1987		1988		1989		1990		1991		1992	1993
	Prog.	Est.	Proj. 1/	Est.	Prog.	Est.	Orig. proj.	Rev. proj.	Revised projections		Proj.	
Baseline scenario												
Current account	-18.8	-12.9	-23.4	-29.0	-23.5	-38.6	-24.0	-8.3	-37.0	-28.0	-28.5	
Trade balance	-36.0	-29.3	-37.2	-43.0	-41.7	-54.9	-39.8	-45.8	-59.3	-51.8	-51.6	
Exports, f.o.b.	15.7	15.4	21.7	15.9	20.8	14.2	24.3	24.5	21.9	27.7	32.9	
Of which: cashews	(...)	(10.9)	(...)	(9.0)	(10.4)	(7.2)	(11.4)	(14.8)	(8.3)	(8.7)	(9.4)	
fish and shrimp	(...)	(0.5)	(...)	(0.9)	(1.1)	(2.3)	(1.6)	(2.4)	(5.3)	(9.4)	(12.6)	
Imports, f.o.b.	-51.7	-44.7	-58.9	-58.9	-62.5	-68.9	-63.9	-70.3	-81.4	-79.5	-84.5	
Of which: foodstuffs	(...)	(-9.7)	(...)	(-13.3)	(-12.8)	(-18.4)	(-9.6)	(-16.1)	(-13.6)	(-11.5)	(-9.6)	
petroleum products	(...)	(-4.7)	(...)	(-3.8)	(-5.7)	(-7.3)	(-5.7)	(-8.3)	(-9.6)	(-10.9)	(-12.2)	
Services (net)	-26.8	-27.2	-31.1	-31.4	-35.1	-43.3	-35.0	-26.2	-40.2	-38.9	-39.6	
Of which: scheduled interest	(-11.2)	(-7.6)	(-13.1)	(-10.6)	(-13.0)	(-12.3)	(-12.2)	(-12.2)	(-15.1)	(-12.7)	(-11.2)	
fishing license fees			(5.6)	(5.7)	(6.0)	(5.7)	(6.1)	(19.8)	(14.2)	(14.2)	(14.2)	
Transfers (net)	44.0	43.6	44.9	45.5	53.3	59.4	50.6	63.8	62.7	62.7	62.7	
Official	43.0	43.6	43.4	44.0	52.3	58.2	49.6	62.6	61.5	61.5	61.5	
Private	1.0	-2.0	1.5	1.5	1.0	1.2	1.0	1.2	1.2	1.2	1.2	
Capital account	15.9	18.6	20.7	18.2	10.7	9.3	12.1	7.9	17.3	12.1	12.3	
Official medium- and long-term disbursements	32.0	33.1	36.0	33.4	28.9	37.0	30.8	32.9	49.6	37.1	37.1	
Balance of payments support	17.0	16.8	19.0	20.7	12.3	15.7	13.5	14.3	17.6	18.1	18.1	
Projects	15.0	16.3	17.0	12.7	16.6	21.3	17.3	18.6	32.0	19.0	19.0	
Scheduled amortization	-16.1	-14.5	-15.3	-15.2	-18.2	-27.7	-18.7	-25.0	-32.3	-25.0	-24.8	
Errors and omissions and private and short-term capital	—	-3.7	2.0	4.1	2.3	-9.7	2.5	5.0	2.6	2.7	2.7	
Overall surplus or deficit (-)	-2.9	2.0	-0.7	-6.7	-10.5	-39.0	-9.4	4.6	-17.1	-13.2	-13.5	
Refinancing of arrears	—	—	2.1	—	—	—	—	—	—	—	—	
Change in debt service arrears (decrease -) 2/	-26.2	-36.9	-4.1	7.1	-16.8	11.0 3/	—	-29.6	—	—	—	
Adjusted overall balance	-29.1	-34.9	-2.7	0.4	-27.3	-28.0	-9.4	-25.0	-17.1	-13.2	-13.5	
Financing	-3.1	34.9	2.7	-0.4	-1.9	28.0	9.4	0.2	-12.2	-6.2	-4.0	
Net foreign assets	-3.1	-11.0	-9.9	-12.3	-1.9	7.7	-6.8	-8.0	-12.2	-6.2	-4.0	
Of which: use of Fund resources (net)	(1.7)	(1.7)	(1.7)	(-1.2)	(2.0)	(2.0)	(2.0)	(-)	(-)	(-)	(-0.4)	
Purchases	(2.0)	(2.0)	(2.9)	(-)	(2.9)	(2.9)	(2.0)	(-)	(-)	(-)	(-)	
Repurchases	(-0.3)	(-0.3)	(-1.2)	(-1.2)	(-0.9)	(-0.9)	(-)	(-)	(-)	(-)	(-0.4)	
Change in National Bank arrears (decrease -)	(-2.8)	(-10.4)	(-9.9)	(0.6)	(-3.4)	(0.1)	(-7.8)	(-3.8)	(-9.6)	(-5.7)	(-2.4)	
Rescheduled debt	...	45.9	12.6	11.9	—	20.3	—	8.2	—	—	—	
Financing gap	32.2	—	—	—	29.2	—	16.2	24.8	29.3	19.4	17.5	
Memorandum items:												
Current account deficit, excluding official transfers	-61.8	-58.5	-66.8	-73.0	-75.8	-96.8	-73.6	-70.9	-98.5	-89.5	-90.0	
In percent of GDP	-37.5	-35.5	-45.7	-47.5	-49.9	-57.2	-45.8	-45.1	-57.4	-49.1	-46.4	
Current account deficit, excluding official transfers and scheduled interest	-50.6	-50.9	-53.7	-62.4	-62.8	-84.5	-61.4	-58.7	-83.5	-76.9	-78.9	
In percent of GDP	-30.7	-30.9	-36.7	-40.6	-41.4	-49.9	-38.2	-37.4	-48.6	-42.2	-40.6	
Debt service ratio 4/												
Before rescheduling	113.2	92.5	95.5	100.0	103.8	155.0	80.6	73.5	111.3	75.6	63.7	
After rescheduling	83.9	43.8	49.1	61.4	...	131.3	...	57.3	...	...	...
Exchange rate (Guinea-Bissau pesos per U.S. dollar, period average)	590	559	969	1,110	1,584	1,810	1,782	2,368	...	...	...
Alternative scenario, 1990-93												
Current account								-13.0	-45.4	-36.8	-43.4	
Trade balance								-49.5	-66.1	-57.8	-62.1	
Exports, f.o.b.								24.5	21.9	27.7	32.9	
Imports, f.o.b.								-74.0	-88.0	-85.5	-95.0	
Adjusted overall balance								-29.7	-25.5	-22.0	-28.4	
Financing gap								29.5	37.7	28.2	32.4	
Memorandum items:												
Current account, excluding official transfers								-75.6	-106.9	-98.3	-104.9	
In percent of GDP								-47.4	-62.3	-53.9	-54.0	

