FOR AGENDA

EBS/87/99

CONFIDENTIAL

May 7, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Guinea-Bissau - Medium-Term Economic and Financial Policy Framework

Attached for consideration of the Executive Directors is a policy framework paper for Guinea-Bissau which will be brought to the agenda for discussion on a date to be announced. An interim report on Guinea-Bissau's request for an arrangement in the structural adjustment facility will be issued shortly.

The Executive Directors of the World Bank will discuss this paper in Committee of the Whole on Tuesday, May 19, 1987.

Mr. Cronquist (ext. 6932) or Mr. Enders (ext. 6895) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

GUINEA-BISSAU

Medium-Term Economic and Financial Policy Framework

Prepared by the Guinea-Bissau authorities in collaboration with the staffs of the Fund and the World Bank

January 1987-December 1989

April 17, 1987

I. Background

1. Guinea-Bissau is a small country on the West African coast with a population of 900,000. An estimated 1985 per capita income of US$180 places the country among the poorest in the world; life expectancy at 38 years is among the world's lowest. The economy is characterized by a large traditional rural sector, producing primarily for self-consumption. Partly for this reason, measurements of economic activity are subject to an unusual degree of uncertainty; in addition the data base is poor. Agriculture, fisheries, and forestry account for about 90 percent of employment and an estimated 50 percent of GDP. The marketed portion of output is largely confined to export crops, primarily cashews, groundnuts, and palm kernels; the main foodcrop is rice.

2. After independence in 1974, Guinea-Bissau faced the task of rebuilding its economy from the devastation of the protracted liberation war which dislocated one fifth of the population, destroyed an important part of the economic infrastructure, and reduced output of the main crops (rice and groundnuts) by over one third. An ambitious public investment program, financed mainly by external borrowing, was implemented, focusing mainly on the manufacturing sector and neglecting the agricultural sector. An agro-industrial complex, costing the equivalent of 20 percent of GDP and financed by commercial credits, was completed but never opened due to design flaws. Inappropriate pricing policies, an increasingly overvalued exchange rate, and an inefficient marketing system prevented recovery of agricultural production, depressed exports, and stimulated a parallel market. The country became dependent on foreign aid to the extent of about 50 percent of GDP; foreign aid financed 80 percent of imports. Severe fiscal imbalances, resulting from a rapid rise in government expenditures and a limited growth in revenues, were increasingly financed by central bank credit, thereby fueling inflation, which reached 50 percent per annum by 1980, while the exchange rate remained unchanged. In the period 1980-82, the external situation was further aggravated by exogenous factors such as drought and depressed world market prices for the country's main exports. The balance of payments deteriorated rapidly, exacerbated by service on an external debt that exceeded GDP by the early 1980s; external arrears accumulated.

3. In an attempt to reverse the rapid deterioration of the economic and financial situation, at the end of 1983 the Government adopted stabilization measures in the context of an economic and financial program. This

program was supported in 1984 by a first credit tranche purchase from the Fund and by a Reconstruction Import Credit from the World Bank. The measures were designed to correct the price distortions, to shift the internal terms of trade in favor of the rural sector, and to improve efficiency in the management of public sector finances. The principal measures included a devaluation of the currency, the Guinea-Bissau peso (100 percent in local currency terms), increases in producer prices for the principal export crops (ranging from 76 percent to 114 percent), increases in consumer prices to reflect the exchange rate action, increases in direct and indirect tax rates, steps to liberalize the marketing system, and, for the first time, the introduction of interest rates on deposits.

4. In 1984 these actions had a positive impact on the agricultural sector, and the volume of crops marketed through official channels rose substantially. Nevertheless, only a limited degree of overall adjustment actually took place. There were delays in the implementation of some of the accompanying structural measures and inappropriate policies in other areas, including substantial overruns in government expenditures. There were also delays in the disbursement of foreign assistance. During 1985 the adjustment process lost momentum although the Government continued to implement a number of corrective measures, including further nominal depreciations of the exchange rate. The financial policies remained expansionary, and the overall fiscal deficit (on a commitment basis and including grants) rose by 62 percent to PG 7.5 billion, equivalent to 47 percent of total expenditures. The external payments situation was further aggravated by depressed world market prices for principal exports such as groundnuts and cotton. The external current account deficit, which had risen by 25 percent to the equivalent of US$36 million in 1984, rose further by 12 percent to US$40 million in 1985, or to nearly four times the level of official exports. At the end of 1985 the accumulated stock of external arrears was equivalent to more than twice the level of official 1985 exports. Outstanding external debt amounted to US$287 million 1/ and the scheduled debt service ratio was 55 percent.

II. Recent Developments

5. The economic and financial deterioration in recent years stems, in part, from a pervasive system of price and marketing controls, including the maintenance of a highly overvalued exchange rate, which is reflected in a 200 percent premium on foreign exchange in the parallel market. This has given rise to massive cost/price distortions and encouraged the expansion of parallel market activities. Officially marketed agricultural output has remained far below potential, and the domestic and external imbalances have been unsustainable with large financing gaps resulting in a further

---

1/ Due to the weak statistical base, the ratios in terms of GDP have been omitted in this paper; however the outstanding external debt is estimated to be 1.7 times GDP.

accumulation of arrears. In 1986 the acute shortage of foreign exchange and the inability to mobilize additional foreign financing limited even essential imports, thus exacerbating the negative effect of the overvalued exchange rate on marketed agricultural output.

6. In April 1986 the Government announced the adoption of a three-year adjustment program that was intended to address the financial imbalances as well as the structural impediments to economic growth. However, no specific corrective actions were taken in the period immediately following the announcement of the program. In August 1986 the Government adopted measures aimed at liberalizing domestic and foreign trade and reducing the scope of price control. As a result, market forces are allowed to play a greater role in the allocation of resources. Most prices are now freely determined, and the private sector can participate in domestic and external trade, except in the case of imports of cereals, petroleum, and pesticides.

