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Guinea-Bissau: 2006 Article IV Consultation, Review of Developments Under the 2005 Staff-Monitored Program, and New Staff-Monitored Program for 2006—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Guinea-Bissau

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2006Article IV consultation with Guinea-Bissau, review of developments under the 2005 staff-monitored program, and new staff-monitored program for 2006, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, Review of Developments Under the 2005 Staff-Monitored Program, and New Staff-Monitored Program for 2006, prepared by a staff team of the IMF, following discussions that ended on March 30, 2006, with the officials of Guinea-Bissau on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 19, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July, 31, 2006 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Guinea-Bissau.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Guinea-Bissau*
Memorandum of Economic and Financial Policies by the authorities of Guinea-Bissau*
Selected Issues Paper and Statistical Appendix
Technical Memorandum of Understanding*
*Also included in the Staff Report.

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INTERNATIONAL MONETARY FUND

GUINEA-BISSAU

Staff Report for the 2006 Article IV Consultation, Review of Developments Under the 2005 Staff-Monitored Program, and New Staff-Monitored Program for 2006

Prepared by the African Department
(In consultation with other departments)

Approved by Sharmini Coorey and Anthony R. Boote
July 19, 2006

- Discussions for the 2006 Article IV consultation and a staff-monitored program (SMP) for 2006 were held in Bissau during March 16–30, 2006. The staff team comprised Mr. Doré (Head), Ms. Ocampos, Mr. Saenz, Mr. Veyrune and Ms. Mendez (all AFR). The team liaised closely with a mission of the World Bank, and the European Union (EU).
- The mission met with the President of the Republic; the Ministers for Finance, Economy, Commerce, Public Administration, and Justice; the Acting Governor and the National Director of the Central Bank of West African States (BCEAO); senior government officials; and representatives of the donor community.
- After the last Article IV consultation was concluded on November 19, 2004, the Executive Directors also discussed the ex post assessment of performance under Fund-supported programs. They noted that the key challenges for the authorities were to restore fiscal discipline, rebuild public administration, and improve the investment climate. Most Directors agreed that the next step in the Fund's engagement could be emergency post-conflict assistance as part of a concerted international effort.
- In their letter of intent (Attachment I), the authorities of Guinea-Bissau request that the staff monitor their economic program for 2006 as described in the accompanying memorandum on economic and financial policies. The program aims to stabilize the fiscal situation by avoiding new domestic arrears for the year as a whole, strengthening institutions, building technical capacity, and implementing structural reforms to improve the investment climate.
- Guinea-Bissau is on the standard 12-month consultation cycle and, like other members of the West African Economic and Monetary Union (WAEMU), has accepted the obligations of Article VIII, sections 2, 3, and 4 of the Fund's Articles of Agreement. Guinea-Bissau maintains an exchange system that is free from multiple currency practices and restrictions on the making of payments and transfers for current international transactions.
- The quality of data has hampered effective surveillance but efforts are underway in Guinea-Bissau to rebuild core statistical databases.

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EXECUTIVE SUMMARY

- **Guinea-Bissau has made major strides in overcoming the effects of a long period of political instability.** The period began in 1998 with a civil war and ended in mid-2003 with a coup. The physical infrastructure was destroyed, the economy stagnated, government administrative capacity virtually collapsed, social conditions worsened, and poverty increased.

- **Parliamentary elections were held in March 2004 and presidential elections in July 2005.** Though the process of rebuilding the administration and addressing the country's economic problems has clearly begun in earnest, policy implementation must remain strong and be complemented by considerable donor support if the country is to solve its problems.

- **The main challenges now are to consolidate peace and political stability and to lay the foundation for sustainable high growth and significant poverty reduction.** This will require Guinea-Bissau to achieve fiscal and debt sustainability and deepen structural reforms.

- **Staff expects a recovery over the medium term, but its strength and timing depend on how well the authorities can come to grips with the political, fiscal, and structural problems besetting the economy**. Staff estimates that real GDP growth recovered to 3.5 percent in 2005, driven by improved agricultural output. The fiscal balance improved, but cash flow problems persisted throughout the year. The deficit (including grants) was lower than budgeted at 12 percent of GDP, compared to 15 percent in 2004, but new domestic arrears accumulated. The macroeconomic outlook for 2006 is favorable, with real GDP growth of about 4 percent and CPI inflation of about 2 percent, barring any major supply shocks.

- **Medium-term policies should focus on strengthening the fiscal position so as to broadly achieve public debt sustainability taking into account debt relief anticipated at the HIPC completion point**. The fiscal program the government has adopted underscores the authorities' resolve to bring public finances under control, but attaining the fiscal objectives depends critically on progress in keeping current spending in check and intensifying revenue mobilization. The emphasis on widening the tax base and reducing exemptions is appropriate, but spending must be effectively monitored from the commitment stage and a monthly cash flow plan, consistent with spending priorities, must be strictly adhered to.

- **The structural reform process, which has languished over the years, needs new impetus**. An action plan for implementing the long-overdue civil service reform is urgently needed to produce a durable reduction in the excessive wage bill. The security reform to be launched with donor support, private sector development initiatives, and measures to rehabilitate roads, electricity, and water infrastructure should help enhance development prospects.

- **A staff-monitored program for April–December 2006 should enable Guinea-Bissau to demonstrate its ability to successfully implement an adjustment program** and move to emergency post-conflict assistance as soon as concerted international assistance emerges, which is likely to be after October 2006.

I. INTRODUCTION

1. **Despite abundant natural resources and arable land, Guinea-Bissau is ranked at the lowest end of the UN human development index, mainly because of the civil war of 1998–99 and the ensuing prolonged political instability and serious governance deficiencies thereafter.**[1] These have led to considerable deterioration in the economy's infrastructure and the living standards of the population, from which the country is trying to recover. The small industrial sector was virtually destroyed, leaving an economy heavily dependent on the cashew sector. After the conflict, real per capita GDP declined by an annual average of 2 percent until 2005 and the delivery of basic social services (potable water, hospital supplies, education) deteriorated sharply. The post-conflict strategy, which was based on an economic program supported by the Poverty Reduction and Growth Facility (PRGF) and interim debt relief from the Initiative for Heavily Indebted Poor Countries (HIPC), began to unravel because the political situation failed to stabilize. The precarious situation called for deep reforms to reverse the downward trend, but institutions and technical capacity remained weak. Government failure to enact sound policies resulted in mounting wage arrears that led to a bloodless military coup in September 2003.[2]

2. **Since mid-2004 Guinea-Bissau has made a major effort to address the political and economic problems of recent years.** After parliamentary elections in March 2004 and presidential elections in July 2005, the government began to rebuild the administration and address the country's economic problems. The political tensions ignited by President Veira's decision in November 2005 to dismiss the majority PAIGC government eased considerably after the Supreme Court ruled that the nomination of the new government was constitutional. Parliament's subsequent approval of the government program and 2006 budget are signs of a broad consensus for political stability and reform. This consensus emerged with the agreement by all political parties to put the national interest above short-term political considerations, following international mediation from the regional institutions (ECOWAS, WAEMU, WADB) in February 2006. The majority PAIGC party signed on the government's program because it features most of the reform policies envisaged by the previous PAIGC government.

[1] Per capita GDP is below US$200; two-thirds of the population live below the poverty line; most social indicators are below the average for sub-Saharan Africa; and the World Bank has classified the country as a LICUS (low income country under stress).

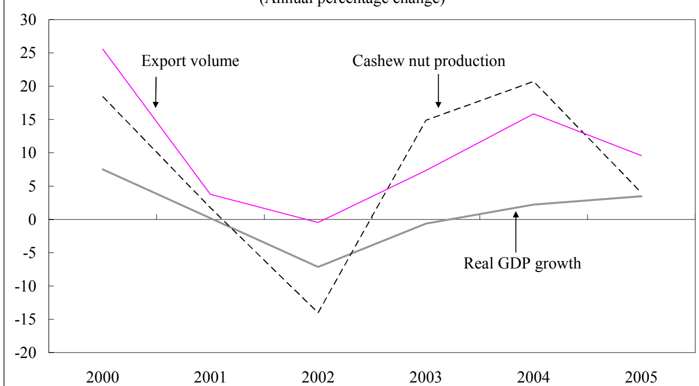
[2] After intensive and broad-based consultation, the military, all but one of the 24 political parties, and representatives of civil society signed a transitional charter instituting an 18-month transition period with a caretaker civilian government and a National Transition Council acting as a parliament.

3. **During the 2006 Article IV consultation discussions, the mission also reviewed the country's performance under the 2005 staff-monitored program (SMP) and reached understandings on a new SMP for April–December 2006**.[3] [4] The new SMP aims to stabilize the macroeconomic situation by strengthening the fiscal position and pave the way for a program that could be supported by emergency post-conflict assistance (EPCA) as part of a concerted international effort. It should also enable the authorities to build a track record of policy performance, which is needed for consideration of a new PRGF-supported program and eventual debt relief.

II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE STAFF-MONITORED PROGRAM FOR APRIL–DECEMBER 2005

4. **Amid signs of a return to political stability, the economic and financial situation has shown some improvement, although serious difficulties remain.** Economic activity in 2005 was stronger than expected. Real GDP growth is estimated to have recovered from an average of 0.5 percent for 2003–04 to 3.5 percent in 2005; it was driven by a good agricultural performance, though activity in other sectors was sluggish. Thus, for the first time since 2001, GDP per capita increased slightly (Table 1)**.** Average consumer price inflation rose to 3.4 percent from 0.8 percent in 2004 as a result of higher import prices (oil and rice) in the first half of the year. Good cereal production later dampened inflationary pressures somewhat and 12-month inflation declined to 1 percent by December 2005.

Figure 1. Guinea-Bissau: Real GDP and Cashew Nut Production, 2000–05
(Annual percentage change)



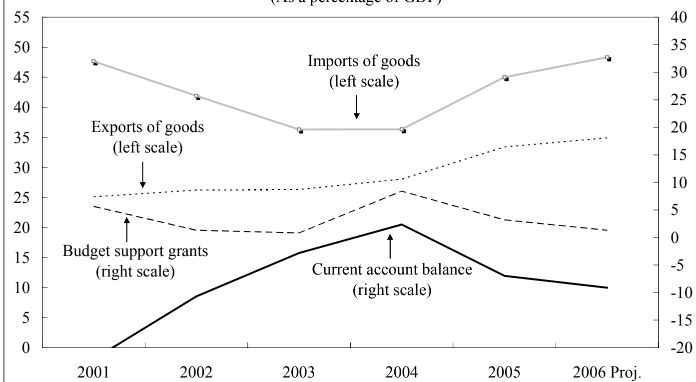
Sources: Guinea-Bissau authorities; and IMF staff estimates.

[3] On June 30, 2005, the Executive Board was informed of an SMP for April–December 2005. The new government, formed in November 2005, quickly indicated its intention to pursue the broad thrust of the SMP for 2005 that had been initiated by the previous government and was to form the basis for discussions on an EPCA.

[4] The mission, which was originally planned to take place in late October 2005, was postponed when the newly elected president dismissed the government. The mission was further delayed because discussions on a new SMP for 2006 were made contingent on the new government obtaining majority support for its program in parliament, which occurred in March 2006.

5. **Notwithstanding the strong growth in exports, the external current account worsened in 2005** because of a large increase in imports and a drop in official transfers and private remittances (Figure 1). Earnings from cashews, the main export crop, were boosted by a substantial increase in world prices as well as a further expansion in production (which was modest, however, after the strong increase of previous years).[5] Imports grew significantly, driven partly by a recovery in domestic demand fueled by rising income from strong export earnings. Current transfers fell, reflecting a substantial decline in external budget support together with lower fishing license revenues. The deficit in the balance of payments, which widened slightly, was financed mainly through debt relief and the accumulation of arrears.

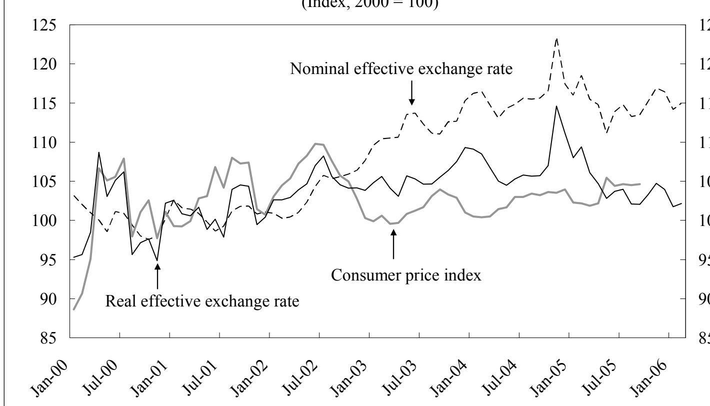
Figure 2. Guinea-Bissau: Current Account Balance and Grants, 2001–06
(As a percentage of GDP)



Sources: Guinea-Bissau authorities; and IMF staff estimates.

6. **In spite of the strong appreciation of the euro against the U.S. dollar over the last five years**, the real effective exchange rate (REER) did not change significantly. The REER has appreciated by only 2.9 percent since 2000 as average inflation remained below that of Guinea-Bissau's trading partners.

Figure 3. Guinea-Bissau: Effective Exchange Rates, January 2000 – February 2006
(Index, 2000 = 100)

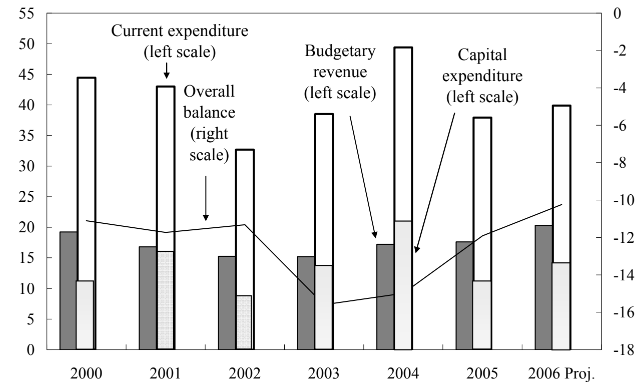


Sources: Guinea-Bissau authorities; and IMF, Information Notice System.

[5] The terms of trade improved sharply (by 9.9 percent) reflecting a 24 percent increase in cashew prices that more than offset the sharp increase in oil prices.

7. **The fiscal balance improved, but cash flow problems persisted throughout 2005.** The budget deficit (including grants) was lower than programmed at 12 percent of GDP, compared to 15 percent in 2004, owing to stronger-than-projected tax revenues and lower nonwage expenditures. The domestic primary fiscal balance on a commitment basis (a program indicator) improved from a deficit of 7.6 percent of GDP in 2004 to 6.9 percent of GDP in 2005. Nevertheless, cash flow problems persisted, as evidenced by the accumulation of CFAF 4.2 billion (2.6 percent of GDP) in new domestic arrears. Budget support from the World Bank and EU that was expected during the second half of 2005 was delayed as a result of the political uncertainty following the presidential election; the government therefore contracted commercial debt amounting to 6.3 percent of GDP, which allowed it to clear part of the new domestic arrears in 2005.[6]

Figure 4. Guinea-Bissau: Fiscal Indicators, 2000–06
(As a percentage of GDP)



Sources: Guinea-Bissau authorities; and IMF staff estimates and projections.

8. **Higher imports and strengthened tax and customs administration helped buoy tax revenue**. Custom receipts were boosted by the large increase of imports—which rose by 43 percent in U.S. dollar terms—and an improvement in customs administration through the verification of imports shipped by land at the destination instead of the border, and the required prepayment of export taxes before shipment. Tax administration was also strengthened through the creation of a Large-Taxpayers Unit with assistance from AFRITAC, and the simplification of the tax regime.

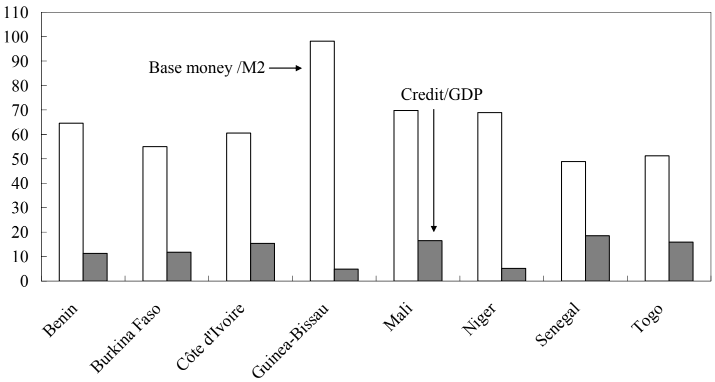
9. **Budget execution improved.** Authorization for expenditure commitments was centralized at the Ministry of Finance and government bank accounts that were not at the BCEAO were closed. To maintain better fiscal control, a Treasury Committee was appointed to reconcile accounts between the Budget Department, the Treasury, and the

[6] In October, the government raised CFAF 6 billion (3.8 percent of GDP) by issuing 180-day treasury bills at 5 percent interest; these bills were placed through the BCEAO, mostly with institutions of the WAEMU area. In December, when external budget support was further delayed, the authorities obtained additional external financing from a bank in Senegal of CFAF 4 billion (2.5 percent of GDP) for 12 months. This loan was collaterized by EU compensation for fishing rights for 2006, but at a substantially higher effective discount rate of 17 percent.

BCEAO. Still, there were some spending slippages, due in part to overruns on the wage bill, which exceeded program target by CFAF 1.9 billion.

10. **Guinea-Bissau's financial system is very thin, but the recent opening of two new regional banks in December 2005 and early 2006 augurs well for the growth of the domestic banking sector.** Formal financial intermediation was very limited during 2005 even by regional standards.[7] Money in circulation is by far the main financial asset, reflecting a preference for cash. Total deposits in 2005 amounted to only 8 percent of GDP. Although the local bank has been increasing its financing of the cashew harvest, average outstanding claims to the private sector during 2005 did not exceed 2.2 percent of GDP; average credit to the government amounted to the equivalent of 1.3 percent of GDP. As elsewhere in the region, the bank is very liquid. The lack of profitable projects has left it with excess reserves that can be used to manage seasonal needs of the private sector or the government. The BCEAO has been concerned about the lack of financial intermediation and is trying to encourage regional banks to operate in Guinea-Bissau. A regional policy bank focused on microfinance opened a branch in Bissau in 2005.

Figure 5. Guinea-Bissau: Recent Monetary Developments, 1995–2005
(Average)



Sources: Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO).

11. **Guinea-Bissau's external debt is clearly unsustainable and can only be resolved through the HIPC Initiative.** After most interim debt relief was suspended, external debt service obligations, except those to multilateral creditors, fell into arrears. Total external public debt including arrears amounted to 332 percent of GDP in 2005; scheduled annual external debt service was about 15.3 percent of GDP (Tables 6–7).

12. **Social indicators for Guinea-Bissau reflect a very low level of human development** (Text Table 1). The data show slow progress and a pressing need for moving toward the millennium development goals (MDGs). Since 2000, the mortality rate of children under 5, for instance, was reduced by only 5 percent and the incidence of tuberculosis increased slightly (Table 8).

[7] For most of 2005, only a single bank operated in Guinea-Bissau.