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

1/ Revised projections in SIV/88/58 (3/10/88).

2/ Excluding arrears of the National Bank.

3/ Represents an accumulation of arrears of US\$29.6 million, including US\$13.9 million on newly incurred commercial debt, and a reduction of arrears through rescheduling and cash payments of US\$18.6 million.

4/ In percent of exports of goods and nonfactor services.

Table IV. Guinea-Bissau: External Debt Summary, 1985-89 ^{1/}

(In millions of U.S. dollars)

	1985	1986	1987	1988	1989
Total medium- and long-term debt ^{2/}	<u>260</u>	<u>297</u>	<u>370</u>	<u>388</u>	<u>432</u>
Official creditors	<u>183</u>	<u>214</u>	<u>285</u>	<u>301</u>	<u>407</u>
Multilateral institutions	100	123	169	179	199
Of which: World Bank	(44)	(59)	(87)	(100)	(121)
Bilateral	83	91	116	122	208 ^{3/}
Private creditors	77	83	85	87	25 ^{3/}
Total short-term debt	<u>44</u>	<u>25</u>	<u>34</u>	<u>35</u>	<u>26</u>
IMF, net	<u>3</u>	<u>2</u>	<u>4</u>	<u>3</u>	<u>5</u>
Other	41	23	30	32	21
Total external debt	<u>304</u>	<u>322</u>	<u>404</u>	<u>423</u>	<u>458</u>

Sources: World Bank; and staff estimates.