7. Although the above measures represent an important corrective action, the Government is aware that their impact would be limited as long as key imports remain subject to price control and while the official exchange rate is highly overvalued. Prices charged by the principal public enterprises and utilities still do not cover costs, and recent adjustments in the official exchange rate have not been sufficient to redirect marketing to official channels.

8. The cost/price distortions have been reflected in and compounded by inappropriate fiscal policies. A major cause of the worsening government finance situation has been the rapid expansion in expenditure, mainly wages and salaries and capital outlays; the latter exceeded the country's absorptive capacity and further increased the unmanageable external debt service burden. The revenue base is inelastic and revenue performance has been affected by the accumulation of tax arrears and by the ad hoc granting of tax exemptions and exonerations, especially for imports. Credit policy in recent years has been mainly dictated by the need to finance the fiscal deficits and, as a result, in 1986, the net advances to the Treasury were equivalent to about 25 percent of money stock at the beginning of the period.

9. The external current account deficit in 1986 is estimated to have declined by 27 percent to US$29 million, and external arrears are estimated to have increased by US$2 million. Exports represented only about 16 percent of imports mainly due to the overvalued exchange rate. The Government continued a policy of small weekly depreciations; the nominal effective exchange rate is estimated to have depreciated by 27 percent in 1985 and by 29 percent in 1986. However, these adjustments have not provided adequate incentive for export production or marketing of export through official channels. The depreciations have not been reflected in a timely manner in administered domestic prices.

10. The scheduled external debt service ratio rose further to 82 percent in 1986. Bilateral debt relief was obtained from two major

creditors 1/ and the Government is pursuing its efforts to obtain additional bilateral debt relief since the debt servicing capacity remains extremely limited.

III. Overview of the Medium-Term Strategy

11. In order to address the protracted balance of payments crisis and to steer the economy on a path towards sustained growth consonant with domestic financial stability and a viable external sector position, the Government has formulated a medium-term economic and financial adjustment program covering the period 1987-89. This program is consistent with the policies outlined in the Government's Letter of Development Policy of March 27, 1987, to IDA, in support of which financial support is being sought for 1987-88 equivalent to about US$40 million from IDA (including the Special Facility for Africa), the African Development Bank, the International Fund for Agricultural Development, Saudi Arabia, and Switzerland.

A. Broad Objectives and Principal Instruments

12. The broad objectives of the medium-term program are to stimulate economic growth, make progress toward a viable balance of payments position, reduce inflation, and achieve relative price stability. The objectives, and the Government's development strategy, have been formulated in the context of the country's economic and social structure, which is characterized by the relatively extensive natural resource base for the expansion of agriculture at low cost and the limited availability of skilled manpower. Consequently, the strategy focuses on a strong expansion of agricultural output and exports based on smallholdings, with a retrenchment of the public sector and its refocusing on provision of social and physical infrastructure in support of production.

13. Central to the process of attaining the broad objectives are economic and financial policies aimed at aligning domestic demand with available resources while generating a favorable environment for private sector economic activity. These policies, which are described below in Chapter IV, include measures to increase external competitiveness, to bring the budgetary deficit under control, to improve production incentives, to improve the public investment programs and reorganize the public enterprise sector, and to liberalize the pricing and marketing systems.

1/ The U.S.S.R. agreed to reschedule all arrears, principal and interest falling due in 1986-90 at a 5 percent interest rate, with a 5-year grace period and a 10-year maturity period. The Portuguese Government agreed to convert its credits into a local currency development fund and to extend a 10-year credit with 4-year grace to cover the payments due in 1987-90 under the rescheduling with Portuguese banks. In addition, in 1985, a rescheduling was reached with Banco do Brasil (the Brazilian Central Bank), and the Netherlands and Canada cancelled their outstanding credits.

B. Anticipated Outcome

14. While the full impact of the program will be felt only in the longer run and is difficult to quantify, the introduction of the economic and financial measures is expected to sustain an average annual rate of growth of real GDP of about 3.5 percent in the period 1987-89 and to progressively reduce the annual rate of inflation from an estimated 45 percent in 1986 to about 8 percent in 1989. However, balance of payments viability will not be obtained in the foreseeable future due to the heavy debt service burden. The external current account deficit (excluding official unrequited transfers) is projected to be reduced by about 24 percent from US$73 million in 1986 to US$55 million in 1989, with imports declining by about 9 percent and exports more than doubling. The scope for additional adjustment measures to reduce further the current account deficit seems limited. At the same time, substantial inflows of official grants and concessional loans in each year of the program period will contribute to a decline in the external financing gap from US$13 million in 1987 to US$9 million in 1989. The projected gap, which takes into account the repayment of arrears on interest to multilateral creditors and some increase in official reserves, is entirely due to the high level of scheduled debt service obligations. The scheduled debt service ratio, which was 82 percent in 1986, is projected at 80 percent in 1989. If debt rescheduling is obtained to fill the unfinanced external gap (see para. 19), the debt service ratio, excluding arrears repayment, would average about 58 percent in the period 1987-89.

15. The overall central government budget deficit (commitment basis and excluding external grants), which was equivalent to 82 percent of total expenditures in 1986, will be reduced to 74 percent of total expenditure in 1987, to 72 percent in 1988, and to 69 percent in 1989. Public investment outlays in U.S. dollar terms will be reduced by 29 percent between 1986 and 1989 to about US$41 million in 1989 due to a substantial restructuring and reduction of the public investment program, which has been prepared in consultation with the World Bank. Monetary policy will emphasize the importance of making bank credit available for productive purposes. The level and structure of interest rates will be adjusted beginning in 1987 to ensure a more efficient allocation of available financial resources and to achieve positive real interest rates. Due to the large inflows of concessional loans in support of the balance of payments in 1987-89, sufficient counterpart funds will be generated to allow the Government to eliminate its net indebtedness to the National Bank. In addition, a large part of the domestic counterpart of these loans will be sterilized in a special blocked account with the National Bank.