Text Table 1. Guinea-Bissau: Millennium Development Goals Selected Indicators

	1997	2000	2003	2004	2004 SSA 1/
Population (in millions)	1.3	1.4	1.5	1.5	719.0
GDP per capita in U.S.$ 2/	218.1	173.1	147.8	132.8	560.0
Net primary enrollment ratio (% of relevant age group)	*45.2*	*45.2*	...	...	63.7
Ratio of girls to boys in education (%)	...	64.9	...	...	83.5
Under 5 mortality rate (per 1000)	...	215.0	204.0	*204.0*	171.2
Life expectancy (in years)	44.1	...	45.5	*45.5*	45.6
Prevalence of HIV, total (% of population ages 15-49)	...	...	...	...	9.4
Access to improved water sources (% of population)	...	...	59.0	*59.0*	58.2
Unemployment rate	...	...	...	...	...

Sources: World Development Indicators database, April 2005; IMF, Sub-Saharan Africa Regional Outlook, September 2005.

Note: data in italics refer to a period different from the one shown.

1/ SSA is Sub-Saharan Africa;

2/ In U.S. dollars, at 2000 prices, using 2000 exchange rates. SSA GDP including Nigeria and South Africa; average excluding them is 351 U.S dollars.

13. **Performance of the SMP in 2005 was uneven.** There was progress on fiscal revenue but slippages on expenditures, particularly wages. Five of seven quantitative targets and six of ten structural benchmarks were met (MEFP, Tables 2 and 3). The quantitative targets for revenue, domestic financing, domestic primary budget deficit, and external public debt were met. However, the ceiling on the wage bill was exceeded, which contributed to the accumulation of domestic arrears (targeted to be zero under the program) as arrears in the payments of goods and services were partly used to finance additional wage expenditures. The mixed performance on structural reforms reflected serious technical capacity constraints, delays in obtaining technical assistance, and the change in government.

III. Report on the Article IV Consultation Discussions and on the Staff-Monitored Program

14. **In the context of the Article IV consultation discussions, the authorities and the staff agreed that the key challenges facing Guinea-Bissau are to achieve sustainable growth, reduce poverty, and make progress towards the MDGs.** Protracted political instability compounded by periodic external shocks over the past decade undermined macroeconomic stability and weakened institutions. Lack of investment and inadequate provision of public services led to a deterioration in physical and human capital and damaged the economy's prospects for growth. The authorities agreed that political stability—even if fragile—opens a window of opportunity for them to implement the necessary policies and obtain much-needed external support to launch the country on a path of sustained growth and poverty reduction.

15. **To achieve these economic and social objectives, the authorities have formulated a medium-term strategy directed to achieving fiscal and external debt sustainability, improving the quality of spending, and mobilizing external financing.** This strategy is reflected in the government program for 2006–09 and the draft Poverty Reduction Strategy Paper (PRSP). Key aspects of this approach in the short term—as reflected in the 2006 SMP—are to improve the fiscal situation by avoiding new domestic

arrears for 2006 as a whole, strengthen technical capacity to prepare and execute macroeconomic policies, and implement essential structural reforms. The macroeconomic framework underlying the SMP is based on achieving real GDP growth of 4.2 percent (about 1½ percent in per capita terms) and an average inflation rate close to 2 percent, in line with the WAEMU convergence criterion. The authorities noted that the SMP was an important step in their post-conflict recovery efforts and were confident that a solid track record of implementing reform policies under the SMP could help restore donor confidence and pave the way for an EPCA, followed by a PRGF-supported program and eventual debt relief.

A. Medium-Term Prospects

16. **Guinea-Bissau's medium-term economic prospects depend critically upon political stability, disciplined financial policies, an acceleration of structural reforms to promote private sector development, and resumption of external financial assistance.** On these assumptions, the medium-term macroeconomic framework envisages annual real GDP growth of about 5 percent and inflation averaging 2 percent in line with the prudent stance of regional monetary policy. Growth will be sustained by continued expansion of agriculture, particularly the solid performance of the cashew sector. Activity in the secondary and tertiary sectors, which were hit hard by the post-conflict instability, would begin to recover in 2007 and help sustain the economic recovery.

Text Table 2. Medium-Term Projections

	2005 Est.	2006 Rev.Budg.	2007 Proj.	2008 Proj.	2009 Proj.
	(Annual percentage change)				
National accounts and prices					
Real GDP at market prices	3.5	4.2	4.8	5.0	5.0
Real GDP per capita	0.2	1.6	2.2	2.8	2.7
Consumer price index (end-of-period)	1.0	2.5	2.0	2.0	2.0
	(In percent of GDP)				
Investments and savings					
Gross investment	14.6	17.2	18.7	20.6	20.5
Of which: government investment	10.0	11.6	12.6	12.6	12.6
Gross domestic savings	-2.9	-0.3	0.6	3.3	3.9
Of which: government savings	-16.7	-10.2	-8.2	-6.0	-2.1
Gross national savings	7.5	12.1	10.8	13.9	14.5
Government finances					
Budgetary revenue	17.6	20.3	20.8	21.2	21.3
Of which: Tax revenues	11.5	11.9	12.3	12.8	13.0
Total domestic primary expenditure	24.5	24.0	23.4	22.9	21.2
Domestic primary balance	-6.9	-3.7	-2.6	-1.6	0.1
Overall balance (commitment basis)					
Including grants	-12.1	-6.1	-8.1	-6.8	-4.8
Excluding grants	-20.5	-17.6	-17.1	-15.7	-13.6
External current account (incl. official transfers)	-7.1	-5.1	-8.0	-6.8	-6.0
Excluding official current transfers	-10.3	-14.1	-14.4	-13.2	-12.3

Sources: Guinea-Bissau authorities; and staff estimates and projections.

17. **The macroeconomic outlook is expected to improve starting in 2006.** Real GDP growth is projected at about 4 percent in 2006 barring major supply shocks and CPI inflation at about 2.5 percent, reflecting inflation trends in the WAEMU region. The external current account deficit is projected to narrow, as strong export growth together with increased revenues from fishing licenses and worker remittances would only be partially offset by rising imports, fueled by a recovery in domestic demand and an increase in foreign-financed public investment, with high import content. The balance of payments

deficit is projected to widen to 15.4 percent of GDP, which would be financed by donor support, accumulation of external arrears, and debt relief.

18. **Medium-term growth will be underpinned by continued strong agricultural performance and fledgling investments in other sectors as donor assistance resumes and the policy environment becomes more positive**. The authorities expect strong growth in construction, and industry—particularly cashew nut processing and industrial fishing activities—which would also help significantly expand Guinea-Bissau's export base. Private investment is expected to strengthen as infrastructure constraints (e.g., in electricity, port facilities, and roads) are partially addressed through real increases in public investment. Preserving political stability and rehabilitating the central administration would also improve the business environment. The staff noted that the consolidation of the recovery would require the authorities to tackle structural weaknesses in the economy, because business confidence had been badly shaken by conflicts and political instability. The strengthening fiscal position beyond 2007 would result in a gradual improvement of national saving over the medium term, leading to a narrowing of the external current account deficit (including grants) to 6 percent of GDP by 2009 (Text Table 2).

19. **With monetary and exchange rate policies determined at the regional level, fiscal policy, supported by structural reforms, will be the main instrument of macroeconomic policy in Guinea-Bissau.** Staff projects that a broadly sustainable fiscal situation—supported by external debt relief—can reasonably be achieved over the medium term if there are strong efforts to increase tax revenue and reduce expenditure. In this scenario, the revenue-to-GDP ratio is assumed to increase steadily, driven mainly by higher tax revenue, which is projected to reach 13 percent of GDP in 2009. Spending pressure resulting from increased donor assistance for poverty reduction will be alleviated by the government's efforts to curb the growth of discretionary spending and cut the wage bill, supported by civil service and military reforms. The domestic primary balance would gradually improve, reaching, by 2009, a level broadly consistent with fiscal sustainability, assuming the HIPC completion point is reached that same year (Appendix V).[8]

20. **While the economic outlook has improved, there are downside risks. These arise from unresolved domestic political and security tensions, weak institutions, slippages in reforms, and vulnerability to exogenous shocks**. In particular, the political and economic risks related to the medium-term scenario are substantial; much will depend on the authorities' commitment to economic reforms. An alternative medium-term

[8] The DSA indicates, for external public debt, a moderate risk of debt distress and, for total public debt, a mixed picture with some indicators remaining above and others falling below the relevant threshold.

scenario, one that recognizes the possibility of prolonged private-sector skepticism and the absence of external financing, would project output growth at only 2 percent—well below Guinea-Bissau's growth potential. If that should occur, per capita income would decline and debt would not be sustainable.

B. Fiscal Policy and Reforms

21. **In the context of making progress toward fiscal sustainability, the discussion of short-term fiscal policy centered on achievement of a domestic primary balance that avoids the accumulation of domestic arrears.** The revised 2006 budget targets a domestic primary deficit of 3.7 percent of GDP, almost half the level of the previous year. This adjustment is mainly based on higher revenue projections as domestic primary expenditure is projected to decline only slightly in relation to GDP (Table 2). The overall deficit on a commitment basis (including grants) is projected to decrease significantly to 6.1 percent of GDP; its financing is consistent—after a further buildup of external arrears—with a sustainable amount of donor support of 8.2 percent of GDP (Text Table 3 and MEFP, para. 12).

22. **Increasing revenues is key to achieving fiscal sustainability.** The authorities expect to further improve nontax revenue in 2006 by better enforcement of fishing rights fees and payment for licenses by cell phone operators, particularly during the remainder of the year. Because tax rates in Guinea-Bissau are not in general below others in the region, additional revenue would need to come mainly from better administration, for which there is considerable scope.[9] The authorities plan to move faster with planned reforms to simplify the tax system, widen the tax base, and combat tax evasion (MEFP, paras. 19–20). The authorities took note of staff concerns about the risks of revenue shortfalls from some fiscal measures that they are contemplating to promote private investment. They agreed to proceed gradually with such measures as reducing the corporate income tax from 30 percent to 25 percent, as the report of the World Bank's Foreign Investment Advisory Service (FIAS) recommended. They also agreed to eliminate discretionary customs duty exemptions by strictly limiting exemptions only to those allowed under international conventions (a structural benchmark under the SMP) and explore the possibility of recording the remaining exemptions in the budget as tax expenditure to make fiscal accounting more transparent.

23. **In view of their cash flow difficulties, the authorities intend to further strengthen budgetary controls, public expenditure management, and cash management systems** so as to avoid new wage and other domestic arrears for the year as

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[9] See Chapter 2 of the Seleted Issues paper for a discussion on the determinants of fiscal revenues in Guinea-Bissau.

a whole (MEFP paras. 15–18). They stressed that in the short term the fiscal impact of their civil service and security reforms would be neutral (MEFP, paras. 11 and 24) as the projected wage bill reduction would be offset by compensation payments to laid-off workers and new pensioners.[10] While supporting efforts to lower medium-term wage costs, staff advised that large-scale retrenchment of personnel should be supported by donor-assisted civil and security service reforms (see para. 31 below). The authorities expect a decline in nominal terms of current spending at the primary level due to better control of discretionary spending. In view of lower-than-expected nontax revenues in the first five months of the year, the authorities have agreed to lower nonwage current spending below the level envisaged in the 2006 budget, in order to ensure that the program fiscal targets are met (MEFP, para 13). A supplementary budget with these measures will be presented to parliament by end-September 2006, ahead of the first program review.

24. **Domestic financing of the budget deficit is constrained by the government's low cash operating balances, which depend on timely donor disbursements** (Text Table 3). Should donor disbursements be delayed, the program permits the authorities to borrow temporarily from regional financial markets by issuing T-bills, with the understanding that the bills will be repaid when the funding is disbursed. Given the lags in accessing the market, though, this strategy may not prevent temporary accumulations of domestic arrears during the year. Nevertheless, given the expected levels of donor funding, the program would not permit accumulation of domestic arrears for the year as a whole. Staff believes that this objective is likely to be achieved in view of the government's commitment to containing domestic primary spending and the likelihood of a new bond issue in July.[11]

Text Table 3

Guinea-Bissau: Financing Gap and Identified Budget Support

	2006 Budget [1/]		Timing of
	CFAF billions	In percent of GDP	expected disbursement
Financing gap (+ = financing needs)	14.3	8.3	
Identified budget support	14.0	8.2	
WAEMU/ECOWAS	3.2	1.9	Q2
EU	4.1	2.4	Q3/Q4
World Bank	5.5	3.2	Q4
EEMF/UNDP	0.6	0.3	Q2
China	0.6	0.4	Q2

Sources: Ministry of Finance and Fund staff estimates.

[1/] Revised 2006 budget based on staff proposal.

25. **The authorities were particularly concerned about settling wage and other domestic arrears, which they estimated at CFAF 37 billion (21 percent of GDP).** They said that the overhang of wage arrears threatens social stability and undermines their

[10] See Chapter 1 of the Selected Issues paper for a discussion on wages and the public sector reform.

[11] The BCEAO has advised the authorities that it would undertake the issue of a new 180-day T-bill on behalf of Guinea-Bissau by end-July, to bridge the EU and World Bank support expected in the last quarter of the year.

efforts to improve public services and stimulate domestic demand. Given the difficult financial constraints and the large size of outstanding arrears, the clearance of these arrears would be a formidable policy challenge. The authorities recognized that previous years' arrears could be paid in 2006 only if external financing is obtained for their clearance (MEFP, para. 14). Staff urged the authorities to launch, with donor assistance, a comprehensive audit of the arrears before seeking financing. Regarding Guinea-Bissau's capital contribution to the WAEMU financial institutions, the authorities acknowledged that, given the weak state of public finances, it would not be possible for Guinea-Bissau to fully meet these obligations in the near term.[12]

C. Monetary, Exchange Rate, and Financial Sector Issues

26. **The authorities believe that Guinea-Bissau's membership in WAEMU has served the country well, because it helped keep inflation at bay despite severe fiscal imbalances.** Staff agreed that monetary conditions in Guinea-Bissau have been appropriate, as indicated by continued low inflation.[13] On the broader issue of WAEMU membership, it has been helpful for Guinea-Bissau to have monetary policy conducted at the regional level by the BCEAO in the context of a common currency pegged to the euro, given the country's limited administrative and institutional capacity. Guinea-Bissau has also benefited from access to the broader regional financial market, rather than being confined to the limited financing available domestically. Although Guinea-Bissau is estimated to have missed all convergence indicators established under the WAEMU's Pact of Convergence, Stability, Growth, and Solidarity,[14] these convergence criteria have nonetheless served as useful benchmarks in the formulation of fiscal policy. In addition, the adoption by Guinea-Bissau of the common external tariff, which resulted in a substantial reduction in its effective tariff rates, has offered the potential for trade expansion.

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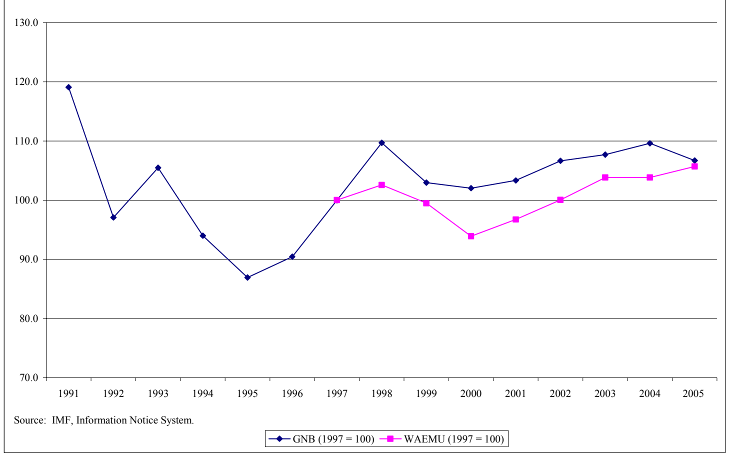
[12] Under the terms of its accession to the WAEMU in 1998, Guinea-Bissau agreed to contribute an equal share as the other members in the capital of the central bank (BCEAO) and the regional development bank (BOAD). The contribution amounting to 50 percent of GDP is to be paid over 25 years starting in 2005, but so far Guinea-Bissau has failed to make any payment.

[13] Nominal interest rates in the WAEMU have remained unchanged since 2004, and the coefficient of reserve requirements for Guinea-Bissau has been set below the average for the region.

[14] The pact sets "primary" or binding targets on the basic fiscal balance, the stock of public debt, inflation, and government arrears; and a number of "secondary" or indicative targets, such as a ceiling on the wage bill as a percentage of fiscal revenues (35 percent), a floor on fiscal revenue as a percentage of GDP (17 percent), a floor of domestically financed investment as a percentage of fiscal revenues (20 percent) and a ceiling on the external current account deficit as a percentage of GDP (5 percent).

27. **The authorities and the staff agreed that the current real effective exchange rate is likely to be close to its equilibrium level, as indicated by its relative stability over the past decade and the robust expansion in export volumes, which have grown at an annual average of 10 percent over the last six years (Figure 1).** After joining WAEMU in 1997, Guinea-Bissau saw its REER appreciate by only slightly more (5 percent) than the monetary union's average REER, which staff has estimated to be broadly in line with the equilibrium level (Figure 6).[15] By 2005, the appreciation of Guinea-Bissau's REER was similar to the WAEMU-wide REER. Although Guinea-Bissau's current account deficits have been sizeable in some years and it has been accumulating external arrears continuously, these factors do not necessarily indicate an overvalued exchange rate as long as the country is assumed to reach the HIPC completion point (with its associated debt relief) in 2009 and to reestablish access to adequate concessional external assistance on a durable basis. Besides export supply shocks, the current account deficit has been partly driven by foreign-financed investment projects, which have a high import content and thus limited impact on the equilibrium real exchange rate. Moreover, the financing gaps in the medium term can be covered by normal flows (Table 4), and no exceptional financing is expected to be needed following debt relief in 2009, suggesting that the real exchange rate today is broadly in line with economic fundamentals.

Figure 6. Guinea-Bissau: Real Effective Exchange Rate



Source: IMF, Information Notice System.

28. **The authorities were concerned that continued appreciation of the euro against the U.S. dollar would challenge their export competitiveness.** Staff indicated that any sustained deterioration in competitiveness would need to be addressed through structural reforms to lower the cost of producing tradable goods.

29. **The authorities pointed out that the development of the financial system had been hampered by persistent political instability** in the country, a weak judicial system and stringent regional financial regulations. However, the BCEAO has recently eased

[15] See *West African Economic and Monetary Union—Selected Issues,* February 2006, Chapter 1. The paper shows that the real effective exchange rate reached its equilibrium level in mid-2002. Although it may have been above the equilibrium level since then, the estimated misalignment is not statistically significant.

regulations on single licensing, which would permit two Senegalese banks to enter the country in 2006 and increase banking competition. As a result, credit to the private sector is expected to expand in 2006.

D. Structural Reforms

30. **The authorities reaffirmed their commitment to accelerate the pace of structural reforms needed to bolster Guinea-Bissau's medium-term growth prospects.** In addition to measures in public finances, the discussions covered reforms in the civil service and security areas and reforms that would help create a business-friendly environment.