^{1/} Data are presented according to World Bank definitions and rounded.

^{2/} Public and publicly guaranteed debt, including debt service arrears.

^{3/} Reflecting in part a reclassification of debt.

Table V. Guinea-Bissau: Indicators of Fund Credit, 1989-2000

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Outstanding Fund credit (end of period)												
In millions of SDRs	3.75	3.75	3.75	3.75	3.45	3.15	2.50	1.75	1.0	0.55	0.10	—
In percent of quota	50.0	50.0	50.0	50.0	46.0	42.0	32.0	23.3	13.3	7.33	1.3	—
Fund repayments and charges												
In millions of SDRs	0.84	0.13	0.13	0.13	0.43	0.43	0.87	0.87	0.87	0.56	0.56	0.21
In percent of projected exports of goods and nonfactor services	4.3	0.3	0.4	0.4	1.0	1.0	1.8	1.6	1.5	0.9	0.8	0.3
In percent of projected gross official reserves	5.3	1.0	0.9	1.0	3.0	2.8	5.3	4.9	4.6	2.7	2.6	0.9

Source: Staff projections.

Table VI. Guinea-Bissau: Selected Social and Demographic Indicators

<u>Area</u>	<u>Population</u>	<u>Density (1990)</u>
36,125 sq. km.	1.0 million (1990) Rate of growth: 1.9 percent (1990)	27.7 per sq. km. 63.6 per sq. km. of arable land
<u>Population characteristics (1987)</u>		<u>Health (1987)</u>
Life expectancy at birth:	39	Population per physician: 7,500
Infant mortality (per thousand):	176	Population per hospital bed: 500
Child death rate: (age 1-4, percent):	31	
Urban population (percent of total)	28	
<u>Income distribution:</u> n.a.		
<u>Access to safe water (1987)</u>		
Percent of population, urban:	21	
rural:	37	
<u>Nutrition (1986)</u>		<u>Education (1987)</u>
Calorie intake as percent of requirements:	68	Adult literacy rate (percent): 15
Per capita protein intake (grams per day):	41	Primary school enrollment (percent): 60
		Secondary school enrollment (percent): 11

Sources: World Bank; and staff estimates.

Guinea-Bissau: Policies and Measures
Under the Program Supported by the Second Annual
Arrangement Under the SAF, 1989

Policies and measures	Status of implementation at end-1989
<u>1. Structural policies</u>	
<u>(a) Pricing and marketing</u>	
Issue decree for the elimination of price controls on private transport.	Implemented.
**Implement a price policy for petroleum products that reflects exchange rate fluctuations and adjust retail prices accordingly every quarter.	Not implemented.
Issue decree for the elimination of price controls on sugar, cooking oil, and private sector imports of fertilizers.	Implemented.
Issue decree for the elimination of the cereal import monopoly.	Implemented.
Adopt an open general license system for imports, except for those included in a negative list to be conveyed to the Fund staff.	Implemented.
<u>(b) Public enterprises</u>	
*Complete liquidation of SOCOMIN.	Not implemented.
* **Complete a diagnostic study of the public enterprise sector, including an inventory of cross-debts; implement a plan of action on the basis of this study in consultation with the staffs of the Fund and the World Bank.	In progress.
Begin implementation of privatization of Armazéns do Povo.	Not implemented.
*Implement EAGB's rehabilitation plan in accordance with World Bank staff recommendations, including a review of tariffs to ensure current cost recovery.	Implemented.