16. A National Commission for Economic Coordination and Management has been established to coordinate the design and implementation of the policy reform program. The Commission has prepared the medium-term framework, which has been used in setting the targets and the policies that are described below. In order to reinforce its administrative capability, the Government has requested technical assistance, principally from IDA, the African Development Bank, IFAD and the UNDP. In addition, the Fund is

providing technical assistance to the National Bank. The implementation and the monitoring of the adjustment program will be conducted by the Government with the assistance of regular visits by World Bank and Fund missions. The World Bank will take the primary role with regard to structural policies and the Fund with regard to external, credit, and fiscal policies. The Fund in conjunction with the Government will establish quarterly credit benchmarks and annual fiscal and balance of payments targets.

IV. Economic and Financial Policies

A. External Policies

17. Given the magnitude of existing price distortions, the Government is aware that only a major shift in present external sector policies, together with the complementary macroeconomic and structural measures described below, can be expected to yield the results required to attain the objectives of the 1987-89 program. Consequently, the Government intends to take the following corrective actions:

(a) With regard to exchange rate policy, the Guinea-Bissau peso will by end-April 1987 be adjusted by a discrete devaluation to the level in the parallel market (PG 650 per U.S. dollar). There will be a full pass-through of the exchange rate action to domestic prices. Subsequently, a flexible exchange rate policy will be pursued, with a view to limit the spread between the rates on the official and the parallel markets to about 10 percent. In this regard, the Government will study in 1987 the possibility of introducing a foreign exchange auction.

(b) Following the exchange rate adjustment, the Government will take steps to facilitate and encourage the surrender of foreign exchange without inquiring about the source, and private importers with valid import licenses will also be free to provide their own foreign exchange. The establishment of an appropriate exchange rate policy should permit the timely elimination of the existing scheme for the retention of foreign exchange by exporters.

(c) During the program period the Government will pursue the liberalization of foreign trade and the simplification of the licensing procedures. As a first step, import licenses will be automatically issued for a list of goods covering about 50 percent of commercial imports by value, excluding petroleum imports, to be agreed with the Fund and the World Bank by end-April 1987. By end-March 1988, the list of goods for which import licenses will be automatically issued will be extended to cover about 75 percent of commercial imports, excluding petroleum, which will continue to be imported by a public enterprise (DICOL). By the end of 1988, this list will be enlarged in the light of experience gained.

(d) The Government will pursue the simplification of the existing tariff structure simultaneous with increasing revenue from tariffs. In this regard, export taxes, except for cashew nuts, will be abolished by end-April 1987. Nevertheless, if there is a substantial and temporary increase in the international prices of some products, the Government may reconsider the system of export taxation. Export taxes on cashews will be reduced from an effective 80 percent in 1986 (including profits of the since-abolished government monopoly) to 50 percent in 1987. Apart from a possible windfall tax, should world market prices rise sharply, this tax will be progressively reduced during 1988-89 with the objective of eliminating it by 1990, provided the fiscal situation evolves as outlined in para. 15. With regard to import taxes, the Government will stop issuing any exemptions and exonerations after end-April 1987. By January 1988, it will abolish all exemptions, except those required under existing treaties and contracts, but negotiations will be opened seeking their reduction or abolition. Furthermore, the Government will prepare proposals for the implementation in 1988 of a uniform import tax without reducing fiscal revenue from imports. The fiscal impact of the tax changes in 1987-89 is indicated below in para. 21.

(e) Given the existing difficult external debt situation, the Government will follow a prudent external debt management policy during the program period 1987-89. In particular, the Government and public entities will not contract or guarantee any new loans with any maturities, if the grant element is less than 50 percent, excluding short-term trade credits and refinancing of existing debt. In April 1986, the Government took a decision specifying that the signing of concessional loans and even grants will require prior authorization by the Council of Ministers, based on an opinion of the Ministry of Plan, which would analyze the impact of the recurrent costs of borrowing on the Government budget and on the foreign exchange balance. With assistance from IDA's Technical Assistance credit and other donors, the monitoring of the total external debt will be improved in 1987 through better coordination between the National Bank and the Ministry of Finance, including the computerization of all data concerning the external public debt by end-1987.

18. The implementation of an appropriate exchange rate policy, together with the supporting financial and structural policy changes indicated below, is expected to reduce Guinea-Bissau's trade deficit during 1987-89. In particular, the liberalization of pricing and marketing policies and the measures to strengthen incentives should encourage the flow of exports through official channels, as well as leading to a recovery in the level of exports, which remain below the 1970 level for groundnuts, fish, and timber. Prospects are particularly good for the expansion of cashew nut exports, in which the country has a comparative advantage, particularly in view of the tree plantings in response to the reform measures since 1983.

At the same time, the volume of imports will fall due to the reduction in public investment and to import substitution for rice, stimulated by liberalization of producer prices. The program will permit financing increased imports of a wide variety of consumer goods, so as to increase the availability of these goods in rural areas, which is vital for increasing exports through offical channels. Thus, assuming no major changes in the current outlook for world commodity prices, the trade deficit is expected to narrow from US$49 million in 1986, to US$40 million in 1987, to US$35 million in 1988, and to US$32 million in 1989.

19. As mentioned above, external financing gaps are projected to emerge in the period 1987-89 and in the medium term, which cannot be filled unless exceptional financing, including additional debt relief, becomes available. The principal bilateral creditors have already agreed to reschedule debt service falling due in 1986-1990 on generous terms (see paragraph 10). The Government has proposed a medium-term scenario in which Guinea-Bissau repays US$14.2 million in arrears in 1987-89, accumulates no new external arrears, and settles in full its scheduled interest obligations to all creditors beginning in 1987, along with payment of all principal to multilateral creditors and of 10 percent of principal due to those private and bilateral creditors with whom rescheduling negotiations will start in 1987. 1/ In this manner, Guinea-Bissau's balance of payments position could be financed. On the other hand, Guinea-Bissau's balance of payments position could be greatly strengthened if other creditors followed the example of Canada, the Netherlands and Portugal by cancelling debt or converting it to a local currency obligation.