31. **Recognizing that the current wage bill is unsustainable and could endanger the fragile macroeconomic stability, the authorities have launched a civil service reform** with the retirement of more than 1,000 employees who had passed the mandatory retirement age. This is to be followed midyear by identifying civil servants and military personnel to be laid off during 2006 (MEFP, paras. 24–25, and structural benchmarks).[16] Staff recommended that a program to reintegrate former civil servants into the private sector be outlined and that adequate and timely funding from donors be ensured to maintain social and political stability. The authorities agreed that, given the lack of absorptive capacity in the private sector and the high retrenchment costs, a program to achieve a sustained reduction of the wage bill can only be implemented gradually within a comprehensive donor-financed medium-term program, to be discussed at a planned roundtable conference.

32. **Cognizant of the link between security and development, the authorities are planning the military and security reforms, for which they hope to garner financing at a donor conference later during the year.** The UNDP and other regional and international partners are helping Guinea-Bissau build stable political institutions and preparations for military reform have started (MEFP, para. 31). The reforms will start with a census of the military (a structural benchmark under the SMP), which should be facilitated by new identification cards to be introduced this year; there will then be a reduction in staff, mostly lower-rank officers and soldiers who receive salaries equivalent to the civil servants to be laid off (MEFP, paras. 26–27).

[16] The public wage bill, including nonwage benefits, has risen from 6.8 percent of GDP in 2000 to 13.4 percent in 2005, well above the 7.9 percent average for African countries. The increase in the wage bill was mainly the result of a salary harmonization process undertaken in 2004 by which salaries of the middle ranks civil service staff (about 80 percent of civil service employees) were adjusted upward to reduce wage differentials with the top rank staff. This was followed by a similar salary adjustment of military and paramilitary personnel to levels comparable to those for the civil service. See Chapter 1 of the selected issues paper.

33. **With assistance from the EU and the World Bank, the authorities also plan to start restoring electricity and water services and rehabilitating Guinea-Bissau's infrastructure this year** (MEFP, para. 28). They believe that improving infrastructure is crucial if they are to improve the investment climate, accelerate growth, and reduce poverty. Staff welcomed the plans for energy reform, privatization of several public commercial enterprises, and the private sector development initiatives launched with World Bank support (MEFP, paras. 29–30, and structural benchmark). It stressed that, given Guinea-Bissau's membership in a monetary union, structural reform was key to improving competitiveness and urged steadfast implementation of the planned measures.

E. External Sector and Public Debt

34. **To foster strong growth and reduce vulnerability to commodity price shocks, value added in the export sector needs to be increased and the export base diversified.** The economy heavily depends on cashew nuts and fishing licenses, and there is potential for increased value added by moving into cashew processing and industrial fishing activities.[17] The authorities said they intend to seek financing to help the private sector build capacity, such as by rehabilitating the fishing ports of Bissau and adding cold-storage facilities. They also hoped that Guinea-Bissau's participation in the U.S. African Growth and Opportunity Act would add impetus to diversification into nontraditional exports.

35. **Recent increases in world oil prices have had only a moderate impact on Guinea-Bissau's external position because they have been more than offset by strong commodity prices.** The fiscal impact has been negligible because retail margins in fuel distribution have been squeezed (see Box 1). The authorities have agreed to introduce an automatic mechanism to adjust the domestic retail price of fuel to world prices, a benchmark under the program .

36. **Guinea-Bissau, which has accepted obligations under Article VIII, maintains a system that is free from restrictions on the making of payments and transfers for current international transactions.** Its trade regime conforms to the WAEMU common regional trade policy. Intraregional trade is essentially free; imports from nonmember countries are subject to the common external tariff (CET). Recently, the authorities changed the tax rates applied to some products so that these tariffs are no longer in line with the CET, but they have requested a waiver from the WAEMU commission. Staff noted that trade liberalization is best pursued through the authorities working with their WAEMU partners to reduce the CET, rather than seeking waivers.

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[17] See Chapter 3 of the selected issues paper for a discussion on the cashew sector.

37. **External debt sustainability analysis reveals a country in severe debt distress; however, if the completion point is achieved before 2010, the risk of debt distress is expected to fall.** The authorities reaffirmed their commitment to making debt service payments to multilateral institutions to preserve their eligibility for multilateral debt relief initiatives. Guinea-Bissau reached the decision point for HIPC debt relief in 2000 and will qualify for the Multilateral Debt Relief Initiative (MDRI) once it reaches the completion point. Given Guinea-Bissau's unsustainable external debt, staff urged the authorities to engage in early and collaborative dialogue with creditors so as to achieve a viable solution to the external debt problem. It welcomed the efforts to reconstitute the external debt database that was lost during the conflict and saw solid improvements in the capacity and resources of the external debt unit, based on foreign technical assistance.

38. **The authorities emphasized their commitment to work actively within WAEMU to promote regional cooperation and economic integration**, but said that political instability had prevented Guinea-Bissau from playing its full part. The country has not yet implemented the regional directive on harmonization of indirect taxation or applied five directives on public finances designed to harmonize budget laws and government accounts and statistics. In 2005, Guinea-Bissau met none of the eight criteria set by the WAEMU Convergence, Growth and Solidarity Pact, and could not submit rolling multiyear convergence programs in 2003 and 2004.

F. Capacity Building and the PRSP Process

39. **There is a need to rebuild the country's institutions and technical capacity.** The authorities recognized the urgency of strengthening institutions to promote political stability and provide adequate services, for which considerable technical assistance will be needed. They also expected the recent creation of a Ministry of Economy, whose responsibilities include technical cooperation with donors, to improve the management of technical assistance. In reviewing technical assistance needs, staff noted the need to be alert to capacity constraints when planning the rebuilding, and identified priority areas for strengthening capacity. It also discussed with the authorities a Statistical Action Plan for inclusion in the PRSP.

40. **The staff recommended that the technical assistance plan for the Ministry of Finance be updated.** Recent missions from West AFRITAC identified technical assistance needs in macroeconomic statistics and all areas of fiscal management, the highest priorities being in the Budget and Customs Departments. But the country's capacity to absorb short-term missions is nearing its limits, and the staff concurs with the authorities that donor support for long-term resident experts is crucial. The authorities welcomed the IMF's one-year assignment of a resident advisor on revenue administration, with donor funding, starting in April 2006.

41. **The authorities recognized that reaching the MDGs by 2015 will be a serious challenge.** They outlined the participatory process that will lead in June to validation of the PRSP and the action plan for 2006 and its submission to Fund and World Bank staff in September. The PRSP is an ambitious plan to reduce poverty, encompassing a large array of measures. Staff recommended careful costing of all measures and a realistic timetable for implementing them. It helped the authorities prepare a central medium-term macroeconomic framework.

IV. The 2006 Staff-Monitored Program: Monitoring and Risks

42. **In the attached memorandum of economic and financial policies (MEFP), the authorities indicate their intention to implement for the period April–December 2006 an economic program they have asked Fund staff to monitor** (Appendix I, Attachment I). The actions that were agreed upon as prerequisites are (i) submission to parliament of a 2006 government budget that is fully consistent with the fiscal program; and (ii) adoption by the cabinet of organic laws for ministries in the context of the civil service reform.

43. **The SMP will be monitored through quarterly indicative targets:** (i) a ceiling on domestic financing of the budget; (ii) a floor on revenue; (iii) a ceiling on the wage bill; (iv) a ceiling on the domestic primary deficit; (v) a ceiling on new domestic arrears,[18] and (vi) ceilings on short- and long-term nonconcessional external debt. The program will also be monitored through structural benchmarks that have macroeconomic and financial implications; as the technical memorandum of understanding states, the government will provide all the data necessary to monitor the program. The staff indicated that discussions on EPCA could start once a concerted international effort emerged.

44. **The program is subject to a number of risks.** The main risk relates to accumulation of domestic arrears in the event of delays in donor disbursements. In addition, attaining the revenue target implies a strong enforcement effort to collect fishing and cell phone license fees. The momentum for civil service and security reform could also weaken under pressures from the military and the trade unions.

V. Staff Appraisal

45. **Guinea-Bissau is at a major crossroads on the way to post-conflict recovery.** While full recovery is expected over the medium term, its strength and timing depend on

[18] A new definition of arrears is being used that would imply a one-time reduction in arrears compared to last year's definition. The change in the definition was made to take into account the need to reflect the normal length of time to process bills because of limited administrative capacity (technical memorandum of understanding, TMU).

how well the authorities come to grips with the political, fiscal, and structural problems besetting the country. To enhance prospects of an early recovery, it is crucial that the authorities improve the economic and financial climate. This will require policies to restore investor confidence, and a strong commitment to addressing longer-term economic problems.

46. **The authorities need to redouble the efforts made in recent years to address the serious economic problems despite the difficult circumstances.** The 2006 SMP should enable Guinea-Bissau to demonstrate its ability to implement a successful adjustment program and avoid the lapses in program implementation that characterized the last PRGF-supported program. With steadfast commitment to the SMP, the prospects for economic recovery and the resumption of external financial assistance are promising. The authorities should use this opportunity to articulate a medium-term strategy that achieves fiscal and debt sustainability and addresses the country's widespread and worsening poverty.

47. **The 2006 budget makes progress in moving Guinea-Bissau toward fiscal sustainability.** The challenge now facing the authorities is to keep current spending in check and intensify revenue mobilization. The emphasis on widening the tax base and reducing exemptions is welcome, but there must also be effective monitoring of spending, starting from the commitment stage, and strict adherence to a monthly cash flow plan that is consistent with spending priorities. The authorities must also be judicious in managing fiscal resources to avoid further accumulation of wage and other domestic arrears that have caused the country hardship in recent years.

48. **A strategy for addressing domestic and external arrears through adjustment, debt relief, and donor assistance is needed.** The authorities should launch a complete audit of domestic arrears and seek external resources for their clearance. External debt service arrears can be addressed only in the context of the HIPC Initiative. The authorities should continue servicing multilateral debt to preserve their eligibility for the MDRI once they reach the HIPC completion point, and embark promptly on discussions with creditors to resolve the external debt problem.

49. **Structural reform, which has languished over the past years, needs new impetus**. Of particular importance is the long-overdue civil service reform launched in March. While the broad objective of the reform aimed at a durable reduction in the excessive wage bill is welcome, the authorities should prepare a program for integrating retrenched workers into the private sector and secure funding from donors so that social and political stability is maintained. Careful implementation of the planned security sector reform (with the assistance of some development partners) should also remove a major constraint on Guinea-Bissau's development agenda.

50. **Membership in the WAEMU has served Guinea-Bissau well.** Inflation has been kept low and the level of the real effective exchange rate seems appropriate, assuming the HIPC completion point is reached in 2009 and durable access to concessional external assistance is resumed. Nevertheless, the economy would benefit from a boost in external competitiveness through further progress on the structural reform agenda. The measures taken to rehabilitate the electricity company, roads, and other infrastructure, and the recent initiatives to improve the investment climate are welcome, but these reforms need to be managed carefully to ensure that limited technical capacity is not overstretched.

51. **Major efforts will be required to rebuild institutional and administrative capacity**. It will be important to ensure coordination of the extensive assistance needs of the country. The government's emphasis on good governance and transparency, which are crucial for restoring relations with donors is welcome.

52. **The mobilization of external assistance will be key to the success of Guinea-Bissau's reform efforts and the achievement of external sustainability.** The recent DSA reveals that the country is currently in severe debt distress. Although debt distress is expected to fall to moderate levels if the HIPC completion point is reached, new assistance should be provided on highly concessional terms preferably in the form of grants to reduce the debt burden.

53. **The 2006 SMP entails a number of risks, but on balance, these risks appear manageable**. The risks relate to the accumulation of domestic arrears, particularly if donor financing is delayed, uncertainty with regard to nontax revenue collection, and the momentum for civil service and military reform. The government has stressed its commitment to reform and donors are supportive. Beyond 2006, it will be key for civil and military service reforms—which entail short-term political risks, but are essential for Guinea-Bissau's medium-term prospects for stability and growth—to be implemented according to a well-designed plan and financed with donor assistance.

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

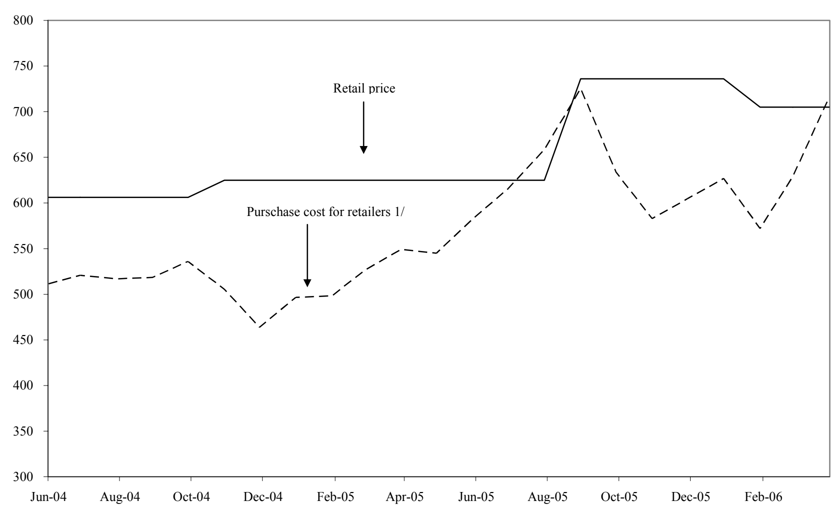
Box 1. Oil Price Adjustment Mechanism

Guinea-Bissau currently fixes the retail price for petroleum products by decree. To insulate the population from oil price volatility, the products covered are fuel, diesel, special mixtures, and diesel reserved for the electricity company. Fixing prices administratively severely distorts the market and undermines fiscal efforts.

Currently, the authorities do not compensate for losses that retailers may incur when the administrative price is set lower than the import price. Under the present system, for a given retail price and tax, the retailer margin changes with the cost of oil. For instance, although gasoline prices started to increase rapidly in April 2004, the authorities did not raise the domestic retail price until March 2005. As a result, retailer margins shrank considerably, to the point where they threatened to discourage gasoline supply. Finally, the authorities adjusted retail prices to avoid shortages and smuggling. In fact, they then adjusted the price by decree four times in less than two years. The adjustments were irregular and infrequent, occurring whenever there was pressure on gasoline supplies.

Staff supported the introduction of an automatic adjustment mechanism and advised that the mechanism should (i) adjust the retail price transparently based on the actual import price (c.i.f.); (ii) rely on full and frequent adjustments in order to avoid lengthy delays in the pass-through of international fuel prices to domestic retail prices; and (iii) synchronize, to the extent possible, the pace of adjustment with prices in Senegal (which uses a similar mechanism) to prevent smuggling, given the high degree of integration between the two economies.

Purchase price pass-through for Gasoline



[1] Transportation costs are estimated base on authorties data

Source : GNB authorities and IMF staff estimates.

Table1. Guinea-Bissau: Selected Economic and Financial Indicators, 2001–06

	2001	2002	2003	2004 Prel.	2005 Est.	2006 Proj. 1/
	(Annual percentage change, unless otherwise indicated)					
National accounts and prices						
Real GDP at market prices	0.2	-7.1	-0.6	2.2	3.5	4.2
Real GDP per capita [2]	-2.7	-9.9	-3.6	-0.8	0.2	1.6
GDP deflator	-5.4	4.6	-2.8	2.7	7.7	3.8
Consumer price index (annual average)[3]	3.3	3.3	1.6	0.8	3.4	2.2
Consumer price index (end of period)[3]	-1.9	2.5	0.7	2.2	1.0	2.5
External sector						
Exports, f.o.b. (based on U.S. dollar values)	-19.4	7.1	16.1	21.8	33.0	7.8
Imports, f.o.b. (based on U.S. dollar values)	10.3	-9.8	0.2	17.2	43.4	6.7
Export volume	3.8	-0.5	7.3	15.0	9.8	7.7
Import volume	10.0	-14.3	-12.9	1.0	30.2	6.6
Terms of trade (deterioration -)	-22.6	2.3	-6.0	-8.7	9.9	0.0
Real effective exchange rate (depreciation -)	1.3	3.2	1.0	1.8	-2.7	...
Nominal exchange rate (CFA francs per U.S. dollar; average)	732.4	694.6	580.1	527.6	526.6	...
Government finances						
Domestic revenue (excluding grants)[4]	-16.9	-11.6	-3.8	17.7	14.1	24.6
Total expenditure	-7.9	-26.1	13.8	33.3	-14.1	7.5
Current expenditure[4 5]	-20.7	-18.0	3.5	20.6	4.7	-3.4
Capital expenditure	32.8	-41.4	41.3	58.1	-41.8	36.4
Money and credit[6]						
Credit to government (net)	-0.2	0.3	-2.4	-7.4	-6.2	-5.7
Credit to the rest of the economy	-0.1	-0.3	-1.8	-1.3	2.5	4.8
Broad money[7]	9.5	24.2	-65.3	44.0	19.9	8.2
Velocity (GDP/broad money)	2.1	1.6	4.5	3.3	3.1	3.1
	(Percent of GDP, unless otherwise indicated)					
Investments and savings						
Gross investment	14.4	9.6	12.6	13.2	14.6	17.2
Of which: government investment	13.7	8.9	11.1	11.1	10.0	11.6
Gross domestic savings	-19.9	-11.8	-1.6	-3.0	-2.9	-0.3
Of which: government savings	-18.3	-12.1	-16.7	-30.1	-16.7	-10.2
Gross national savings	-7.7	-1.0	9.8	16.2	7.5	12.1
Government finances						
Budgetary revenue[4]	16.8	15.3	15.2	17.2	17.6	20.3
Total domestic primary expenditure[4]	21.5	19.4	20.2	24.8	24.5	24.0
Domestic primary balance	-4.7	-4.2	-5.0	-7.6	-6.9	-3.7
Overall balance (commitment basis)						
Including grants	-11.7	-11.3	-15.6	-15.0	-12.1	-6.1
Excluding grants	-26.2	-17.4	-23.3	-32.2	-20.5	-17.6
External current account (including official current transfers)	-22.1	-10.7	-2.8	3.1	-7.1	-5.1
Excluding official current transfers	-36.2	-18.7	-12.0	-11.7	-10.3	-14.1
Excluding official transfers (other than fishing licenses)	-31.0	-12.7	-6.2	-5.4	-5.6	-8.5
Net present value of external debt/exports of goods and nonfactor services (in percent)					656.9	611.2
Nominal stock of debt, including arrears	459.1	500.7	474.5	487.7	440.6	429.2
Memorandum items (millions of U.S. dollars unless otherwise indicated)						
Current account balance (including official current transfers)	-44.0	-21.8	-6.6	8.2	-21.4	-15.9
Overall balance of payments	-38.0	-15.6	-114.2	-9.6	-23.1	-48.2
Nominal GDP at market prices (billions of CFA francs)	145.9	141.9	137.1	142.6	158.8	171.8
Nominal stock of debt (end of period; excluding arrears)	776.9	853.9	915.2	1024.0	1002.1	993.3
Nominal stock of arrears, end of period	137.5	169.1	206.4	293.8	327.0	349.8

Sources: Guinea-Bissau authorities, and IMF staff estimates and projections.