Guinea-Bissau: Policies and Measures
Under the Program Supported by the Second Annual
Arrangement Under the SAF, 1989 (continued)

Policies and measures	Status of implementation at end-1989
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(c) Public investment

*Prepare and implement a three-year rolling investment plan for 1989-91, in consultation with the World Bank staff.	Implemented.
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*Prepare an inventory of projects and update it on a regular basis. Data on projects should include estimated recurrent costs to be financed by the budget, terms and conditions of financing, and implications for the debt service.	In progress.
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Integrate all public investment outlays into the government budget and budgetary control process, particularly: all revenues, including food aid counterpart funds, and all expenditures, including capital outlays financed with domestic resources.	In progress.
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*Strengthen the role of the National Commission for Economic Coordination and Management in programming and monitoring of public investment.	Implemented.
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(d) Statistical base

Strengthen the monitoring of government cash transactions and external debt, and prepare monthly treasury balance sheets.	In progress.
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Improve BNG's accounting procedures in accordance with Fund staff recommendations, particularly external sector transactions.	In progress.
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Prepare national account estimates and a consumer price index, with technical assistance from the World Bank and UNDP.	In progress.
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Prepare quarterly reports of economic and financial performance under the SAF.	In progress.
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Guinea-Bissau: Policies and Measures
Under the Program Supported by the Second Annual
Arrangement Under the SAF, 1989 (continued)

Policies and measures	Status of implementation at end-1989
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2. <u>Financial policies</u>	
(a) <u>Fiscal policy</u>	
Enhance tax collection.	Not implemented.
Allow no new import tax exemptions.	Not implemented.
Reduce the export tax on cashew nuts to 34 percent of the export value.	Implemented.
Adopt a 1989 budget that is consistent with the adjustment program.	Implemented.
Establish a civil service register to monitor government employment policy.	Not implemented.
Implement a simplified customs tariff; eliminate import duty and tax exemptions, including the exemptions of the Government, the public enterprises, and the shops operating in foreign currency.	Not implemented.
Reduce the number of civil servants by 10 percent in 1989, of which 5 percent is to be effected by June 1989.	Not implemented.
Eliminate the subsidized sales of rice and other basic foodstuffs to civil servants.	Implemented.
(b) <u>Monetary and credit policies</u>	
Raise interest rates to achieve positive real interest rates, and simplify the interest rate structure.	Implemented.

Guinea-Bissau: Policies and Measures
Under the Program Supported by the Second Annual
Arrangement Under the SAF, 1989 (continued)

Policies and measures	Status of implementation at end-1989
Adjust lending and deposit rates periodically to maintain positive real interest rates.	Not implemented.
**Observe quarterly benchmarks on net domestic assets and on net credit to the Government, established in agreement with the Fund staff.	Not observed at end-September; the benchmark on net domestic assets was not observed at end-December.
Prepare and send to the Fund staff a monthly report on credit to the private sector and public enterprises by type of credit and by main economic sectors.	Not implemented.
Strengthen the credit committee with a view to improving and monitoring credit developments.	Not implemented.
Prepare central bank legislation in consultation with the Fund staff, and complete arrangements for the establishment of a commercial bank.	Implemented.
<u>External policies</u>	
(a) <u>Exchange rate policy</u>	
Pursue a flexible exchange rate policy to sustain the competitiveness of principal exports and to balance foreign exchange supply and demand.	Not implemented.
Continue the weekly devaluation of the official exchange rate, as needed, to keep the spread between the official and the parallel market exchange rates within 20 percent.	Not implemented.
Maintain gross official reserves at a level equivalent to at least the level at end-1988.	Implemented.

Guinea-Bissau: Policies and Measures
Under the Program Supported by the Second Annual
Arrangement Under the SAF, 1989 (concluded)

Policies and measures	Status of implementation at end-1989
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(b) External debt management

**Permit no contracting or guaranteeing of new loans with a grant element of less than 50 percent, except normal trade credits and refinancing of existing debt.	Not implemented.
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Complete satisfactory arrangements to cover the projected external financing gap.	Not implemented; arrears accumulated.
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Consolidate all medium- and long-term foreign debt under the auspices of the Ministry of Finance.	Implemented.
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Prepare and send to the Fund staff a foreign exchange budget for 1989.	Not implemented.
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Source: EBS/89/131, June 28, 1989.

*Measures that are also included in the World Bank's structural adjustment program.

**Denoting benchmarks.