B. Fiscal policies

20. In order to achieve the program's medium-term fiscal objectives, the Government will take measures to reduce the fiscal imbalances by raising revenues, and containing overall expenditure growth. The deficit will be entirely financed by the use of part of the domestic counterpart of external balance of payments loans (paragraph 24).

21. Revenue performance, particularly in 1987, will depend critically on the impact of the depreciation of the exchange rate on the taxable base. The Government will require full pass-through of the exchange rate action for foreign fishing licenses and for imports financed by official development assistance. Other import revenues will rise as exemptions are abolished. The additional receipts from these measures are projected at a level equivalent to 34 percent of total tax and non-tax receipts in 1987. A further increase of 5 percent of receipts will come from doubling the rate of the tax on production of alcoholic beverages from the present rate

---

1/ The attached table (Annex I) indicates debt service due by creditors in 1987-91 and arrears on principal and interest to these creditors at end-1986.

of PG 125 per liter, and doubling the rate of the National Reconstruction Tax and extending its coverage. However, these increases will, in part, be offset by a reduction in receipts from export taxes as discussed in paragraph 17(d). Other measures to enhance revenues include the introduction of an ad valorem tax on sales of gasoline (see below, paragraph 32), and improvements in tax administration and tax enforcement, in particular the collection of overdue taxes and the abolition of ad hoc tax exemptions and exonerations, especially for imports. Although the impact of the latter measures is difficult to quantify, total tax receipts are projected to increase more than threefold in 1987, and by an average of 17 percent a year in 1988-89.

22. During the program period, the Government intends to make every effort to restrain expenditure growth. Since the principal factor responsible for the rapid increase in current expenditures has been the wage bill, the size of the civil service will be reduced by 30 percent over the three-year period 1987-89, beginning with a 5 percent reduction in 1987. This measure is projected to reduce expenditures by PG 1.0 billion over this period. In order to provide some compensation in 1987 for the estimated inflation rate (some 35 percent), and taking into account that the average civil service salary in Guinea-Bissau is the lowest in the region, a general salary increase of 25 percent will be granted in 1987. After 1987 the real wage rates will be kept constant; the ratio of wages to total tax and non-tax revenue, which was 106 percent in 1986, will decline to 45 percent in 1987, to 41 percent in 1988, and to 35 percent in 1989. Other current expenditures, excluding interest on the public debt, in particular foreign travel, material and supplies, which will increase in 1987 mainly due to the exchange rate action, will be contained in 1988-89.

23. Although there is no official medium-term investment program, the level of investment outlays in 1987-89 has been reviewed in consultation with the World Bank. The Government has decided to reduce these outlays by 16 percent in U.S. dollar terms to US$48 million in 1987 to be followed by an additional reduction of 15 percent in U.S. dollar terms over the next two years in line with the country's absorptive capacity. All investment outlays will be oriented toward the directly productive sectors, the development of human resources, and the rehabilitation of existing infrastructure. The investment priorities in 1988-89 will be reviewed with the World Bank, and the start-up of new projects will be limited to those for which the technical, economic, and financial suitability has been demonstrated through the use of cost/benefit analysis to the extent possible. The criteria by which investments will be judged will include conformity with the overall development strategy, realizing quick yields, placing no inappropriate burden on a recurrent budget when completed, increasing human capital resources, and contributing to a net inflow to the balance of payments.

C. Credit Policies

24. A prudent monetary policy will be pursued consonant with the adjustment objectives. Total domestic credit will be contained without

compromising the financing needs for the marketing of the cash crops and the productive activities of the private sector and public enterprises. There will be no net recourse to bank credit by the Government in view of the proposed fiscal adjustment and the availability of budgetary support. Furthermore, as mentioned above, the outstanding net indebtedness of the Government to the National Bank will be eliminated during the program period and substantial Government deposits will be sterilized in a special account with the National Bank. These deposits will not be drawn upon for any reason during the period 1987-89.

25. The authorities will follow a flexible interest rate policy in order to encourage domestic financial savings and more efficient use of bank credit. Hence, deposit and lending rates will be raised in 1987 with a view to achieving positive real rates in 1987-88, and these rates will subsequently be adjusted periodically in view of market conditions.

26. Through its ongoing technical assistance, the IMF will provide expertise to improve the availability of monetary statistics on a timely basis for the effective monitoring of the adjustment program. The World Bank is providing technical assistance to improve the accounting procedures of the National Bank and will also provide assistance to separate the central banking functions of the National Bank from its commercial and development banking functions through a program to be implemented by July 1987, in accordance with the existing enabling legislation. The Government will in 1988 implement the recommendations of a study, to be completed by March 1988, for the possible establishment of private commercial banks, including foreign-owned ones.

D. Promotion of Priority Productive Sectors

27. In order to expand agricultural output, the Government intends to open up the agricultural sector to market forces. The producers will receive prices that reflect export parity at a realistic exchange rate. The guaranteed minimum producer prices will be adjusted annually to reflect the effect of the currency depreciation, adjusted for changes in international prices and costs of production. With the new commercial policy announced in August 1986, merchants are free to purchase crops from producers at or above the guaranteed minimum prices. The existing export taxes will be eliminated or reduced, as explained above in paragraph 17(d).

28. The Government has prepared, in conjunction with the 1987 UNDP agricultural sector consultation, a sectoral strategy paper, aimed at redirecting foreign assistance to high priority needs in the agricultural sector. Further steps to stimulate output in the primary sectors will include: (a) encouraging competition in marketing through continuing reform of the parapublic trading firms; (b) redesigning the mangrove rehabilitation projects and the integrated rural development projects, in collaboration with donors and creditors, in the light of the conclusions of the agricultural sector consultation; and (c) approaching all foreign holders of fishing rights to renegotiate existing license agreements so

that payment will be based on tonnage and duration of the license rather than on the value of the catch.