[1] Based on government budget for 2006.

[2] Projections based on population growth of 2.5 percent per year.

[3] There is a break in the series in July 2002, when Guinea-Bissau adopted a new harmonized CPI index.

[4] In 2004, domestic revenue includes CFAF 2,342 million in payments to Guinea-Bissau soldiers participating in the UN Liberia peacekeeping mission. The same amount is recorded in current expenditure under salaries.

[5] In 2004 and 2005, includes CFAF 3.4 billion for legislative elections and CFAF 1.6 billion for presidential elections.

[6] Change in percent of beginning-of-period stock of broad money.

[7] In 2003, the BCEAO corrected its estimate of currency in circulation resulting in a large drop of base money.

Table 2. Guinea–Bissau: Central Government Operations, 2001–07

(In billions of CFA francs)

	2001	2002	2003	2004 Prel.	2005 Est.	2006 Rev. Budget	2007 Proj.
Revenue and grants	45.6	30.4	31.4	49.1	41.3	54.6	54.3
Revenue	24.5	21.7	20.8	24.5	28.0	34.9	37.9
Tax revenue	14.8	11.9	11.9	11.8	18.3	20.5	22.3
Nontax revenue[1]	9.7	9.8	8.9	12.7	9.6	14.3	15.5
Grants	21.1	8.7	10.6	24.5	13.4	19.7	16.4
Budget support	8.3	1.9	1.1	12.0	5.1	5.9	0.0
Project grants[2]	12.9	6.8	9.5	12.5	8.3	13.8	16.4
Total expenditure	62.8	46.4	52.8	70.4	60.5	65.1	68.9
Current expenditure	41.1	33.7	34.9	42.1	44.0	42.6	41.8
Wages and salaries[1]	11.0	10.5	13.6	16.2	21.3	19.2	17.7
Goods and services	7.4	7.7	3.9	4.5	7.6	5.6	7.9
Transfers	7.2	7.4	5.1	5.0	6.1	9.4	7.5
Other current expenditures[2]	3.3	1.2	4.5	7.7	2.4	3.0	3.6
Scheduled interest	12.2	6.9	7.7	8.7	6.7	5.5	5.1
Domestic interest	0.6	0.8	0.5	2.7	0.4	0.3	0.3
External interest	11.6	6.1	7.3	6.0	6.3	5.1	4.8
Capital expenditure and net lending	21.6	12.7	17.9	28.3	16.5	22.5	27.1
Public Investment Program	20.0	12.7	15.3	15.8	15.9	20.0	22.9
Domestically financed	2.5	0.7	0.1	0.5	1.1	2.3	4.1
Foreign financed	17.5	12.0	15.2	15.3	14.8	17.7	18.8
Other capital expenditure	1.7	0.0	2.7	12.5	0.6	2.5	4.2
Domestically financed	0.0	0.0	0.4	1.5	0.6	1.8	1.8
Foreign financed (including DRRP[3])	1.7	0.0	2.3	11.0	0.0	0.7	2.4
Overall balance, including grants (commitment basis)	-17.1	-16.1	-21.4	-21.4	-19.2	-10.5	-14.7
Overall balance, excluding grants (commitment basis)	-38.3	-24.7	-32.0	-45.9	-32.5	-30.2	-31.1
Net domestic arrears	1.9	1.4	14.8	1.5	-0.1	-0.5	0.0
Accumulation current year	1.9	5.3	17.7	3.9	4.2	0.0	0.0
Payments previous years	0.0	-3.9	-2.9	-2.4	-4.3	-0.5	0.0
External interest arrears current year	2.8	2.8	5.8	4.5	3.8	3.0	2.7
Float and statistical discrepancies	-2.8	1.5	0.7	2.6	-0.4	0.0	0.0
Overall balance, including grants (cash basis)	-15.3	-10.3	0.0	-12.7	-15.9	-7.9	-11.9
Financing	15.3	10.3	0.0	12.7	15.9	7.9	11.9
Domestic financing	-0.7	3.6	-5.4	-1.6	-1.3	-1.9	-2.0
Bank financing	-3.9	3.2	-4.5	-1.2	-1.5	-2.5	-2.2
Of which: IMF repayments/repurchases	-0.5	-1.1	-2.8	-2.8	-1.7	-2.2	-1.8
Of which: capital contribution WAEMU	0.0	0.0	0.0	0.0	-2.1	-2.8	-2.8
Nonbank financing	3.1	0.4	-1.0	-0.4	0.2	0.6	0.2
Foreign financing (net)	16.0	6.7	5.5	14.3	17.2	-4.3	4.4
Disbursements	4.6	4.9	8.0	13.8	6.5	4.6	4.8
Projects	2.9	4.9	5.7	6.2	6.5	4.6	4.8
Programs	1.7	0.0	2.3	7.6	0.0	0.0	0.0
Amortization (scheduled)	-17.4	-19.7	-19.0	-18.9	-18.0	-14.1	-14.2
Treasury bills and regional financing	0.0	0.0	0.0	0.0	10.0	-9.9	0.0
Of which: regionally placed					9.0	-8.9	0.0
External arrears	2.8	14.4	11.8	14.9	13.4	9.5	9.2
Debt relief	26.0	7.1	4.7	4.5	5.3	5.6	4.5
Gross financing gap (+ = financing needs)	0.0	0.0	0.0	0.0	0.0	14.2	9.5
Identified budget support						14.0	
Residual financing gap						0.2	9.5

Sources: Guinea-Bissau authorities, and IMF staff estimates and projections.

Table 2. Guinea–Bissau: Central Government Operations, 2001–07 (concluded)

(Percent of GDP)

	2001	2002	2003	2004 Prel.	2005 Est.	2006 Rev. Budget	2007 Proj.
Revenue and grants	31.3	21.4	22.9	34.4	26.0	31.8	29.8
Revenue	16.8	15.3	15.2	17.2	17.6	20.3	20.8
Tax revenue	10.1	8.4	8.7	8.3	11.5	11.9	12.3
Nontax revenue[1]	6.7	6.9	6.5	8.9	6.1	8.3	8.5
Grants	14.5	6.1	7.7	17.2	8.4	11.5	9.0
Budget support	5.7	1.3	0.8	8.4	3.2	3.4	0.0
Projects[2]	8.8	4.8	6.9	8.8	5.2	8.1	9.0
Expenditure	43.0	32.7	38.5	49.4	38.1	37.9	37.9
Current expenditure	28.2	23.8	25.5	29.5	27.7	24.8	23.0
Of which: wages and salaries[1]	7.5	7.4	10.0	11.3	13.4	11.2	9.7
Interest	8.4	4.8	5.6	6.1	4.2	3.2	2.8
Domestic interest	0.4	0.5	0.3	1.9	0.3	0.2	0.2
External interest (scheduled)	8.0	4.3	5.3	4.2	4.0	3.0	2.6
Capital expenditure and net lending	14.8	8.9	13.1	19.9	10.4	13.1	14.9
Public Investment Program	13.7	8.9	11.1	11.1	10.0	11.6	12.6
Domestically financed	1.7	0.5	0.0	0.3	0.7	1.3	2.2
Foreign financed	12.0	8.5	11.1	10.8	9.3	10.3	10.3
Other capital expenditure	1.2	0.0	1.9	8.8	0.4	1.5	2.3
Domestically financed	0.0	0.0	0.3	1.1	0.4	1.1	1.0
Foreign financed (including DRRP[3])	1.2	0.0	1.7	7.7	0.0	0.4	1.3
Overall balance, including grants (commitment basis)	-11.7	-11.3	-15.6	-15.0	-12.1	-6.1	-8.1
Overall balance, excluding grants (commitment basis)	-26.2	-17.4	-23.3	-32.2	-20.5	-17.6	-17.1
Overall balance, including grants (cash basis)	-10.5	-7.3	0.0	-8.9	-10.0	-4.6	-6.6
Financing	10.5	7.3	0.0	8.9	10.0	4.6	6.6
Domestic financing	-0.5	2.5	-4.0	-1.1	-0.8	-1.1	-1.1
Foreign financing (net)	11.0	4.7	4.0	10.1	10.8	-2.5	2.4
Of which: external arrears	1.9	10.2	8.6	10.5	8.5	5.5	5.0
Of which: debt relief	17.8	5.0	3.4	3.2	3.3	3.3	2.5
Financing gap (+ = financing needs)	0.0	0.0	0.0	0.0	0.0	8.3	5.2
Identified budget support						8.2	
Residual financing gap						0.1	
Domestic primary balance[4]	-4.7	-4.2	-5.0	-7.6	-6.9	-3.7	-2.6
Revenue	16.8	15.3	15.2	17.2	17.6	20.3	20.8
Primary expenditure	21.5	19.4	20.2	24.8	24.5	24.0	23.4
Current	19.8	18.9	19.8	23.4	23.5	21.6	20.2
Capital	1.7	0.5	0.3	1.4	1.1	2.4	3.2

Sources: Guinea-Bissau authorities, and IMF staff estimates and projections.

[1]In 2004, domestic revenue includes an amount of CFAF 2,342 million representing payment to Guinea-Bissau soldiers for services toward the peacekeeping mission in Liberia. The same is recorded in current expenditure under salaries.

[2]In 2004, includes an amount of CFAF 3.4 billion in donor funding for legislative elections.

[3]Demobilization, reinsertion, and reintegration program DRRP).

[4]Defined as revenue (excluding grants) minus primary current expenditure, minus domestically financed capital expenditure.

Table 3. Guinea-Bissau: Monetary Survey, 2001–06

	2001	2002	2003[1]	2004	2005	2006 Proj. [2]
			(Billions of CFA francs)			
Total assets	78.1	95.0	30.2	43.4	52.0	56.3
Net foreign assets	31.5	48.3	13.7	32.5	37.5	45.1
Central bank	37.2	51.2	7.7	26.6	36.9	42.8
Deposit money banks	-5.7	-3.0	6.0	5.9	0.5	2.3
Assets	2.8	5.5	6.0	6.5	3.8	2.5
Liabilities	-8.5	-8.4	0.0	-0.5	-3.2	-0.2
Net domestic assets	46.6	46.8	16.4	10.9	14.6	11.2
Net domestic credit	19.8	23.0	17.8	12.0	12.3	12.2
Net claims on government	15.4	18.8	15.2	9.7	9.0	6.4
Net claims on central government	15.4	18.8	15.2	9.7	9.0	6.4
Central bank	16.5	19.7	16.0	10.5	12.5	10.1
Claims	20.3	20.2	17.9	15.1	13.3	10.4
Advances to the treasury	14.2	14.3	12.0	9.5	7.7	5.0
Statutory limit	2.5	2.8	2.6	2.1	1.9	1.6
Use of Fund credit	11.7	11.4	9.5	7.4	5.6	3.4
Other advances				0.0	0.3	0.0
Consolidated loans	6.1	5.9	5.8	5.6	5.5	5.4
Deposits	-3.7	-0.5	-1.9	-4.6	-0.7	-0.4
Deposit money banks	-1.1	-0.9	-0.8	-0.7	-3.5	-3.7
Claims	0.0	0.3	0.5	1.0	0.1	0.0
Deposits	-1.1	-1.2	-1.3	-1.7	-3.7	-3.7
Credit to the economy	4.4	4.2	2.7	2.3	3.3	5.8
Other items (net)	26.8	23.8	-1.4	-1.1	2.3	-1.0
Liabilities	70.1	87.0	30.2	43.4	52.0	56.3
Broad money	70.1	87.0	30.2	43.4	52.0	56.3
Local currency	70.1	87.0	30.2	43.4	52.0	56.3
Base money	53.1	71.1	21.3	32.6	39.9	42.3
Demand deposits and quasi money	17.1	15.9	8.9	10.9	12.1	14.0
Demand deposits	16.3	14.6	8.3	10.3	11.0	13.2
Quasi money	0.8	1.3	0.6	0.6	1.1	0.7
			(Annual change as percent of beginning-of-period money stock, unless otherwise indicated)			
Net foreign assets	4.7	23.9	-39.7	62.4	11.4	14.7
Net domestic assets	6.7	0.3	-34.9	-18.4	8.5	-6.5
Domestic credit	-0.8	4.5	-6.0	-19.3	0.8	-0.2
Credit to the governement	-0.2	0.3	-2.4	-7.4	-6.2	-5.7
Credit to the economy (percent)	-0.1	-0.3	-1.8	-1.3	2.5	4.8
Other items (net)	7.5	-4.3	-28.9	0.9	7.7	-6.3
Broad money	9.5	24.2	-65.3	44.0	19.9	8.2
Velocity (GDP/M2)	2.1	1.6	4.5	3.3	3.1	3.1

Sources: Central Bank of West African States (BCEAO); and IMF staff estimates and projections.

[1]In 2003, the BCEAO revised its estimate of currency in circulation, broad money, and net foreign assets. The mission will check these figures.

[2]Based on government budget for 2006.

Table 4. Guinea-Bissau: Balance of Payments, 2001–09

	2001	2002	2003	2004 Prel.	2005 Est.	2006 Proj. 1/	2007	2008	2009
	(Billions of CFA francs)								
Goods and services	-50.0	-30.4	-19.4	-23.1	-27.7	-30.1	-33.0	-33.3	-34.0
Goods	-20.7	-11.8	-5.0	-3.8	-9.6	-10.0	-10.7	-9.4	-8.3
Exports, f.o.b	36.6	37.2	36.1	40.0	53.1	59.7	65.1	70.7	76.7
Of which : cashew nuts	34.5	32.9	32.3	38.4	49.2	55.3	60.5	65.8	71.5
Imports, f.o.b	-57.4	-49.1	-41.1	-43.8	-62.7	-69.7	-75.9	-80.2	-85.1
Services (net)	-29.3	-18.5	-14.4	-19.3	-18.1	-20.0	-22.3	-23.9	-25.7
Credit	5.4	5.1	5.0	4.1	6.7	7.5	7.7	7.8	8.0
Debit	-34.6	-23.6	-19.4	-23.4	-24.8	-27.6	-30.0	-31.7	-33.6
Income (interest scheduled)	-11.6	-6.1	-7.3	-6.0	-6.3	-5.1	-4.8	-4.4	-4.1
Current transfers (net)	29.4	21.3	22.8	33.5	22.7	26.5	23.3	24.7	25.8
Official[2 3]	20.6	11.4	12.6	21.0	12.6	15.5	11.7	12.4	12.8
Of which: balance of payments support grants	8.3	1.9	1.1	12.0	5.1	5.9	0.0	0.0	0.0
Of which: fishing license fees	7.6	8.5	8.0	9.0	7.5	9.6	11.7	12.4	12.8
Private	8.8	9.9	10.2	12.5	10.2	11.0	11.7	12.3	13.1
Current account									
Including official transfers	-32.2	-15.2	-3.8	4.4	-11.3	-8.7	-14.5	-13.0	-12.3
Excluding official transfers [4]	-45.3	-18.1	-8.5	-7.6	-16.3	-14.7	-14.5	-13.0	-12.3
Excluding official transfers and interest payments [4]	-33.6	-12.0	-1.2	-1.6	-10.0	-9.5	-9.7	-8.6	-8.2
Capital and financial balance	4.4	4.3	-62.4	-9.4	-0.9	-17.7	-7.5	-7.3	-7.4
Capital account	9.1	27.2	9.4	15.4	10.3	16.0	18.7	19.6	20.6
Financial account	-4.6	-22.9	-71.8	-24.9	-11.2	-33.7	-26.2	-26.9	-28.0
Official medium- and long-term disbursements	4.6	4.9	8.0	13.8	6.5	4.6	4.8	5.1	5.4
Balance of payments support	1.7	0.0	2.3	7.6	0.0	0.0	0.0	0.0	0.0
Projects	2.9	4.9	5.7	6.2	6.5	4.6	4.8	5.1	5.4
Scheduled amortization	-17.4	-19.7	-19.0	-18.9	-18.0	-14.1	-14.2	-14.2	-17.0
Treasury Bills	0.0	0.0	0.0	0.0	10.0	-9.9	0.0	0.0	0.0
Commercial banks' net foreign assets	-0.6	2.9	9.8	-0.1	-5.4	1.7	0.2	0.2	0.1
Private net foreign assets and errors and omissions[5]	8.8	-11.0	-70.6	-19.6	-4.3	-16.0	-17.0	-18.0	-16.5
Overall balance	-27.8	-10.8	-66.2	-5.1	-12.2	-26.4	-22.0	-20.3	-19.6
Financing	27.8	10.8	66.2	5.1	12.2	26.4	22.0	20.3	19.6
Net foreign assets (increase -)[5]	-3.7	-14.0	43.5	-18.9	-10.3	-5.9	-4.0	-3.0	-2.8
Of which: net IMF credits	-0.5	-1.1	-2.8	-2.8	-1.7	-2.2	-1.8	-1.0	-0.8
Purchases and loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchases and repayments	-0.5	-1.1	-2.8	-2.8	-1.7	-2.2	-1.8	-1.0	-0.8
Debt relief	25.9	7.7	5.1	4.5	5.3	5.6	4.5	2.2	9.8
Change in debt-service arrears (decrease -)	5.6	17.2	17.6	19.4	17.2	12.5	11.9	11.5	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	14.2	9.5	9.6	12.7
	(In units indicated)								
Memorandum items									
Export volume growth (percent)	3.8	-0.5	7.3	15.0	9.8	7.7	6.9	6.9	6.7
Import volume growth (percent)	10.0	-14.3	-12.9	1.0	30.2	6.6	6.6	3.7	4.3
Scheduled debt service									
In percent of exports and service credits	69.1	60.9	64.0	56.6	40.7	28.6	26.0	23.6	24.9
In percent of total government revenue	118.6	118.9	126.1	101.8	87.1	55.2	50.0	45.4	48.7
Current account balance (percent of GDP)									
Including official transfers	-22.1	-10.7	-2.8	3.1	-7.1	-5.1	-8.0	-6.8	-6.0
Excluding official transfers	-36.2	-18.7	-12.0	-11.7	-10.3	-14.1	-14.4	-13.2	-12.3
Stock of external arrears, end of period	80.4	97.6	115.2	134.6	151.9	164.4	176.3	187.8	187.8
Overall balance (percent of GDP)	-19.1	-7.6	-48.3	-3.6	-7.7	-15.4	-12.1	-10.5	-9.6

Sources: BCEAO; and IMF staff estimates and projections.

[1]Based on staff proposal for 2006

[2]Including food aid and technical assistance to projects

[3]In 2004, includes CFAF 2,342 million for remuneration to Guinea-Bissau soldiers for participation in the UN peace keeping mission in Liberia.

[4]Does not exclude fishing licenses.

[5]A drop in the level of net foreign assets in 2003 reflects a change in the methodology for the calculation of this series BCEAO applied for 2003 and afterward. The counterpart of this break in the net foreign assets series in 2003 is included under errors and omissions. The mission will discuss these changes with the authorities.