29. Output in agriculture (including fishing) is expected to increase by 3 to 4 percent per annum in real terms in the period 1987-89 since the proposed policies will stimulate: (i) an increase in production from the extensive acreage of cashew trees that has been planted since 1983; (ii) rapid increase in rice yields from low-cost restoration of mangrove fields (Guinea-Bissau was for many years an exporter of rice, and production costs are among the lowest in Africa); (iii) restoring groundnut output to the level of the 1950's as a result of the application of currently unavailable fertilizer and the greater incentive to produce for sale; (iv) substantial increases in the local value added in fishing through displacement of foreign boats operating in national waters; and (v) utilization of the country's extensive and largely untapped forestry resources, possibly in conjunction with foreign private investors.

E. Public Enterprises

30. The Government is undertaking a diagnosis of the public enterprise sector to be completed by June 1988 with financing from the World Bank. The recommendations of this study will be implemented as part of the annual adjustment programs for 1988-89. The principal public enterprises are two trading firms (Armazens do Povo and Socomin), the electrical utility (EAGB), and the oil distribution company (DICOL); most of the remainder is accounted for by some two dozen small public and mixed industrial enterprises. A reform of the trading firms, with assistance from the EEC, has been under way since 1984 and will continue. These firms have already transferred over 200 of their 270 retail outlets to the private sector, laid off about 20 percent of their labor force, with a further 40 percent to be laid off by end-1987, and have started to produce financial statements. Their monopoly over the marketing of export crops was abolished in August 1986; the Government intends to gradually phase out the monopoly over cereals imports. As the private sector expands its activities in the trading sector, the future role of the public trading firms will be re-evaluated.

31. The principal loss-making public enterprise is the electrical utility (EAGB), which is under the Ministry of Industry and National Resources and which covers only the city of Bissau. A sector review with the World Bank will be undertaken in 1987. On the basis of its recommendations a management contract will be signed, if needed, with a foreign firm to strengthen the managerial and technical capabilities of EAGB. This firm will progressively assume management of the regional electrical network and generators currently under the control of the Ministry's Directorate General of Electricity, as electrification of these rural centers is completed. To ensure that by 1989 EAGB's revenues cover its costs, the level and the structure of the electricity tariffs will be revised each year beginning in 1987 in agreement with the technical services of the World Bank so that the Fund can be assured that there will be no transfers or subsidies from the government budget to EAGB from that date.

Furthermore, in order to generate financial resources to pay for fuel and essential repairs to the distribution system, EAGB will implement a new tariff collection policy by September 1988, in line with World Bank recommendations.

32. The oil distribution company (DICOL) will increase the retail prices for all petroleum products, including the price charged to EAGB, in consultation with the Fund and the World Bank, with the objective of closing the gap between existing retail prices and the import parity price at a realistic exchange rate, by April 1987. In addition, a 10 percent ad valorem tax on retail sales of gasoline will be introduced in April 1987, in consultation with the Fund and the World Bank, in view of the objective of reaching a retail price level for gasoline approximating that in neighboring countries by March 1988. The entire proceeds of this tax will be transferred monthly by DICOL to the Treasury.

F. Pricing Policies

33. Until 1986, price control covered all imported goods, either directly or via controls on intermediation margins. In August, 1986, all intermediation margins were eliminated. Directly controlled prices on all imports, except petroleum products, rice, sugar, cooking oil, cement, fertilizer, pesticides, and insecticides were also eliminated in August 1986. The controlled prices for cement, insecticides, and pesticides will be abolished in April 1987. The retail prices of petroleum products, rice, sugar, cooking oil, and fertilizer will be adjusted starting in April 1987, in consultation with the Fund and the World Bank, with the aim of achieving full import parity pricing in 1987. The controlled prices for transport services will be replaced in 1987 by a system of maximum and minimum rates that will be adjusted periodically for the variations in cost components. The latter system will be applied only to transport to and from the interior of the country and will be phased out in 1989 in order to encourage a more efficient use of the country's limited supply of trucks and boats.

V. Social Impact

34. The adjustment program will have a significant effect on increasing the income of the poorest group in Guinea-Bissau, namely, small farmers. Higher farm gate prices and greater import availability will increase the welfare of the majority of the population who live in the rural sector, more than offsetting the impact of higher prices for imports, increased taxation, and lower government services. Real rural per capita consumption is expected to rise by about 0.5 percent per annum in 1987-89. At the same time, some urban groups--especially Government employees--will be adversely affected by at least the initial phase of adjustment, as Government salaries fall in real terms. In addition, following the planned reduction in public capital outlays, urban employment opportunities in the public sector are likely to decline.

35. The Government plans a threefold approach to respond to the negative impact of adjustment on certain social groups: (i) Temporary compensation: In collaboration with the World Food Program and other food aid donors, the Government has put in place a program to provide rice at low prices for Government employees, especially for the lowest paid group that spends one-third of its income on rice. Although there is no cost to the Government for this scheme, the rice price will be increased gradually to reach the market price at the end of the program period; (ii) Protection of vulnerable groups: The Government will implement a program, supported by proposed IDA credits under preparation, to ensure that health and education services are improved for vulnerable groups; (iii) Retraining: With assistance from the UNDP and other donors, the Government has put in place a program for retraining and resettling in the villages laid-off employees, aided by severance compensation payments, with additional financing to be sought with the support of the World Bank (see paragraph 22). In order to ensure that the poor participate in the process of economic growth, the proposed expansion of credit to the private sector will permit direction of credit to new small businesses to absorb some of those laid off. Finally, in view of the paucity of data upon which to base Government social policies, a World Bank-managed study financed by UNDP will be launched to evaluate the real income effects of the structural adjustment program and the pace of adjustment at the household level in representative segments of the population. Furthermore, an ongoing survey of the impact of the adjustment program in the countryside among the rural poor will be financed by the UNDP and IFAD.

VI. Financing Requirements

36. As set out in Annex II, the total financing requirement for the period 1987-89 amounts to US$229 million before arrears liquidation and reserve accumulation. To this must be added a margin for some increase in foreign exchange reserves and for settlement of arrears. The Government intends to eliminate all arrears to multilateral institutions in 1987-89 and to reduce other outstanding external arrears by US$7.4 million. At the end of 1989 the stock of outstanding external arrears will amount to an estimated US$9.8 million. The total financing requirement for 1987-89, including arears liquidation and increase in reserves, will then be US$245 million.

37. On the basis of existing commitments, US$111 million is expected to be disbursed by donors and creditors. In the light of the historical record of commitments and in view of the proposed adjustment program, additional disbursements of US$101 million from new commitments are assumed to be realistic, excluding possible disbursements under the SAF. The disbursements in 1987-89 under existing and possible new commitments from IDA (including associated Special Facility for Africa financing) are estimated at US$24 million in project credits and US$29 million in program credits. The other principal creditors under existing and expected new commitments are the ADF, IFAD, Kuwait, Saudi Arabia, and the UNDP; the principal donors providing grants are France, the Netherlands, Sweden, and

Switzerland. Grants are being reprogrammed toward assistance in support of the adjustment effort, and project assistance is conservatively set below historical levels. To improve coordination among donors and creditors, the World Bank intends to sponsor in late 1987 a session on program assistance within the UNDP Roundtable framework.

38. On the basis of the total expected disbursements described above, other than the Structural Adjustment Facility (SAF), a financing gap of the order of US$34 million would remain for the period 1987-89. This gap could be financed through additional exceptional financing, including additional debt relief, and disbursements under the SAF. The Government is approaching on a bilateral basis its main creditors, which are listed in Annex I, to seek such debt relief. As the Government proceeds with the implementation of the adjustment measures, it is also expected that the international community would be encouraged to provide further exceptional financing.

Guinea-Bissau. Debt Service by Principal Creditors
(in thousands of US dollars)

Creditors	Outst. end 86	Arrears end 86	Debt Service 1987	1988	1989	1990	1991	1992
Multilaterals	112920.0	6848.5	4003.3	4477.1	4488.0	4301.5	4145.7	3708.6
princip.		3875.2	2047 6	2609.6	2789.3	2695.7	2633.7	2724.5
interest		2973.4	1955.7	1867.6	1698.8	1605.8	1512.0	984.1
ADF	21640.0	492.7	299 6	298.9	318.2	340 9	340.0	339.1
princip.		50.7	139.9	139.9	159.6	183.0	183.0	183.0
interest		442.0	159.7	159.0	158.6	157.9	157.0	156.1
ADB	17060.0	2794.3	1872.1	1806 1	1740.2	1674.2	1608.3	1542.4
princip.		820.0	894.2	894 2	894.2	894.2	894.2	894.2
interest		1974.3	977.9	911.9	846.0	780.0	714.1	648.2
IDA	58730.0	123.2	524.6	513.5	527.0	526.3	590.9	155.4
princip.		0 0	0.0	0.0	90.0	90.0	155.4	155.4
interest		123 2	524.6	513.5	437.0	436.3	435.5	
EEC	780.0	0.5	5.8	5 8	5.8	5.8	5.7	5.5
princip.		0.0	0.0	0.0	0.0	0.0		
interest		0.5	5.8	5.8	5.8	5.8	5.7	5.5
OPEC	8620.0	3085.7	1023.2	1018.2	1013.2	722.9	505.3	502.8
princip.		2987.8	996.8	996.8	996.8	711.1	496.8	496 8
interest		97.9	26.4	21.4	16.4	11.8	8.5	6 0
BADEA	4010.0	337.0	227.0	783.6	832.6	890.7	954.7	1022.7
princip.		16.7	16.7	578.7	648.7	727.7	812.7	901.7
interest		320.3	210.3	205.0	184.0	163.0	142.0	121 0
FIDA	340.0	1.0	3.4	3.4	3.4	3.4	3.4	3.4
princip.		0.0	0.0	0.0	0.0	0.0	0.0	0.0
interest		1.0	3.4	3.4	3.4	3.4	3.4	3.4
CEDEAO	190.0	14.2	16.6	16.6	16.6	16.6	16.6	16.6
princip.		0.0	0.0	0.0	0.0	0.0	0.0	0.0
interest		14.2	16.6	16.6	16.6	16 6	16.6	16.6
EIB	1550.0	0.0	31.0	31.0	31.0	120.7	120.8	120.7
princip.		0.0	0.0	0.0	0.0	89.7	91.6	93.4
interest		0.0	31.0	31.0	31.0	31.0	29.2	27.3
Bilaterals 1/	95490.0	14532.3	10530.2	8690.3	7477.6	6740.5	9272.1	8520.6
princip.		10927.5	7092.6	6794 1	5757.4	5135.6	7545.7	7268.1
interest		3604.8	3437.6	1896.2	1720.2	1604.9	1726.4	1252.4
Portugal 2/	5560.0	887.0	720.4	713.3	703.6	1071.6	854.2	564.0
princip.		360.7	493.6	503.2	513.1	901.2	704.3	457.8
interest		526.3	226.8	210.1	190.5	170.4	149.9	106.2
France	4240.0	3683.4	194.0	186.8	179.6	70 0	66.8	63.7
princip.		2934 6	130.5	130.5	130.5	52.6	52.6	52.6
interest		748.8	63.5	56.4	49.1	17.4	14.2	11.1
China	10100.0	0.0	152.6	152.6	152.6	958.6	958.6	806.0
princip.		0.0	152.6	152.6	152.6	958.6	958.6	806.0
interest		0.0	0.0	0.0	0.0	0 0	0.0	0.0
West Germany	230.0	3.2	30.2	43.2	41.1	37.1	35.1	33.0
princip.		0.0	14.0	28.0	28.0	28.0	28.0	28.0
interest		3.2	16.1	15 1	13.1	9.1	7.1	5 0
Algeria	2140.0	1553.7	333.2	323.7	314.2	142.5	141.8	4 7
princip.		1146.1	295.7	295.7	295 6	133.3	133.3	4 7
interest		407.6	37.5	28.0	18.6	9.2	8.5	0 0