Table 5. Guinea-Bissau: Obligations to the Fund 2006–10

(As of April 30, 2006)

	2006					2007					2008	2009	2010
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total			
						(Millions of SDR)							
Total	0.69	0.74	0.69	0.53	2.65	0.69	0.76	0.24	0.52	2.22	1.29	1.05	0.54
Principal	0.68	0.72	0.68	0.51	2.59	0.68	0.74	0.24	0.51	2.17	1.25	1.02	0.51
PRGF	0.68	0.72	0.68	0.51	2.59	0.68	0.74	0.24	0.51	2.17	1.25	1.02	0.51
Credit Tranche [1]	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest and Charges	0.01	0.03	0.01	0.02	0.06	0.01	0.02	0.01	0.02	0.05	0.04	0.04	0.03
Net charges SDR Account	0.01	0.01	0.01	0.01	0.03	0.01	0.01	0.01	0.01	0.03	0.03	0.03	0.03
Charges Credit Tranche	-	-	-	-	0.00	-	-	-	-	0.00	-	-	-
Interest PRGF	-	0.02	-	0.02	0.03	-	0.01	-	0.01	0.02	0.01	0.01	0.00
Assessments	-	0.00	-	-	0.00	-	0.00	-	-	0.00	0.00	0.00	0.00
						(Millions of U.S. dollars) [2]							
Total	0.99	1.07	0.99	0.76	3.81	0.99	1.10	0.35	0.76	3.20	1.87	1.52	0.78
Principal	0.98	1.03	0.98	0.73	3.73	0.98	1.07	0.34	0.73	3.13	1.81	1.47	0.74
PRGF	0.98	1.03	0.98	0.73	3.73	0.98	1.07	0.34	0.73	3.13	1.81	1.47	0.74
Credit Tranche [1]	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest and Charges	0.01	0.04	0.01	0.03	0.09	0.01	0.03	0.01	0.02	0.07	0.06	0.05	0.04
Net charges SDR Account	0.01	0.01	0.01	0.01	0.04	0.01	0.01	0.01	0.01	0.04	0.04	0.04	0.04
Charges Credit Tranche	-	-	-	-		-	-	-	-		-	-	-
Interest PRGF	-	0.03	-	0.02	0.05	-	0.02	-	0.01	0.03	0.02	0.01	0.01
Assessments	-	0.00	-	-	0.00	-	0.00	-	-	0.00	0.00	0.00	0.00

Sources: IMF, Finance Department (FIN); and IMF staff estimates and projections.

[1] EPCA (from General Resources Account) already payed off in 2005.
[2] Based on World Economic outlook projections for SDR per US dollar.

Table 6. Guinea-Bissau: External Debt Outstanding, 2004–10 [1]
(Millions of U.S. dollars)

	2004	2005	2006
Total external debt outstanding (end of year; including arrears)	1024.0	1002.1	993.3
Multilateral	517.2	493.7	480.8
African Development Bank Group	141.4	135.8	132.7
Arab Bank for Economic Development in Africa (BADEA)	9.2	9.2	9.3
Economic Community of West African States (ECOWAS)	3.9	3.9	3.9
European Investment Bank (EIB)	8.7	8.5	8.5
International Fund for Agricultural Development (FIDA)	11.1	10.9	11.0
International Development Agency (IDA)	301.3	289.8	283.7
Islamic Development Bank (IsDB)	15.6	15.3	15.3
OPEC Fund	8.1	8.1	8.1
Banque Ouest Africaine de Development (BOAD)	1.7	...	...
International Monetary Fund (IMF)	15.5	12.2	8.3
Bilateral creditors	506.0	507.1	511.2
Paris Club (cutoff date: December 1986)	366.5	362.0	364.9
Belgium	15.5	16.9	17.3
Brazil	17.4	18.1	18.6
France	14.4	13.5	13.8
Germany	1.3	1.3	1.4
Italy	198.8	194.6	193.1
Portugal	107.0	106.1	108.9
Russia	0.7	0.7	0.7
Spain	11.3	10.8	10.9
Other bilateral creditors	139.5	145.1	146.4
Commercial	0.8	1.3	1.3
Banque Franco-Portugaise	0.8	1.3	1.3

Sources: Guinea-Bissau authorities; IMF and staff estimates and projections.

[1] Estimates are based on incomplete and unreconciled data provided by the Guinea-Bissau authorities and on IMF and WB staff estimates and projections.

Table 7. Guinea-Bissau: External Arrears Outstanding, 2004–10[1]

(Millions of U.S. dollars)

	2004	2005	2006
Total stock of arrears outstanding (end of year)	293.8	327.0	349.8
Multilateral	31.8	33.8	35.8
African Development Bank Group	0.0	0.0	0.0
Arab Bank for Economic Development in Africa (BADEA)	8.1	8.5	8.9
Economic Community of West African States (ECOWAS)	3.3	3.4	3.5
European Investment Bank (EIB)	6.5	6.6	6.6
International Fund for Agricultural Development (FIDA)	3.1	3.4	3.7
International Development Agency (IDA)	0.0	0.0	0.0
Islamic Development Bank (IsDB)	2.6	3.7	4.8
OPEC Fund	8.1	8.1	8.1
Banque Ouest Africaine de Development	0.2	0.2	0.2
International Monetary Fund (IMF)	0.0	0.0	0.0
Bilateral	330.7	352.4	364.1
Paris Club (cutoff date: December 1986)	189.4	208.0	218.4
Belgium	3.6	5.0	6.4
Brazil	7.7	10.3	13.1
France	8.8	10.1	11.4
Germany	0.5	0.5	0.6
Italy	152.6	162.1	163.2
Portugal	16.2	19.8	23.4
Russia	0.1	0.2	0.3
Non-Paris Club	141.3	144.4	145.7
Abu Dhabi Fund for Arab Economic Development	0.2	0.2	0.2
Algeria	9.5	9.6	9.6
Angola	17.0	17.0	17.0
Kuwait	49.5	51.5	52.0
Libya	4.1	4.1	4.1
Pakistan	2.6	2.6	2.6
Saudi Arabia	15.5	15.6	15.6
Taiwan, P.C	43.0	43.9	44.6
Commercial			
Banque Franco-Portugaise	0.8	1.3	1.3

Sources: Guinea-Bissau authorities; and IMF staff estimates and projections

[1] Estimates are based on incomplete and unreconciled data provided by the Guinea-Bissau authorities and on IMF and WB staff estimates and projections

Table 8. Guinea-Bissau: Millennium Development Goals, 1990–2004

	1990	1994	1997	2000	2003	2004
Goal 1: Eradicate extreme poverty and hunger						
Percentage share of income share held by lowest 20%	..	*5.0*	..	..	..	..
Population below US$1 a day	..					
Population below minimum level of diatary energy consumption (%)	..					
Poverty gap at US$1 a day (incidence x depth of poverty)	..					
Poverty headcount, national (% of population)	..	..	..	..	..	..
Prevalence, of underweight in children (% of children under 5)	..	..	..	25.0	..	..
Goal 2: Achieve universal primary education						
Net primary enrollment ratio	38.0		45.2	45.2		
Primary completion rate, total (% of relevant age group)	..	..	27.9	27.7	..	..
Proportion f pupils starting grade 1 who reaches grade 5						
Youth literacy rate						
Goal 3: Promote gender equality and empower women						
Proportion of seats held by women in national parliament (%)	20.0	..	10.0	8.0	8.0	8.0
Ratio of girls to boys in primary and secondary education (%)	..	..	..	64.9	..	..
Ratio of young literate females to males (% ages 15-24)	..	..	..	..	..	..
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	10.8	..	..	..	..	..
Goal 4: Reduce child mortality						
Immunization, measles (% of children ages 12-23 months)	53.0	68.0	51.0	59.0	61.0	61.0
Mortality rate, infant (per 1,000 live births)	153.0	143.0	..	132.0	126.0	126.0
Mortality rate, under-5 (per 1,000)	253.0	235.0	..	215.0	204.0	204.0
Goal 5: Improve maternal health						
Births attended by skilled health staff (% of total)	..	25.0	..	34.7	..	..
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	1,100	..	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases						
Contraceptive prevalence (% of women ages 15-49)	..	..	..	8.0	..	..
Incidence of tuberculosis (per 100,000 people)	162.1	172.5	180.7	189.4	198.4	198.4
Children orphaned by HIV/AIDS	..	..	..	..	..	..
Prevalence of HIV, total (% ages 15-49)	..	..	..	..	..	..
Tuberculosis cases detected under DOTS (%)				46.4	55.2	55.2
Goal 7: Ensure environmental sustainability						
Improved water source (% of population with access)	..	..	..	..	*59.0*	..
Improved sanitation facilities (% of population with access)	..	..	..	..	*34.0*	..
Access to secure tenure (% of the population)						
CO2 emissions (metric tons per capita)	0.8	0.2	0.2	0.2		..
Forest area (% of land area)	85.5	..	..	77.8	..	..
Nationally protected areas (% of total land area)	..	..	..	..	..	..
Goal 8: Develop a global partnership for development						
Aid per capita (current US$)	126.6	151.5	98.8	58.9	97.5	97.5
Debt service (PPG and IMF only, % of exports of G&S, excl. workers' remittances)	22.0	18.0	16.0	21.0	9.0	9.0
Fixed line and mobile phone subscribers (per 1,000 people)	6.2	6.6	6.9	9.3	9.2	*9.2*
Internet users (per 1,000 people)		..	0.2	2.5	14.8	14.8
Personal computers (per 1,000 people)	..	..	..	..	..	..
Unemployment, youth female (% of female labor force ages 15-24)	..	..	..	..	..	..
Unemployment, youth male (% of male labor force ages 15-24)	..	..	..	..	..	..
Unemployment, youth total (% of total labor force ages 15-24)	..	..	..	..	..	..
Other						
Fertility rate, total (births per woman)	7.1	..	7.1		6.6	6.6
GNI per capita, Atlas method (current US$)	220	200	220	160	140	160
GNI, Atlas method (current US$) (billions)	0.2	0.2	0.3	0.2	0.2	0.3
Gross capital formation (% of GDP)	29.9	21.8	24.0	11.3	12.4	12.4
Life expectancy at birth, total (years)	42.4	..	44.1	…	45.5	45.5
Literacy rate, adult total (% of people ages 15 and above)	..	..	..	..	..	..
Population, total (millions)	1.0	1.2	1.3	1.4	1.5	1.5
Trade (% of GDP)	47.0	50.8	58.5	83.3	73.4	75.1

Source: World Development Indicators database, April 2006

Bissau, July 3, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington D.C. 20431
U.S.A.

Dear Mr. de Rato:

1. Guinea-Bissau has taken important steps to overcome the effects of a long period of political instability that started with a civil war in 1998–99 and ended with a bloodless coup by mid-2003. During this period there was a virtual collapse of the government's administrative capacity, a significant deterioration of the fiscal stance, and a stagnant economy. Political and economic stability have been regained since parliamentary and presidential elections were held in 2004 and 2005. A new government was nominated in December 2005, and a ruling by the Supreme Court on its constitutionality and subsequent parliamentary approval of the government program have eased political tensions. In the context of a staff-monitored program (SMP) in 2005, which this government endorsed, the country started rebuilding the administrative capacity of the state and stabilizing the macroeconomic environment.

2. The priorities of our government are to strengthen public administrative capacity, enforce adherence to regulations and laws, and prepare the ground for reactivation of economic growth. The program for 2006, which is part of a broader government program for 2006–09, in line with the draft Poverty Reduction Strategy Paper intends to improve the fiscal situation through better tax and public expenditure management so as to avoid domestic arrears. The program also sets forward macroeconomic policies and structural reforms that will be key for improving the investment climate and reducing widespread poverty in the country. Recognizing that a reduction in the wage bill is crucial to achieving fiscal sustainability, we are starting a civil service and security reform in 2006, aimed at rationalizing the organizational structures.

3. In its meeting on Guinea-Bissau on November 19, 2004, the Executive Board of the IMF concluded that the next step in Fund engagement could be emergency post-conflict assistance (EPCA), provided that such assistance was part of a concerted international effort. Based on the progress we have made thus far, we are confident that such a concerted effort will emerge later this year, and we intend then to request the start of discussions on a program that can be supported by the Fund under EPCA. Meanwhile, we request that the staff of the Fund monitor our economic program, which is expected to

help us establish a track record of policy performance and pave the way for the post-conflict assistance.

4. The details of the program for 2006 are included in the attached Memorandum on Economic and Financial Policies (MEFP), which was approved by the Council of Ministers. The government believes that the policies and measures set forth in the MEFP are adequate for achieving the objectives of the program, but we will take any further measures that may become appropriate for that purpose. In such cases, as well as before implementing policies that could adversely affect the program, we will consult the Fund.

5. To assist the Fund in assessing progress with implementing the program, we will provide the required information on a regular basis, as detailed in the attached Technical Memorandum of Understanding. Moreover, we invite the staff of the Fund to review performance under the program quarterly, on the basis of the quantitative and structural indicators (Tables 2 and 4 of the MEFP), as well as on the overall implementation of the program.

Sincerely yours,

/s/

Víctor Luís Mandinga
Minister of Finance

Attachments:

- Memorandum on Economic and Financial Policies
- Technical Memorandum of Understanding

MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES FOR 2006

Bissau, July 3, 2006

I. INTRODUCTION

6. **Building on its program for 2006–09, the draft PRSP (DENARP) and the Action Plan for 2006, the government of Guinea-Bissau is committed to the goal of consolidating peace and political stability and laying the foundation for sustainable high growth and significant poverty reduction.** To help achieve these broad objectives and restore confidence in macroeconomic management, the government intends to pursue policies under a Fund staff-monitored program during April–December 2006. The government is determined to take the necessary actions and to intensify its efforts in order to strengthen the public finance situation, accelerate the implementation of structural reforms, and improve its financial relations with creditors.

7. This memorandum describes recent economic developments and provides an overview of the planned policies and measures for 2006.

II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE STAFF-MONITORED PROGRAM DURING 2005

8. **Despite difficult conditions, progress has recently been made on the political and security fronts.** The approval by parliament of the new government program is an encouraging sign of support for reforms urgently needed, including civil service and military reforms. Moreover, the new military leadership has pledged allegiance to the constitution and its neutrality in political affairs, and reduced internal tensions by reincorporating senior officers from different military factions of the civil war. However, the persistence of security risks was highlighted recently by the renewed conflict in the northern part of the country with rebel factions in Casamance. The government has since taken stringent security measures to secure its northern border with Senegal.

9. **The economic and financial situation has also shown some improvement, although serious difficulties remain.** Rules-based government has been largely restored and a start has been made with addressing the fiscal and economic problems. Most importantly, fiscal control has been reestablished, including by centralizing the authorization for expenditure commitments in the Ministry of Finance and closing all government bank accounts outside the central bank (BCEAO). Efforts have also been made to improve budget preparation and tax administration, which has allowed for a significant increase in tax revenues.

10. **Real GDP growth is estimated to have rebounded to 3.5 percent on the back of a good performance of cashew nut and grains harvest.** Activity in other sectors, however, remained sluggish. In particular, industry and tourism have lagged behind because the country lacks basic facilities such as electricity; public administration also did not contribute to growth as the supply of public services did not improve. Average CPI inflation rose to 3.4 percent in 2005 reflecting an increase in the prices of imported goods mainly during the first half of the year. Reflecting a large increase in import and a drop in private remittances, the external current account balance turned into a deficit of 7.1 percent of GDP.

11. **The fiscal situation is also improving, but the government continues to face difficulties in cash flows, due in part to shortfalls in external assistance.** The overall budget deficit (including grants) in 2005 was lower than programmed at 12 percent of GDP compared to 15 percent in 2004, thanks to a stronger-than-projected tax revenue. Current primary expenditures were higher than projected, reflecting overruns in the wage bill, which represented about 75 percent of revenue in 2005. As a result, nonwage current spending, including to the social sectors, was kept below its budgeted level in 2005. The improvement in the domestic primary fiscal balance (a program indicator), from a deficit of 7.6 percent of GDP to 6.9 percent of GDP in 2005, masks a persistent cash flow problem, as evidenced by the accumulation of new domestic arrears. In the face of delays in budget support from the World Bank and EU, initially expected during the second semester of 2005, the government contracted commercial debt amounting to 6.3 percent of GDP, which allowed for the clearance of part of the new domestic arrears in 2005; but an outstanding stock of CFAF 4.2 billion of these arrears remained. Moreover, external debt service, except to the IMF, World Bank, and AfDB remained unpaid.

12. **Performance under the SMP has been mixed.** The targets for revenue, domestic financing and the domestic primary budget deficit (commitment basis) were met. But, the indicative targets for the wage bill for the year as a whole, and the accumulation of new domestic arrears were breached (Table 2). Progress on structural reform was also mixed, reflecting serious technical capacity constraints and delays in obtaining technical assistance, and the change in government. Only 6 out of the 10 structural benchmarks were met (Table 3).

III. Objectives and Policies for 2006

13. **Consolidating the fragile peace and political stability require maintaining macroeconomic stability and implementing deeper structural reforms.** The policies for 2006 aim at improving the fiscal situation, restoring confidence in macroeconomic management, and strengthening technical capacity in preparing and implementing macroeconomic policies.

14. **The macroeconomic framework underlying the staff-monitored program (SMP) is based on the achievement of real GDP growth of 4.2 percent, higher than the population growth rate; and an average annual inflation rate close to 2 percent, in line with the WAEMU convergence criterion.** In addition to preserving recent gains in real per capita income, the SMP also aims to support poverty reduction by accelerating the pace of priority spending within the scope of the existing budget.

Fiscal policies

15. **The government is committed to pursuing a prudent fiscal policy.** Revenue as a percentage of GDP is projected to increase by about 3 percentage points, reflecting better enforcement of fishing licenses, payment of licenses by cell phone operators, and continued improvement of customs administration controls implemented since 2005. Domestically financed expenditures are projected to decrease as a proportion of GDP with respect to 2005. As a result, the overall deficit (including grants) is projected to fall to 6.1 percent of GDP from 12 percent in 2005. Mainly reflecting large scheduled external debt service amounting to CFAF 19.7 billion (11.4 percent of GDP), of which debt relief covers only CFAF 5.7 billion (3.3 percent of GDP), the budget for 2006 shows an overall financing gap of CFAF 26.8 billion (17.2 percent of GDP) for this year. Taking into account debt service payments that will fall into arrears, the financing gap for 2006 amounts to CFAF 14.2 billion.

16. **On the expenditure side, the government's policy is aimed at reining in discretionary spending in order to free the resources needed to address the increasing needs of the poorest population groups in the areas of health and education, as well as to maintain and improve basic infrastructure.** Accordingly, budgeted current primary expenditure as a ratio to GDP will be reduced by 1.9 percentage points, while domestically-financed investment expenditure will be increased by 1.3 percentage points over the outturn for 2005. The wage bill is expected to decline by CFAF 2.1 billion as a result of the implementation of the first phase of the civil service reform marked by the retrenchment of nearly 2,800 civil servants. However, transfers are projected to rise by about CFAF 3.3 billion, reflecting partly the cost associated with such program.