Creditors	Outst. end 86	Arrears end 86	Debt Service 1987	1988	1989	1990	1991	1992
Saudi Fund	6250.0	186.5	333.5	328.6	492.5	485.9	479.3	472.7
princip.		141.5	244.6	244.6	413.8	413.8	413.8	413.8
interest		45.0	88.9	84.0	78.7	72.1	65.5	58.9
Soviet Union	32220.0	236.4	832.7	1014.7	1142.7	1268.3	5682.0	5302.9
princip.		236.4	236.4	236.4	236.4	236.4	4378.4	4378.4
interest		0.0	596.3	778.3	906.3	1031.9	1303.6	924.5
Abu dhabi Fund	150.0	24.8	16.0	15.6	15.2	14.8	14.4	14.0
princip.		11.6	11.6	11 6	11.6	11.6	11.6	11.6
interest		13.1	4.4	4.0	3.6	3.2	2.8	2.3
Angola	16150.0	2750.5	6649.3	4519.7	3103.1	1796.0	0.0	0.0
princip.		2001.3	4632.9	4132.3	2923.0	1731.9	0.0	0.0
interest		749.2	2016.4	387.4	180.1	64.1	0.0	0.0
Kuwait Fund	13260 0	813.5	735.2	906.0	892.4	878.9	865.4	851.8
princip.		544 9	492.5	676.8	676 8	676.8	676.8	676.8
interest		268 6	242.7	229.2	215.6	202.1	188.6	175.0
Libya	3720.0	3720.0	0.0	0.0	0.0	0.0	0.0	0.0
princip.		3000.0	0.0	0.0	0.0	0.0	0.0	0.0
interest		720.0	0.0	0.0	0.0	0.0	0.0	0.0
Switzerland	7030.0	1560.4	1253.5	1199.4	1144.2	1088.4	1028.7	971.8
princip.		911.0	881.7	885.6	889.1	892.6	892.6	896.2
interest		649 4	371.8	313.8	255.1	195.8	136.1	75.6
Financial Instit.	24290.0	0.0	6005.5	5606.9	5344.7	5080.3	4813.7	4527.0
princip.		0 0	4030.5	4048.3	4064 4	4080.6	4096.8	4096.8
interest		0 0	1975.0	1558.6	1280.3	999.7	716.9	430.2
Overland Trust B.	24290.0	0.0	6005.5	5606.9	5344.7	5080.3	4813.7	4527.0
princip.			4030.5	4048 3	4064.4	4080.6	4096.8	4096.8
interest			1975.0	1558.6	1280.3	999.7	716.9	430.2
Suppliers 3/	2910.0	2069.7	302.7	295.7	288.6	0.0	0.0	0.0
princip.		1689.5	281.6	281.6	281.6	0.0	0.0	0.0
interest		380.2	21.1	14.1	7.0	0.0	0.0	0.0
GDR (UNITECH)	2910.0	2069.7	302.7	295.7	288 6	0.0	0.0	0.0
princip.		1689.5	281.6	281.6	281.6	0.0	0.0	0.0
interest		380.2	21.1	14.1	7.0	0.0	0.0	0.0
Total publ.sect	235610.0	23450.5	20841.7	19070.0	17598 9	16122.3	18231.5	16756.2
princip.		16492.1	13452.2	13733.6	12892.7	11911.9	14276.2	14089.4
interest		6958.4	7389.4	5336.4	4706.3	4210.4	3955.2	2666.8
Debt of Nat Bank	52200.0	2700.0	1835.0	2758.0	1509.0	1405.0	8490.0	10835.0
princip.		0 0	1529.0	2204 0	1243.0	1189.0	4015.0	6841.0
interest		2700.0	306.0	554.0	266.0	216.0	4475.0	3994.0
Total debt service	287810.0	26150.5	22676.7	21828.0	19107.9	17527.3	26721.5	27591.2
princip.		16492.1	14981.2	15937.6	14135.7	13100.9	18291.2	20930.4
interest		9658.4	7695.4	5890.4	4972.3	4426.4	8430.2	6660 8

Source: National Bank of Guinea-Bissau.
1/ Excludes debt service to Portugal; see note 2.
2/ Under the 1986 agreement, the debt to Portugal is to be repaid in local currency.
3/ Excludes a debt to a Belgian supplier (H. Fontaine) which is in dispute.

GUINEA-BISSAU:
External Financing Requirements, 1986-91
(in millions of U.S. dollars)

	1986	1987	1988	1989	1990	1991
External current account deficit, excl. official unrequited transfers	-72.9	-66.5	-59.9	-55.5	-54.1	-55.1
Amortization	-8.1	-14.9	-16.0	-14.2	-13.4	-20.1
Repurchases	-1.1	-0.3	-1.1	-0.9	0.0	0.0
Subtotal	-82.1	-81.7	-77.0	-70.6	-67.5	-75.2
Change in arrears (decrease -)	1.7	-8.2	-3.0	-3.0	-5.0	0.0
Change in reserves(increase -)	-3.2	0.0	-0.2	-1.5	-1.0	0.0
Total financing requirement	83.6	89.9	80.2	75.1	73.5	75.2
Disbursements: Existing commitments	83.6	56.0	34.7	20.0	9.5	5.0
Grants	43.5	33.0	21.0	15.0	7.0	4.0
Program grants	(11.9)	(8.9)	(3.5)	(1.5)	(1.0)	(0.0)
Multi- and bilateral loans	17.9	21.0	12.7	4.0	1.5	0.0
IDA project credits	(7.0)	(8.0)	(6.2)	(0.5)	(0.0)	(0.0)
IDA program credits	(2.6)	(5.3)	(1.0)	(0.0)	(0.0)	(0.0)
Other program loans	(0.0)	(1.0)	(0.0)	(0.0)	(0.0)	(0.0)
Other capital, errors, omissions	22.2	2.0	1.0	1.0	1.0	1.0
Disbursements: forecast new commitments, excluding SAF	0.0	21.0	33.8	46.0	56.5	62.8
Grants	0.0	10.0	15.0	20.0	29.0	33.0
Program grants	(0.0)	(3.0)	(4.5)	(6.5)	(7.0)	(8.0)
Multi- and bilateral loans	0.0	11.0	18.8	26.0	27.5	29.8
IDA project credits	(0.0)	(0.0)	(2.0)	(7.0)	(7.0)	(7.0)
IDA program credits	(0.0)	(5.0)	(9.0)	(9.0)	(9.0)	(9.0)
Other program loans	(0.0)	(5.7)	(6.0)	(7.0)	(7.0)	(7.0)
SAF	-	1.8	1.2	1.2	0.0	0.0
Potential debt rescheduling	-	11.1	10.5	7.9	7.5	7.4

Notes: Program aid includes food aid.
IDA includes Special African Facility but not joint financing.
Rescheduling in 1987-88 is of 90% of principal of non-reschedulued bilateral and private debt; thereafter, it is residual item.
Other capital in 1986 includes US$19.4 million in refinancing of arrears.
Cofinancing of IDA SAL provides the expected 1987-89 disbursements from new commitments for other program loans, most of which are at an advanced stage of processing.

Guinea Bissau: Summary and Implementation Timetable of Economic and Financial Adjustment Policies, 1987-1989

Policy Areas	Objectives and Targets	Measures	Timetables
1. External Policies			
a. Exchange rate	Eliminate differential between official and parallel market exchange rates	* 60% devaluation in foreign currency forms with a flexible exchange rate policy thereafter	1987
b. Exchange system	Encourage repatriation of foreign exchange	Encourage surrender of foreign exchange irrespective of its source	1987
		* Abolish schemes for retention of export receipts by exporters	1988
c. Foreign trade liberalization	Reduce quantitative restrictions	* Issue import licenses automatically for 50% of non-petroleum commercial imports in 1987 and for 75% in 1988; with a further expansion thereafter	1987-89
d. Taxes on exports and imports	Reduce export taxes, eliminate exemptions and exonerations, and achieve uniform tariff rates	* Eliminate export taxes except on cashews (1987); reduce cashew export tax to 50% in 1987, and thereafter in function of fiscal situation	1987-89
		* Cease issuing import tax exemptions and open negotiations to eliminate existing ones (1988) (see also 2(a) below)	1988
		* Complete by March 1988 study on fiscal impact of uniform tariff and implement its recommendations	
e. External debt management	Contracting or guaranteeing new loans on concessional terms only	* No new loans with grant element of less than 50%, except normal trade credits and refinancing of existing debt	1987
	Service external debt on orderly basis and reduce arrears. No new external arrears	Proposals for rescheduling to all private and bilateral creditors who have not yet rescheduled	1987-89
2. Fiscal Policy			
a. Revenues	Simplify tax system, improve collection, and increase tax rates	* No new tax exemptions and curtailment of existing exemptions; increase in specific tax rates imposition of an ad valorem tax on gasoline sales	1987
b. Expenditures	- Contain current expenditures by reducing the number of civil servants and limit wage rate increases - Reduce and restructure investment outlays	* Reduce the number of civil servants by 5% (1987) and agree on plan for a further 25% reduction in 1988-89 * Limit wage increases to 25% in 1987 and agree on further limits in 1988-89 * Reduce investment outlays by 16% in US$ terms in 1987 and by a further 15% in 1988-89	1987-89
3. Monetary and Credit Policy			
a. Credit	Design policies consistent with the targets for the balance of payments, inflation, and growth. Priority in access to bank credit to be given to the private sector and equally to the public enterprises.	No net use of bank credit by the Government in 1987-89 and a elimination of the Government's debt to the National Bank	1987-89

*/ Refers to measures incorporated in Bank's proposed Structural Adjustment Credit

b. Institutional structure	Institutional reform	* Improve BNG accounting system	1987
		* Begin separation of commercial and central banking functions of BNG	1987
		* Implement recommendations of study on establishment of private commercial banks	1988
c. Interest rate	Flexible interest rate policy with the aim of achieving positive real rates	* Lending and deposit rates to be adjusted periodically beginning in 1987 to achieve positive real rates during the program period	
4. <u>Priority Sectors</u>			
a. Agriculture	- Export parity pricing without implicit or explicit taxation	* Adjust minimum producer prices annually	1987-89
	- Continuing reform of parapublic trading firms	* Eliminate export taxes, except on cashew nuts (1987); see 1(d) above	
	- Prepare agricultural sector strategy and reevaluate investments in line with it	* Prepare sector strategy	1987
		* Redesign mangrove rice and integrated rural development projects in line with conclusions of the 1987 sectoral consultation	1988
b. Fishing	Increase revenue from licenses	* Renegotiate agreements	1987-88
5. <u>Public Enterprises</u>			
a. Electricity company	- Strengthen management - Achieve full cost recovery	* Sector review with World Bank; if necessary, engage foreign management	1987
		* Increase tariffs annually, with cost recovery by 1989	1987-89
		* Introduce new tariff collection policy	1988
b. Oil distribution company	Maintain import parity pricing; introduce tax on retail sales of gasoline	* Increase prices	1987-88
		* Achieve import parity for heavy fuels	1988
		* Achieve retail price levels in neighboring countries for gasoline products	1988
6. <u>Pricing and Marketing</u>			
a. Administrative pricing	Reduce price control and achieve import parity pricing for controlled goods	* Eliminate controlled prices on all imports, except rice, sugar, cooking oil, petroleum, fertilizer	1987
		* Increase prices for remaining products to achieve import parity pricing	1987
b. Marketing reform	Encourage private trade and transport	* Simplify licensing procedures	1987
		* Replace controlled transport prices by maximum and minimum rates	1987 1989
		* Eliminate controlled prices for transport services	
7. <u>Social Impact</u>			
a. Accompanying social policies	Reduce the negative social impact of the program	* Implement a study of social impact with aid from World Bank	1987-89

*/ ...ers to measures incorporated in Bank's proposed Structural Adjustment Credit