17. **With the parliamentary approval of the government program as a sign of an emerging broader consensus for reforms, the outlook for new financing has improved.** The European Union's budget support amounting to CFAF 7.7 billion is expected for disbursement in April and December, and the regional organizations (WAEMU and ECOWAS) began in February the disbursement of a budget support amounting to CFAF 5.5 billion to help cover wage payments in March 2006, settle debt service due to the IMF and World Bank and pay past arrears. However, the postponed budget support under preparation by the World Bank amounting to CFAF 5.5 billion is not

expected until December, 2006. Assistance for 0.3 percent of GDP by China has already been received. The government also intends to contact its external creditors to seek solutions to the high external debt payments. This, combined with additional external resources from the multidonor-supported EEMF, would allow the gap to be fully covered.

18. **In view of the weakness in nontax revenue performance observed during the first five months of the year, in order to ensure program targets are met, the government has undertaken additional expenditure cuts beyond those included in the 2006 budget.** These measures, which will become effective immediately, comprise reductions in transfers of CFAF 600 million and in other nonwage expenditures of CFAF 500 million. The government will submit to parliament by end-September 2006, an amendment to the budget law to reflect these adjustment measures.

19. **In line with the budget, the government does not anticipate the payment of previous years' arrears in 2006, unless specific external financing for their clearance is obtained.**[19] The government intends to launch with donor assistance, a comprehensive audit of these arrears and seek external financing for their clearance later. Meanwhile, a program of wage arrears clearance will be prepared during 2006. If a donor financial assistance is found, this program will be executed in consultation with Fund staff. However, the government's first priority would be to avoid the accumulation of new arrears.

Public expenditure management

20. **The government recognizes the need to improve budget execution and cash flow management, with the twofold objective of improving public expenditure management and preventing the accumulation of domestic and external payments arrears.** Short-term fiscal policy will thus focus on avoiding new domestic arrears over the year as a whole, within the framework of a day-to-day fiscal management on the basis of a strict cash management system. A circular has been issued by the Prime Minister to strengthen the mandate of the Treasury Committee, in charge of implementing the cash flow plan. The Treasury Committee will be guided by a cash-flow plan for 2006 (Table 1), based on the budget for 2006. Starting immediately and in cooperation with the BCEAO, the movements in the treasury accounts will be reconciled with the expenditure allocations of the Treasury Committee and authorized commitments by the Budget Department on a daily basis.

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[19] Some domestic claims on government from 2000–05, mainly wages, were settled selectively during the first quarter of 2006, to reduce political tensions.

21. **The government will also ensure that all expenditure commitments, irrespective of their actual payment, will be entered in the accounting system maintained by the Budget Department without delay.** In order to follow budget execution, the Ministry of Finance will, within two weeks after the end of each month, prepare a report comparing the budget and actual expenditure by main budget category. The government will further strengthen budgetary control procedures. It will provide support for external audits of the government's end-year treasury accounts by the Audit Court, and parliamentary examination of budget review laws within the timeframe specified by WAEMU directives. In order to increase transparency and donor confidence, the government has allowed the UNDP and the EU to participate in the Treasury Committee as observers.

22. **While the cash rationing system is expected to help avoid new arrears on discretionary expenditure items, temporary arrears on nondiscretionary items may arise during the year.** The large share in expenditure of wages and other nondiscretionary outlays, the concentration of tax revenue in the middle of the year, and the concentration of World Bank and other donor financing during the second semester, imply that, without additional financing, new arrears (on a commitment basis) on these expenditure categories may arise during the first part of the year. At the end of the complementary period of the budget execution for 2005, these arrears, salaries included, amounted to CFAF 4.1 billion. Clearing such arrears will get the highest priority when new financing is found.

23. **The government has introduced since 2002 a procurement reform program in the public sector with the assistance from the Netherlands.** After being successfully implemented in five pilot ministries (education, health, finance, agriculture, and infrastructure) with the creation of a General Directorate of Public Procurement (DGCP) and a National Committee for monitoring public contracts (CNCS) in 2002 and 2004, respectively, the reform will be extended to the rest of the public sector in 2006 with assistance from the World Bank in the context of its support to low-income countries under stress (LICUS). Moreover, public finance management in Guinea-Bissau is still governed by outdated laws adopted back in 1986. The government will strive to align the country's legal and regulatory framework with the WAEMU norms.

Tax reforms

24. **The government intends to continue with tax reforms initiated by the previous government.** There is considerable scope to generate additional revenue from better administration. The main measures envisaged under the current budget include, tightened customs control through the verification of import declarations at main destination sites (where control is more effective) instead of at the border for goods entering the country by land, and declaration and payment of export taxes before exportation takes place. Efforts

will also be pursued to strengthen control over the payment of customs tariffs, including for petroleum products and rice. The Customs Department will step up regional cooperation, including for the valuation for tax purposes of rice imports. Custom exemptions, which represented nearly 40 percent of total custom revenue, will be reduced by putting an end to discretionary exemptions. The government intends to record these exemptions in customs revenue and register the counterpart tax spending in the budget.

25. **The planned fiscal reform for 2006 aims to simplify the tax system, widen the tax base, promote investment and competitiveness, promote voluntary compliance, and combat tax evasion.** The process of simplifying the tax system started with the elimination of several low-yielding taxes in the budget for 2005. Corporate income tax rates were already unified and a minimum tax was introduced for companies that are unable to provide a balance sheet.[20] The banderole system for alcoholic beverages and cigarettes, a structural benchmark under the program, will be implemented by end-July 2006. These reforms will be continued in 2006 in close cooperation with measures to improve the investment climate. Following up on the recommendations of the World Bank's Foreign Investment Advisory Service (FIAS) Department report, the government intends to reduce the effective marginal tax rate by lowering the corporate income tax from 30 percent in 2005 to 25 percent in 2006. This measure is only expected to impact revenue collection in 2007, when taxes on 2006 corporate profits are paid. With the view to improve revenues, the government intends to strengthen corporate taxes by making cashew nut exporters pay their taxes in advance.

26. **The government recently implemented a reduction in tariffs and sales tax for a number of products it considers to be heavily weighted in the consumption basket of the population (including rice, wheat, sugar, cement, and gas), and thus could have a strong impact on poverty.** Some of these measures brought the tariff classification out of line with the WAEMU common external tariff. The government has requested a waiver from the WAEMU commission for these specific cases. These fiscal measures will have a moderate revenue impact in 2006, while contributing to reduce fraud and tax evasion. Regarding export taxes on cashews, cooperation between the ministries of Finance and Commerce will be strengthened to ensure that the reference price for taxation of such exports closely reflects actual prices.

27. **Measures will be taken to protect and increase revenue from the fishing sector, which accounts for more than one-fourth of government revenue.** Surveillance

[20] With assistance from AFRITAC, a Large-Taxpayers Unit (LTU) has been set up; allowing for the centralization of tax accounts from large firms in a single file, by requiring the submission of their end-of-year financial statements and balance sheet. A minimum rate of 0.5 percent of total sales is imposed on those firms declaring zero or negative profits.

of territorial waters will be stepped up with the repair of two boats, and the acquisition of additional monitoring equipment. The latter is part of a US$3 million, four-year project financed by AfDB that started in 2005, and includes the construction of a port for fishing vessels, acquisition of additional boats, fish processing facilities, and training, among others. The Scientific Project for Fisheries financed by the EU will also contribute significantly to the development of this sector: a survey of the stock of fish and shrimp was carried out in 2005, and another one is planned for this year that will allow the authorities to estimate the rate of depletion of this resource; and assistance programs for local fishermen include provision of fishing and storage equipment. Moreover, agreements under which fishing licenses are obtained against payments in kind or for settling government obligations were stopped in 2005 and any new agreement will be based on monetary payment only. All fishing agreements will be harmonized. These measures are also supported by the EU, World Bank, and the AfDB.

IV. Structural Reforms, Governance, and Transparency

28. **The severity of Guinea-Bissau's problems implies that they can only be solved durably through deeper structural reforms over the medium term and with donor assistance.** In addition to structural reforms in taxation and public expenditure management, the government remains committed to implementing a reform of the public administration (civil and military) and other structural measures such as privatization and energy reform. It will aim at improving governance and transparency in all its operations. To accelerate growth and meet substantial demand for social services, the government has also launched a number of private sector development initiatives.

Civil service reform

29. **The key element in reducing expenditure is personnel costs.** At about 75 percent of revenue, the high level of personnel expenditure is the main reason for the serious fiscal problems, and it also leaves little room for social policies and for promoting higher economic growth. The principal causes of the high wage bill are excessive levels of public sector employment and high level staff, as the average wage does not appear to be out of line with respect to other countries in WAEMU.[21] However, the reduction in personnel costs must be implemented in the context of a comprehensive public sector reform program. A new census conducted in 2005 has revealed a total of about 12,000 civil servants.[22] The results of this census are now being compared with the payroll

[21] Preliminary estimates indicate that the average wage is about one-fifth of the average public sector wage in Senegal while GDP per capita in Guinea-Bissau is approximately one-fourth of that in Senegal.

[22] A harmonization in wages conducted in mid-2004 led to an increase in the total wage bill in spite of the decreased number of staff.

maintained by the Ministry of Finance. Starting in July 2006, a new test-based appointment of key administrative posts will be launched with the objective of replacing political appointees by competent civil servants in the highest areas of responsibilities.

30. **The government intends to accelerate the pace of the reform starting with the 2006 budget.** It will be based on a Public Sector Reform Law, which will be adopted by the Council of Ministers in July, following the adoption of organic laws for the various ministries. A steering committee, chaired by the Prime Minister and including representatives of the labor unions, employers organizations, and civil society, has also been recently established. Several donors, including the EU, the UNDP and Portugal, have announced support for the program, and additional support will be sought at the time of the Round Table conference. The reform will be implemented in two stages. The first stage started in June 2006 with the retirement of more than 1,000 employees, of which 391 had already passed the mandatory retirement age in 2005. In addition, a freeze on new hiring and promotions will take effect. These wage bill reduction efforts, will be complemented during the rest of the year by identifying civil servants and military personnel who need to be laid off during 2006. In the second stage of the reform, a program of re-insertion in the private sector will be launched, with assistance from donors. A number of initiatives will be enacted to facilitate private sector absorption of these workers.

Military and security reform

31. **The government believes that the reforms of the security sector are a necessary condition for securing lasting peace and moving ahead with its development agenda.** It also recognizes the positive impact of such reforms on the public finances. The size of the military increased sharply as a result of the war; about 4,000 military were retrenched under the post-conflict demobilization program (PDRRI), but the number of military is still high, nearly 5,000 by some estimates. Despite efforts to harmonize the wage scales with the civilian administration, the wage bill for the military has remained excessive.

32. **Following a mission by the U.K. security sector development advisory team in October 2005, the government issued on February 7, 2006 a decree creating an inter-ministerial committee on security sector reform.** Subsequently, a steering committee, chaired by the Minister of Defense was set up to orient the work of a technical team and approve its proposals before submitting them to the cabinet. Meanwhile, the government intends to conduct in July 2006 a census of the military—in preparation for a military reform program—and identify the contractual workers, who will be incorporated into the civil service or laid off. A census of the paramilitary for the entire country has been completed.

Other structural reforms and private sector development initiatives

33. **Improving the outlook for economic growth requires repairing the damage from the conflict at the outset.** The EU is financing the rehabilitation of roads, while the World Bank is preparing assistance to rehabilitate the electricity company and other infrastructure. The government will submit an electricity bill to parliament in July 2006, which aims at reforming the institutional framework of the sector, opening financial bids for a long-term leasing contract of the power and utility (EAGB), and creating an independent regulatory agency. The government intends to seek donor assistance with the rehabilitation of the commercial and fishing ports of Bissau and cold-storage facilities, as well as with repairing and re-equipping the many schools that were destroyed during the conflict.

34. **The rehabilitation efforts will be supported by policies to improve the investment climate.** An action plan for simplifying procedures for trade and investment, is being implemented under the World Bank-financed project for the rehabilitation and development of the private sector (PRDSP). Recent initiatives aimed at removing obstacles to private investment include (i) a review of the Investment Code; (ii) adhesion to MIGA and other FDI-guarantees agencies such as FAGACE; (iii) the introduction of a single stop for potential investors; (iv) the preparation of a draft law on build-operate-transfer (BOT) procedures for projects requiring public/private partnerships; (v) creation of export processing zones; (vi) elimination of administrative barriers; (vii) elimination of most license (fee) requirements for the industrial and commercial sector, including for imports and exports; (viii) identification and elimination of remaining constraints for private sector involvement in strategic sectors such as cashew nut production and processing, the fishing sector, and rice and fruit and vegetable production. Labor laws will be brought in line with the provisions of the Organization for the Harmonization of Trade Legislation in Africa (OHADA).

35. **The government has also initiated a privatization program aimed at reducing state participation in commercial and production activities.** Starting with the 2006 budget, some 14 companies with a total market value of CFAF 2.6 billion, including two hotels, will be brought to the point of sales. Privatization will be carried out in a transparent manner, using public bidding procedures.

Governance and transparency

36. **Promoting good governance will remain a cornerstone of government policies.** The UN system has taken the lead in providing assistance in promoting political stability, supported by ECOWAS, the CPLP, and other international partners. Key immediate issues are military reform and political institution and capacity building, but also improving good

governance and transparency, the lack of which was a major factor behind the civil war. To enhance fiscal accountability, the government will continue to: (i) apply rules and regulations in government operations; (ii) strengthen the political and democratic institutions, including at a local level; (iii) apply measures to increase the efficiency and effectiveness of government administration; and, (iv) strengthen with donor assistance, the judiciary system; and (v) reinforce the means and independence of the audits court to allow it to perform its control of budget execution.

37. **To improve transparency in public finances, the Ministry of Finance will continue publishing monthly a summary table on fiscal developments, which started in July 2005.** More generally, the National Committee for Social Cooperation—which is chaired by the Prime Minister and includes trade unions and employer organizations—will be reactivated and meet regularly to discuss economic developments and reform policies.

38. **The promotion of regional integration is one of the central elements of the government's economic policy.** The government remains committed to the implementation of policies required to meet the objectives under the WAEMU's Convergence, Growth and Solidarity Pact. Given its prolonged economic crisis, Guinea-Bissau was unable to respect any of the eight convergence criteria set by WAEMU at end-2005. Little progress has also been achieved with respect to the other regional initiatives. While the common external tariff was adopted in 2000, the country continue to avail itself of the safeguard measures allowed under the CET. The five directives on the public finances, and the directive on the harmonization of indirect taxes have still not been applied. However, the government intends to request technical assistance in tax administration, with a view to introducing a single-rate value-added tax in 2007.

Financial sector issues

39. **The government will also continue efforts to strengthen the financial system, whose landscape has been shaped by the establishment of a new commercial bank (Banco da União, BDU) and a policy bank (the regional solidarity bank, BRS), since February 2006 and December 2005, respectively.** It is expected that two commercial banks from the WAEMU region will take advantage of the single licensing law and open branches in Bissau by end-2006. The BRS will focus on the financing of microprojects. The Ministry of Finance will support and supervise the development of microfinance, and prudential supervision of the banks will be provided through the BCEAO and the WAEMU's Banking Commission. The banking system remains reasonably sound, although credit concentration poses a vulnerability risk for the sector.

40. **Guinea-Bissau made recourse to the regional market for short-term government paper for the first time in October 2005.** The treasury collected

CFAF 6 billion (about 4 percent of GDP) by issuing a six-month treasury bill that was mostly subscribed by banks outside Bissau at a rate of 5.5 percent. These bills have been repaid only partially, due to delays in the ECOWAS disbursement. Over the medium term, the government intends to issue treasury bills for liquidity purposes and also to support financial market development in the region.

External debt issues

41. **The budget is burdened by high internal and external debt service obligations.** The main element in domestic debt concerns the commitment, following Guinea-Bissau's accession to the WAEMU, to contribute to the capital of the BCEAO and the Monetary Agency of West Africa, and the West African Development Bank (BOAD); this debt amounts to CFAF 70 billion (40 percent of GDP), to be paid over 25 years, starting June 2005. However, at about 10 percent of projected annual revenue for the coming years, these payments would seriously undermine the ability to improve the fiscal situation. Therefore, the government intends to seek assistance from its partners to clear the payment arrears of 2005 and reduce payments for 2006 (still pending) and 2007; a longer-term solution will be sought at the time of the Round Table conference.

42. **The external debt problem can only be resolved in the context of the HIPC Initiative.** Without debt relief, annual debt service payments amount to more than half of annual revenue. The government intends to continue to cooperate closely with the IMF in order to allow returning to a program that can be supported under the PRGF in the future, which would also allow debt relief under the HIPC Initiative to resume. In the interim, it will undertake every effort to remain current on debt service, especially to multilaterals and those creditors that can provide new assistance. In this context, efforts are ongoing to set up with interested donors a multilateral debt-service fund that will help the country honor its obligations vis-à-vis its multilateral creditors in the perspective of the MDRI for which Guinea-Bissau is eligible. Moreover, the government will engage in an early and collaborative dialogue with the other creditors so as to achieve a viable solution to the external debt problem until this can be addressed under the HIPC Initiative. Any new external debt will be on strictly concessional terms, with a grant element of at least 50 percent. The external debt database is in the process of being rebuilt and debt management strengthened, with technical assistance from Debt Relief International.

V. Social Policies and the PRSP Process

43. **The government is firmly committed to the Millennium Development Goals (MDGs), which are clearly reflected in its Poverty Reduction Strategy Paper (PRSP).** To that end, the growth and development objectives underlying its economic and financial program for 2006 were based on the guidelines specified in the PRSP. The government's

PRSP for 2006–09 indicates a core objective of reducing poverty from its current level of two-thirds to a substantially low level by 2015, and at the same time makes progress toward reaching MDGs in education, literacy, health, water, sanitation, and housing. The strategy has four pillars: (i) strengthening governance, modernizing the public administration and enhancing macroeconomic stability; (ii) promoting economic growth and job creation; (iii) improving the access to basic social services; and (iv) improving living conditions for vulnerable groups. The document is expected to be finalized and submitted to the respective Executive Boards of the World Bank and the International Monetary Fund in the second half of 2006. The government intends to seek donor assistance in implementing these policies at a Round Table conference, which is tentatively planned for November 2006.

44. **In line with the government's poverty strategy, social policies aim at increasing access to primary health care and basic education, implementing specific poverty alleviation measures and improving the opportunities for employment.** One in five children does not reach the age of five. Moreover, HIV/AIDS is a major threat to the future of Guinea-Bissau, where knowledge of this disease and its prevention is minimal. Further, about 70 percent of the population cannot read or write. In the health sector, efforts aim at improving primary health care, and especially at the fight against malaria. The government is also planning to increase HIV/Aids awareness, to improve the training of health-care workers, regulate pharmaceutical activities, and update the diagnosis and treatment database. In education, the main priorities are the rehabilitation of classrooms and teacher training. The government has received support in these areas from the World Bank and other donors.

VI. Capacity Building and Technical Assistance

45. **The country's institutions and technical capacity need to be largely rebuilt.** The civil war and its aftermath resulted in a severe weakening of the institutions required for a democracy and a market-based economy, many of which were still being built up before the war. Moreover, many educated and experienced cadre left the civil service and the country. Strengthening is urgently needed to promote political stability, and to provide adequate government services, for which considerable technical assistance will be needed. As a first step, the government has requested donor assistance for the preparation of a comprehensive country technical assistance plan to identify priority areas.

46. **Recent missions from the World Bank and the IMF—including by its regional technical assistance center West AFRITAC—identified technical assistance needs in all areas of fiscal management as well as in macroeconomic statistics (Table 5); the highest priority is assistance to the Budget and Customs Departments.** Short-term missions are reaching the limits of absorption capacity, and the government's especially

seeking donor support for assigning long-term resident experts. Such experts will be assigned qualified counterparts, who will be allowed to stay in their function for a sufficient period to allow technical expertise to be transferred. In this vein, the one-year assignment of a resident advisor on revenue administration by the IMF (with donor funding), to start work in Bissau in April 2006, is expected to contribute significantly to the strengthening of the Ministry of Finance.

47. **It will be important to ensure adequate coordination of the extensive assistance needs, which may require involvement of multiple donors.** A first step in this direction has been the preparation of the Action Plan in 2005, which should become the common framework for donor assistance. Moreover, while the Ministry of Foreign Affairs will remain responsible for overall relations with donors, the Ministry of Economy will be in charge of coordinating technical cooperation with donors.

VII. Program Monitoring

48. **The monitoring of progress with implementing the program outlined above will be based on the quantitative and structural indicators provided in Tables 2 and 4.** The quantitative targets are (i) a ceiling on domestic financing of the budget; (ii) a floor on budgetary revenue; (iii) a ceiling on the wage bill; (iv) a ceiling on the domestic primary deficit; (v) a ceiling on new domestic arrears; and (vi) ceilings on public sector short- and long-term nonconcessional external debt. The structural benchmarks relate to the strengthening of tax administration and collection, and improving transparency in public finance developments. The government will provide all necessary data to monitor the program as indicated in the technical memorandum of understanding. To ensure the success of the program, the government has taken the following prior actions:
(a) submission of the 2006 government budget to parliament; and (b) adoption by the cabinet of organic laws in the context of the civil service reform.

Table 1. Guinea-Bissau: Treasury Cash-Flow Plan 2006[1]

(Millions of CFA francs)

	Jan. Actual	Feb. Actual	Mar. Actual	Apr. Actual	May Actual	Jun. Proj.	Jul. Proj.	Aug. Proj.	Sep. Proj.	Oct. Proj.	Nov. Proj.	Dec. Proj.	Total Proj.	Percent of GDP
Inflows	**1,357**	**3,032**	**4,848**	**1,733**	**7,188**	**7,042**	**4,912**	**10,011**	**4,714**	**3,046**	**1,632**	**14,289**	**63,806**	**37.0**
Revenue and grants	1,105	869	4,800	1,733	6,888	4,292	4,462	3,170	2,681	2,410	1,632	6,719	40,761	23.7
Revenue	1,105	869	2,500	1,733	3,280	4,292	4,462	3,170	2,681	2,410	1,632	6,719	34,853	20.2
Taxes	851	790	1,820	1,394	1,724	2,670	3,600	1,897	1,829	1,400	1,071	1,467	20,513	11.9
Nontax revenue	254	79	680	339	1,556	1,623	862	1,273	852	1,009	561	5,252	14,339	8.3
Budget support			2,300		3,608	0	0	0	0	0	0	0	5,908	3.4
Bank financing	252	2,164	48	0	0	0	0	0	0	0	0	0	2,464	1.4
BCEAO (treasury account) (use of deposits = +)	252	164	48			0	0	0	0	0	0	0	464	0.3
Commercial bank (BAO)		2,000		0	0								2,000	1.2
Other financing	0	0	0	0	300	0	0	6,251	0	0	0	0	6,551	3.8
Treasury bills								6,000					6,000	3.5
Privatization	0	0	0	0	300	0	0	251	0	0	0	0	551	0.3
Identified budget support	0	0	0	0	0	2,750	450	589	2,034	637	0	7,571	14,030	8.1
Outflows	**4,218**	**4,106**	**4,220**	**3,254**	**7,446**	**6,384**	**4,522**	**3,780**	**3,797**	**4,459**	**3,774**	**14,042**	**64,001**	**37.1**
Current primary expenditure	2,862	3,550	2,897	2,118	2,656	3,292	3,292	3,292	3,292	3,292	3,292	3,265	37,097	21.5
Wages and salaries	1,838	1,940	1,688	1,528	1,527	1,527	1,527	1,527	1,527	1,527	1,527	1,500	19,182	11.1
Fixed remunerations	1,613	1,656	1,465	1,366	1,334	1,334	1,334	1,334	1,334	1,334	1,334	1,307	16,743	9.7
Variable and eventual remuneration	70	88	71	36	39	39	39	39	39	39	39	39	578	0.3
Embassy, personnel expenses	2	18	50	5	36	36	36	36	36	36	36	36	361	0.2
Food	153	178	102	121	118	118	118	118	118	118	118	118	1,500	0.9
Goods and services	494	547	584	118	484	484	484	484	484	484	484	484	5,613	3.3
Of which: embassies' goods and services	1	18	45	2	35	35	35	35	35	35	35	35	346	0.2
Transfers	470	832	548	429	630	921	921	921	921	921	921	921	9,352	5.4
Social security (include pensions)	275	376	389	369	315	315	315	315	315	315	315	315	3,932	2.3
Others	195	456	158	60	314	605	605	605	605	605	605	605	5,420	3.1
Other current expenditure	60	231	77	43	16	360	360	360	360	360	360	360	2,950	1.7
Memo: nonclassified expenditures		*399*												
Capital expenditure	241	324	114	74	400	400	400	400	400	400	400	541	4,097	2.4
Public investment (domestically financed)	241	324	114	74	400	400	400	400	400	400	400	541	4,097	2.4
Public investment program	40	8	49	0	270	270	270	270	270	270	270	270	2,255	1.3
Capital goods	201	316	65	74	131	131	131	131	131	131	131	272	1,842	1.1
Payment of domestic arrears and complimentary period	910	144	272	356	0	0	0	0	0	0	0	-1,182	500	0.3
Complimentary period	910		272									-1,182	0	0.0
Current year													0	0.0
Previous to 2005		144		356									500	0.3
Bank financing	162	0	913	591	707	82	787	0	81	652	0	1,309	5,283	3.1
BCEAO	162	0	152	59	0	82	787	0	81	652	0	1,161	3,135	1.8
Debt to BCEAO	0	0	0	59	0	0	163	0	0	96	0	120	438	0.3
BCEAO—other (includes arrears— IMF account)	162	0	0	0	0	0	624	0	0	556	0	1,029	2,370	1.4
Interest on domestic debt	0	0	152	0	0	82	0	0	81	0	0	13	327	0.2
Commercial bank (BAO)			761	532	707	0	0	0	0	0	0	148	2,148	1.2
Non-classified expenditures	0	0	0	0	3,600	2,400	0	0	0	0	0	9,900	15,900	9.2
Treasury bills					3,600	2,400						6,000	12,000	7.0
Regional commercial banks												3,900	3,900	2.3
Debt service to multilaterals	43	88	24	115	83	210	43	87	24	115	82	210	1,124	0.7
Float	**-2,861**	**-1,073**	**628**	**-1,521**	**-258**	**659**	**390**	**6,231**	**917**	**-1,413**	**-2,143**	**247**	**-195**	**-0.1**
Memo item: accounts payable (end- of period)	-2,861	-3,934	-3,306	-4,826	-5,084	-4,425	-4,035	2,196	3,113	1,700	-442	-195		
Of which Arrears							3,000	0	0	0	0	0		
Of which: wage arrears							3,000	0	0	0	0	0		
Of which: non-wage arrears						0	0	0	0	0	0	0		

[1]Based on 2006 revised draft budget.

Table 2. Guinea-Bissau–Quantitative Indicators under Staff Monitored Program of 2005–06

(Billions1 CFA francs)

	2005						2006		
	End-Jun.		End-Sept.		End-Dec.		End-Jul.	End-Oct.	End-Dec.
	Actual	Prog	Actual	Prog	Actual	Prog	Prog	Prog	Prog
Domestic financing of the budget[2]	2.3	2.1	-5.5	-2.2	-5.6	-3.7	-6.2	-0.6	-11.8
Domestic primary budget balance (commitment basis)[3]	-4.5	-5.6	-0.4	-9.1	-11.0	-12.9	-4.4	-7.2	-6.3
Revenue[4]	3.6	14.0	18.8	20.6	28.0	26.8	18.0	27.0	34.9
Wage bill[5 6]	5.0	10.2	10.0	15.0	22.4	20.5	11.6	16.2	19.2
Accumulation of domestic arrears[5]	1.8	0.0	4.7	0.0	4.2	0.0	3.0	0.0	0.0
External public debt, maturities <=1 year[5]	0	0	0	0	0	0	0	0	0
External non-concessional public debt, maturities > 1 year[5]	0	0	0	0	0	0	0	0	0

[1]Cumulative from January 1 of the corresponding year. The definition of the aggregates for 2006 is provided in the technical memorandum of understanding (TMU). For definition of the aggregates for 2005 quantitative targets, refer to the TMU of the 2005 staff-monitored program.

[2]Ceiling. If the actual amount of external budgetary assistance falls short of program forecasts, the ceiling will be increased for the full amount of the shortfall. The programmed amounts of external assistance in 2006 are (on a cumulative basis) CFAF 9.1 billion, by end-July, CFAF 12.4 billion by end-October, and CFAF 19.9 billion by end-December. Definition applied in 2005 includes payment of previous years domestic arrears and therefore differs from definition applied in 2006 as stated in TMU.

[3]Floor. If the actual amount of external budgetary assistance surpasses program forecasts, the floor will be decreased by the full amount of the difference between actual and programmed external budgetary assistance. The programmed amounts of external assistance in 2006 are (on a cumulative basis) CFAF 9.1 billion by end-July, CFAF 12.4 billion by end-October, and CFAF 19.9 billion by end-December.

[4]Floor. This floor on revenue will be fully adjusted for advances or delays in the European Union's compensation for fishing rights compared to the assumptions underlying the program. The program assumes payments of CFAF 4.8 billion in December 2006.

[5]Ceiling.

[6]Definition applied in 2005 includes transfers to the National Assembly and excludes transfers to embassies; therefore, it differs from definition in 2006 as stated in TMU.

Table 3. Guinea Bissau: Structural Indicators Under the Staff-Monitored Program for April—December 2005

Structural indicators	**Target date**	**Status as of March 28, 2005**
Establishment of a Large-Taxpayers Unit within the Ministry of Finance.	End-June 2005	Done
Implement banderole system for alcoholic beverages and cigarettes.	End-June 2005	Partially done
Transfer the collection of customs duties and taxes to the Office of Customs in the port of Bissau.	End-June 2005	Done
Complete discussions will all ministries and other budgetary units on the budget for 2006.	End-September 2005	Done
Approval by the Council of Ministers of the Organic Law of the Ministry of Economy and Finance.	End-September 2005	Not done (organic laws for Ministry of Finance and Ministry of Economy have been elaborated and await approval by Council of Ministers)
Rehabilitation of the taxpayer master file.	End-December 2005	Done
Implementation of the new organizational chart of the Customs Department.	End-December 2005	Not done (lack of technical assistance)
Implementation of censuses of the military and paramilitary.	End-December 2005	Partially done: paramilitary census completed in Bissau
Reconciliation of changes in the treasury accounts at the BCEAO with expenditure authorized by the Treasury Committee, and immediate liquidation of such expenditure.	Continuous	Done
Collect full amount of taxes due on (i) imports of petroleum products through the port in Bissau; (ii) rice imports; and (iii) cashew nut exports.	Continuous	Done

Table 4. Guinea Bissau: Structural Benchmarks Under the
Staff-Monitored Program,
April 1, 2006–December 31, 2006

Preconditions	**Target date**	**Status as of June 1, 2006**
Approval of organic laws of ministries by the Council of Ministers.	Mid-May 2006	Done
Submission to parliament of the government budget fully consistent with the fiscal program presented in this MEFP.	Mid-May 2006	Done
Structural indicators		
Launch of a test-based recruitment program of high level civil servants.	End-July 2006	
Eliminate discretionary customs duty exemptions (i.e., those not set under international conventions).	End-July 2006	
Implement an excise stamp or banderole for alcoholic beverages and cigarettes.	End-July 2006	
Implementation of military census.	End-July 2006	
Identify civil servants and military personnel to be laid off during 2006.	End-July 2006	
Enact the new electricity bill for the energy sector.	End-September 2006	
Introduce an automatic adjustment mechanism for petroleum product prices.	End-December 2006	
Bring three state-owned companies in the production and commercial sectors to the point of sales.	End-December 2006	

Table 5. Technical Assistance Needs of the Ministry of Finance

Department	Area	Long term	Short term	(Possible) provider
Cabinet Minister	Macrofiscal advisor	X[1]		(IMF)
Budget	Expert expenditure management	X		(EU)
	Expert expenditure management	X		(EU)
	Accounting system	X		(France)
	Computerization expenditure accounts	X[2]		France/EU
	Public financial management		X	IMF/FAD
Treasury	Advisor to the Treasurer	X		BCEAO
	Advisor		X	
Tax Department	Expert on tax code		X (3–6 months)	(Portugal)
	Computerization of revenue accounting	X		
	Advisor Directorate of Large Enterprises		X (6 months)	(West AFRITAC)
Customs	Advisor for revising customs statute	X		
	Customs advisor	X		
	Advisor implementing ASYCUDA ++			AfDB
External debt	Debt management		X[3]	DRI
Microfinance	Advisor		X	(West-AFRITAC)
Conjuncture	Advisor, fiscal analysis	X		
Planning	National accounts advisor	X		
	Implementation System of National Accounts 1993		X	IMF/AFRISTAT

[1] TA requested and under consideration.
[2] TA in place.
[3] First mission conducted in January 2005.

TECHNICAL MEMORANDUM OF UNDERSTANDING FOR THE STAFF-MONITORED PROGRAM FOR 2006

Bissau, July 3, 2006

49. This memorandum describes the definitions of the quantitative indicators for the staff-monitored program (SMP) for 2006 (Table 2) of the Memorandum on Economic and Financial Policies (MEFP) in accordance with the understandings reached between the authorities of Guinea-Bissau and the staff of the IMF. It also specifies the agreed periodicity and deadlines for transmission of data to the staff of the IMF for program monitoring purposes.

VIII. QUANTITATIVE INDICATORS AND ADJUSTORS

A. Quantitative Indicators

50. The quantitative indicators (Table 2 of the MEFP) are the following:

a. cumulative floors on government revenue;

b. cumulative ceilings on the government wage bill;

c. cumulative floors on the domestic primary fiscal balance (on a commitment basis);

d. cumulative ceilings on new domestic payments arrears of the government, including wage arrears.

e. cumulative ceilings on the change in net domestic financing of the budget; and

f. cumulative ceilings on new nonconcessional external debt contracted or guaranteed by the government.

Quantitative indicators have been set for end-July, end-October, and end-December 2006, and their values are cumulative from January 1, 2006. Indicative targets for new nonconcessional external debt are continuous.

Definitions and computation

51. **For the purposes of the SMP, the government is defined as the central government of Guinea-Bissau.** This definition excludes public entities with autonomous legal personality whose own budget is not included in the central government budget.

52. **For the SMP, government revenue includes all tax and nontax receipts and excludes external grants.** The cash-flow estimates are based on the revenue estimates in the approved budget for 2006, which are adjusted for revenue items that are offset by corresponding expenditure or financing items. In particular, an adjustment is made for the revenue from the European Union that is earmarked for the fishing project (CFAF 656 million, offset in domestically financed capital expenditure).

53. **The SMP uses a broad definition for the targeted ceiling on the government wage bill.** The wage bill as understood under the program target includes (i) all staff (permanent and temporary) of the civil service and the military and paramilitary, and encompasses the budget categories 01.01.00 (gross wages) and 01.02.00 (bonuses and subsidies); (ii) payments for food (budget category 02.02.04); and (iii) transfers to embassies for expenditures on personnel (budget category 03.07.01.1). The quarterly targets are given in Table 1 below.

Table 1. Targets for the Broadly Defined Wage Bill, 2006
(Cumulative, in millions of CFA francs)

	Jul.	Oct.	Dec.
Wages (01.01.00)	10,101	14,102	16,743
Bonuses and subsidies (01.02.00)	383	500	578
Food (02.02.04)	908	1,263	1,500
Emabassies: expenditure on personnel (03.07.01.1)	182	289	361
Total wage bill under the SMP target	11,574	16,155	19,182

Source: Budget 2006.

54. **The domestic primary fiscal balance on a commitment basis is based on the cash-flow estimates provided in Table 1 of the MEFP.** It is calculated as the difference between the revenue defined in para. 4 of this TMU and domestic primary expenditure on a commitment basis. The latter consists of current expenditure plus domestically-financed capital expenditure (corrected for the EU-financed expenditure for the fishing project),

excluding all interest payments, externally financed capital expenditure, and the capital contribution to WAEMU financial institutions. Government commitments include all expenditure for which commitment vouchers have been approved by the Ministry of Finance; automatic expenditure (such as wages and salaries, pensions, utilities, and other expenditure for which payment is centralized); and expenditure by means of offsetting operations. The estimated July, October, and December domestic primary balances for 2006 are provided in Table 2 below.

Table 2. Estimates of the Domestic Primary Balance, 2006
(Cumulative, in millions of CFA francs)

	Jul.	Oct.	Dec.
Revenue	18,241	26,502	34,853
Current expenditure excluding interest	20,665	30,540	37,097
Domestically financed capital expenditure	1,954	3,155	4,097
Balance	-4,378	-7,194	-6,341

Source: Table 1, MEFP.

55. **New domestic payments arrears of the government are defined as any of the following:** i) Any bill that has been received by the spending ministry from a supplier of goods and services, delivered and verified and for which, payment has not been made within 90 days after the due date of payment, unless otherwise stipulated in the contract between the suppliers and the government; ii) wages and salaries and any payment to a government employee that were due to be paid in a given month but remained unpaid on the thirtieth day of the following month.

56. **Net domestic financing of the budget is defined based on the cash-flow estimates in Table 1 of the MEFP.** Bank financing consists of the net changes in the balances in the treasury accounts at the BCEAO and at the commercial bank(s)—excluding balances in those accounts that are not freely available for budget financing, such as accounts that are held under double signature arrangements with donors—as well as in the outstanding amounts of loans from the BCEAO and the commercial bank(s). Domestic nonbank financing encompasses changes in debt owed to projects, changes in the stock of treasury bills placed in the domestic (regional) market, loans from foreign commercial banks within the WAEMU region, and privatization receipts, as well as any other domestic financial debt held outside the banking sector, other than arrears, that may arise. Table 3 below provides the details.

Table 3. Estimates of Domestic Financing, 2006
(In millions of CFA francs)

	Jul.	Oct.	Dec.
	(Cumulative change)		
Domestic financing	-6,243	-644	-11,841
Bank financing	-543	-1,195	-2,492
BCEAO	-543	-1,195	-2,344
Treasury accounts	464	464	464
Statutory advance	-119	-180	-300
Consolidated debt ex-BCN and ex-BCGB	-103	-138	-138
IMF	-786	-1,342	-2,370
Commercial bank(s)	0	0	-148
Other financing	-5,700	551	-9,349
Privatization receipts	300	551	551
Treasury bills placed in regional market	-6,000	0	-6,000
Financing from foreign banks in WAEMU region	0	0	-3,900

Source: Table 1, MEFP.

57. **The indicators for external debt are cumulative ceilings on new nonconcessional external debt contracted or guaranteed by the government.** For the purposes of the SMP, the definitions of "debt" and "concessional borrowing" are as follows:

a. The indicator for external debt applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted by the Executive Board of the IMF on August 24, 2000 but also to commitments contracted or guaranteed for which value has not been received. For purposes of these guidelines, the term "debt" is understood to mean a current, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided that the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair, or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt. For the purposes of monitoring the SMP, arrangements to pay over time obligations arising form judicial awards to external creditors do not constitute nonconcessional external borrowing.

b. Loan concessionality is assessed on the basis of the commercial interest reference rates (CIRRs) established by the OECD. A loan is said to be on concessional terms if, on the initial date of contraction of the loan, the ratio of the present value of the loan, calculated on the basis of the reference interest rates, to its nominal value is less than 50 percent (that is, a grant element of at least 50 percent). For debts with a maturity exceeding 15 years, the ten-year reference interest rate published by the OECD is used to calculate the grant element. For shorter maturities, the six-month market reference rate is used. Purchases from the IMF are excluded from this limit.

58. **The concept of government for the purposes of the indicators on external debt is broader than the one used for the budget aggregates, including all debt that may ultimately be deemed to be a liability of the state.** In addition to the government as defined in para. 3, the definition includes administrative public institutions, public enterprises authorized to contract, guarantee, or accommodate nonconcessional borrowing, scientific and technical public institutions, professional public institutions, industrial and/or commercial public institutions and local governments.

B. Adjusters

59. The following adjusters will be in effect:

- **The floors on revenue will be fully adjusted for advances or delays in the EU's compensation for fishing rights** compared to the assumptions underlying the program. The program assumes payments of CFAF 4.8 billion in December 2006.

- **The floors on the domestic primary fiscal balance (on a commitment basis) will be adjusted in line with the external budget support.** In particular, the floor on the domestic primary balance will be lowered in case of higher budget support than programmed, for the full amount of the excess. The program assumes external budget support of (cumulative from January 1, 2006) CFAF 9.1 billion by end-July 2006, CFAF 12.4 billion by end-October 2006 and CFAF 19.9 billion by end-December 2006.
- **The ceiling on domestic financing will be adjusted in line with the adjustment of external budget support.** In particular, the ceiling will be increased in the case of shortfall in external budget support, by the full amount of the shortfall. The program assumes external budget support of (cumulative from January 1, 2006) CFAF 9.1 billions by end-July 2006, CFAF 12.4 billion by end-October 2006, and CFAF 19.9 billion by end-December 2006.

IX. Program Monitoring

60. **To allow monitoring of developments under the program, the Ministry of Finance will regularly report the following information to the staff of the IMF**:

- The monetary survey, the balance sheet of the central bank, and the balance sheet of the commercial banks, (monthly, within six weeks following the end of the month);

- The net claims on the government held by the banking system, including details on the balances in the treasury accounts freely available for budget financing (the treasury account, the solidarity account, and the special account) (monthly, within ten days of the end of the month);

- The monthly report of the Treasury Committee, including tables on revenue by tax and expenditure by budget line, and a table, reconciling the revenue and expenditure data with the changes in the treasury accounts at the BCEAO (monthly, within ten days after the end of the month);

- The detailed reports on revenue and expenditure by budget line and a completed summary table on central government operations (TOFE) monthly, two weeks after the end of the month;

- A monthly table providing the end-of-period stock of unpaid bills by the treasury (RAP), sorted out by budget category (wages, goods and services, etc.); and payment delays (i.e., period in which payment orders were made);

- The amount and terms of new external debt (concessional or not) contracted or guaranteed by the government (within four weeks after the end of the month);

- A monthly table on the disbursements of budget support (grants and loans), by donors (two weeks after the end of the month);

- Indicators to assess overall economic trends, such as the household consumer price index and exports of cashew nuts (when such information becomes available);

- A table with a description of the status of implementation of the structural indicators in Table 4 of the MEFP (within two weeks after the end of the month); and

- Information on any type of financial assistance received and not programmed. This should be reported on a continuous basis.

61. **The Ministry of Finance will provide the staff of the IMF with any other information that the Ministry or the staff of the IMF deem necessary for program-monitoring purposes.**

62. **The above data will be provided to the Assistant-Economist at the local office of the IMF in Bissau (Mr. Fonseca) for further transfer to the African Department of the IMF in Washington, D.C.**

Guinea-Bissau: Financial Position in the Fund
As of April 30, 2006

I. Membership Status: Joined: March 24, 1977; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	14.20	100.00
Fund holdings of currency	14.20	100.00
Reserve Position	0.00	0.00
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	1.21	100.00
Holdings	0.39	32.36

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
PRGF Arrangements	7.36	51.86

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	Dec 15, 2000	Dec 14, 2003	14.20	5.08
PRGF	Jan 18, 1995	Jul 24, 1998	10.50	10.50
SAF	Oct 14, 1987	Oct 13, 1990	5.25	3.75

VI. Projected Payments to Fund
(SDR Million; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	2006	2007	2008	2009	2010
Principal	1.91	2.17	1.25	1.02	1.02
Charges/Interest	0.06	0.05	0.04	0.04	0.03
Total	1.96	2.22	1.30	1.05	1.05

VII. Implementation of HIPC Initiative:

	Enhanced Framework
I. Commitment of HIPC assistance	
Decision point date	Dec 2000
Assistance committed	
by all creditors (US$ million) [1/]	416.00
Of which: IMF assistance (US$ million)	11.91
(SDR equivalent in millions)	9.20
Completion point date	Floating

II. Disbursement of IMF assistance (SDR million)	
Assistance disbursed to the member	0.54
Interim assistance	0.54
Completion point balance	--
Additional disbursement of interest income[2/]	--
Total disbursements	0.54

[1/] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point; assistance under the enhanced framework is expressed in NPV terms at the decision point. Hence the two amounts can not be added.

[2/] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim.

VIII. Implementation of MDRI Assistance: Not Applicable

Decision point - point at which the IMF and the World Bank determine whether a country qualifies for assistance under the HIPC Initiative and decide on the amount of assistance to be committed.

Interim assistance - amount disbursed to a country during the period between decision and completion points, up to 20 percent annually and 60 percent in total of the assistance committed at the decision point (or 25 percent and 75 percent, respectively, in exceptional circumstances).

Completion point - point at which a country receives the remaining balance of its assistance committed at the decision point, together with an additional disbursement of interest income as defined in footnote 2 above. The timing of the completion point is linked to the implementation of pre-agreed key structural reforms (i.e., floating completion point).

Prepared by Finance Department

IX. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the BCEAO is subject to a full safeguards assessment. A new safeguards assessment of the BCEAO was completed on November 4, 2005. The assessment found that progress has been made in strengthening the BCEAO's safeguards framework of the bank since 2002 when the last safeguards assessment took place.

The BCEAO now publishes a full set of audited financial statements and improvements have been made to move financial reporting closer to International Financial Reporting Standards (IFRS). Furthermore, an internal audit charter has been put in place and mechanisms have been established to improve risk management and risk prevention and follow-up on internal and external audit recommendations has been strengthened.

The new assessment identified a number of areas where further steps would help solidify the progress made. The main recommendations relate to improvements in the external audit process (including the adoption of a formal rotation policy), further enhancement of the transparency of the financial statements by fully adopting IFRS, and further strengthening of the effectiveness of the internal audit function.

X. Exchange System and Exchange Rate Arrangement

Guinea-Bissau accepted the obligations of Article VIII, Sections 2, 3, and 4 with effect from January 1, 1997. It joined the West African Economic and Monetary Union (WAEMU) in 1997, and the exchange system common to all members of the union is free from multiple currency practices and exchange restrictions on the making of payments and transfers for current international transactions. Since January 1, 1999, the CFA franc has been pegged to the euro at a fixed rate of € l=CFAF 655.95. On May 31, 2005, the rate of the CFA franc in terms of the SDR was CFAF 784.61=SDR 1.

XI. Article IV Consultation

Guinea-Bissau is on the standard 12-month consultation cycle. The last Article IV consultation discussions with Guinea-Bissau were held in Bissau June 19–July 2, 2004. The staff report (IMF Country Report No. 05/69) was discussed by the Executive Board on November 19, 2004. A selected issues paper and a statistical annex (IMF Country Report No. 05/94) were also circulated to the Board.

XII. Technical Assistance

Department	**Type of Assistance**	**Time of Delivery**	**Purpose**
MAE	Expert	March 20–July 23, 1994	Assisting in banking supervision
MAE	Expert	June 6, 1994–January 26, 1997	Assisting in monetary policy
MAE	Expert	June–December 1995	Advising on bank accounting
STA	Staff	March 4–15, 1996	Assessing the quality of monetary, balance of payments, and government statistics
FAD	Staff	September 8–24, 1996	Advising on tax administration and tax policy
FAD	Staff	March 9–25, 1997	Advising on import tariff reform and the design of a general sales tax (GST)
MAE	Expert	June–September 1997 (three short-term missions)	Assisting in the transformation of the central bank into a branch of the Central Bank of West African States (BCEAO)
FAD	Expert	September 8–24, 1997	Assisting in the design and implementation of GST and in strengthening fiscal control

FAD	Expert	October 19, 1997–April 10, 1998	Assisting in GST implementation
FAD	Expert	June 3–15, 1998	Assisting in GST implementation
FAD	Expert	January 1, 1999–March 2, 1999	Tax administration advisor
FAD	Expert	April 15, 1999–June 14, 1999	Tax administration advisor
FAD	Staff	July 13–27, 1999	Assessing budget management and the tax system
FAD	Expert	January 24, 2000-March 5, 2000	Tax administration advisor
FAD	Expert	January 2001	Tax administration advisor
FAD	Expert	February 2001	Peripatetic public expenditure management advisor
FAD	Expert	July 2001	Peripatetic public expenditure management advisor
FAD	Staff	April 2003	Expenditure management
FAD	Staff	April 2003	Revenue administration
STA	Expert	March 2003	GDDS—Real sector statistics
STA	Expert	May 2003	GDDS—Fiscal statistics
WEST AFRITAC	Resident Advisor	November 2003	Public expenditure management
WEST AFRITAC	Resident Advisor; Expert	February 2004	Tax administration
WEST AFRITAC	Resident Advisor; Expert	March 2004	Customs administration
WEST AFRITAC	Expert	May 2004	Tax administration
WEST AFRITAC	Resident Advisor	May 2004	Public debt management
WEST AFRITAC	Resident Advisor	June 2004	Budget preparation and execution
WEST AFRITAC	Resident Advisor	August 2004	Assessing the priority needs for technical assistance and assisting the authorities with the preparation of a work plan for improving compilation of balance of payments and international investment position statistics.
WEST AFRITAC	Resident Advisor; Short-Term Expert	August 2004	Government finance statistics
WEST AFRITAC	Short-Term Expert	September 2004	Government finance statistics
WEST AFRITAC	Short-Term Expert	October 2004	Customs administration
WEST AFRITAC	Resident Advisor	November 2004	Public expenditure management

WEST AFRITAC	Resident Advisor; Short-Term Expert	November 2004	Tax administration
WEST AFRITAC	Resident Advisor; Short-Term Expert	February 2005	Tax administration
WEST AFRITAC	Resident Advisor; Short-Term Expert	March 2005	Public expenditure management
WEST AFRITAC	Resident Advisor; Short-Term Expert	April 2005	Customs administration
WEST AFRITAC	Resident Advisor; Short-Term Expert	May 2005	Tax administration
WEST AFRITAC	Resident Advisor; Short-Term Expert	November 2005	Customs administration
WEST AFRITAC	Resident Advisor; Short-Term expert	November 2005	Tax administration
WEST AFRITAC	Resident Advisor; Short-Term Expert	November 2005	Public expenditure management/accounting
WEST AFRITAC	Resident Advisor; Short-Term Expert	January 2006	Tax administration
WEST AFRITAC	Short-Term Expert	March 2006	Public expenditure management/accounting
WEST AFRITAC	Resident Advisor; Short-Term Expert	January 2005	Government finance statistics
WEST AFRITAC	Resident Advisor	June 2005	Microfinance supervision
WEST AFRITAC	Resident Advisor	October 2005	Government finance statistics
WEST AFRITAC	Resident Advisor	March 2006	Real sector statistics

XII. Resident Representative

The post of resident representative was opened in September 1997 and is covered by the Resident Representative in Senegal, Mr. Ousmane Doré.

Guinea-Bissau: Relations with the World Bank Group

1. As of April 30, 2006, IDA had approved 29 credits for Guinea-Bissau. Eight credits had been in the transport and infrastructure sector, three in the energy sector, three for strengthening the country's management capability (Technical Assistance (TA)/Economic Management), two for financing urgently needed imports in support of the government's economic recovery program, one in the agricultural sector, three in the health sector, two in the education sector, one in the social sector, three for structural adjustment, one for economic rehabilitation and recovery, one for private sector rehabilitation and development, and one for natural resource management. The total value of these projects is about US$ 309.9 million equivalent, of which US$293.2 million has been disbursed. As of March 31, 2006, the undisbursed balance was US$25.8 million.

Structural adjustment credits

2. IDA has approved a total of US$63.4 million for structural adjustment operations. These include two structural adjustment credits (SACs), one supplementary SAC, and one economic rehabilitation and recovery credit (ERRC). The SACs supported the government's program in the areas of economic liberalization and reform of the public administration and public enterprise sectors, and the ERRC supports peace building following the political unrest, promotes the revival of the economy and encourages the pursuit of reforms. Parallel financing of the SACs came from Switzerland (US$5.3 million equivalent), the Saudi Fund for Development (US$3.2 million equivalent), the International Fund for Agricultural Development (US$5.3 million equivalent), the African Development Fund (US$ 23.3 million equivalent), the Netherlands (US$7.5 million equivalent), the U.S. Agency for International Development (USAID) (US$4.5 million), and Japan (US$2 million equivalent).

Lending program

3. For fiscal year (FY) 2005, IDA approved an HIV/AIDS project and a coastal and biodiversity management project. IDA also proposes to provide budgetary assistance of US$10 million and support a Multi-Sector Infrastructure Rehabilitation Project (MIRP) of US$20 million in FY2006. Moreover, the World Bank will to provide US$1.6 million grant under the Low Income Country Under Stress (LICUS) initiative, and continues to provide interim assistance to the country as part of the Initiative for the Heavily Indebted Poor Countries (HIPC). Finally, an interim strategy (ISN) is being prepared and is planned for approval in FY2007.

Nonlending program

4. The Bank prepared a Public Expenditure Review (PER) in 2003 and an Integrated Poverty and Social Assessment (IPSA) in 2005. A PER update and a Country Integrated Fiduciary Assessment (CIFA) are planned for FY2006.

International Finance Corporation (IFC)

5. The IFC's current portfolio consists of two investments: one in agribusiness (US$0.25 million), and one in the financial sector (US$0.28 million) to support a commercial bank (Banco da África). Both have been fully disbursed.

Guinea-Bissau: Statistical Issues

63. Despite the authorities' efforts to reestablish their statistical data capabilities, the quality of data has hampered effective surveillance. Data compilation was severely impaired during the 1998–99 civil war.

64. Guinea-Bissau is a participant in the General Data Dissemination System (GDDS). Its GDDS metadata have been posted on the Fund's Dissemination Standards Bulletin Board since November 2001. However, the metadata and plans for improvement need to be reviewed as they have not been updated since June 2001 (February 2003 for national accounts).

65. The authorities report updates on exchange rates and monetary data in a timely manner. However, external trade and fiscal sector statistics have not been reported to STA for publication in the *IFS* since 1997. Annual national accounts reports have improved, with current price data being reported up to 2002. However, constant price GDP estimates remain seriously out of date. An area-wide page for the WAEMU was introduced in the January 2003 issue of *IFS*.

National accounts

66. Inadequate data sources for national accounts statistics remain a major hurdle to improving the country's databases. The GDP aggregate is mostly based on crude assumptions and coefficients derived from the 1986 benchmark-year estimates. The National Institute of Statistics and Censuses (INEC) was seriously affected by the armed conflict, and still requires substantial technical assistance to rebuild capacity for compiling production statistics. Guinea-Bissau is receiving technical assistance in real sector statistics through West AFRITAC.

Consumer prices

67. Since July 2002, a harmonized CPI has been compiled, based on the same structure as in other WAEMU countries. However, the price data are collected only for the capital Bissau.

Government finance

68. Between 2000–02, the authorities made substantial progress in preparing timely reports on monthly and quarterly budget executions. These fiscal data reports were widely circulated to relevant national institutions; however, they have not been prepared since early 2003. Moreover, the quarterly reports are no longer submitted for publication in *IFS*. The most recent annual data in the *Government Finance Statistics Yearbook (GFSY)* are for 1989.

69. In March and April 2003, two missions from the Fiscal Affairs Department of the IMF—one in revenue administration and the other in expenditure management—visited Guinea-Bissau. A third mission during the same period—in the context of the regional GDDS project—made recommendations on improving fiscal data. Two experts from West AFRITAC visited Bissau in February and March 2004, to begin implementation of the recommendations of the April 2003 mission on revenue administration. The February mission assisted the authorities to set up of a unit for the monitoring of large enterprises in the Domestic Tax Department of the Ministry of Economy and Finance (MEF), and the March mission provided TA in the area of customs administration.

Monetary and financial statistics

70. Since Guinea-Bissau's entry in the WAEMU on May 1, 1997, the BCEAO has assumed responsibility for compiling and reporting to STA monetary data for Guinea-Bissau, as is the practice for other member countries in the Union. Guinea-Bissau has adopted the new accounting and reporting procedures for monetary and financial statistics in accordance with the BCEAO's guidelines. Monthly data on monetary statistics for Guinea Bissau are reported on a regular basis for publication in *IFS*, albeit with some delays.

71. The accuracy of monetary statistics is affected by large cross-border movements of currency among BCEAO member countries and delays of up to two years in the recording of such movements. In 2005, the BCEAO made substantial revisions to the estimates of banknotes in circulation in member states resulting from cross-border banknote movement. These revisions are due to changes in the method to estimate currency in circulation in the WAEMU countries. The revised method, based on updated sorting coefficients ("coefficients de tri"), has been applied retroactively from December 2003.

72. In March 2006, as part of the authorities' efforts to implement the MFSM's methodology, the BCEAO reported to STA central bank data for June 2005 for all member countries using the Standardized Report Form (1SR).

Balance of payments statistics

73. Guinea-Bissau reports trade data to AFR for operational purposes using information from customs. It also reports balance of payments and international investment position statistics to STA on an annual basis. Nevertheless, balance of payments data remain weak, due mostly to substantial unregistered trade and inconsistencies between data on net foreign assets as reported by the BCEAO and other economic indicators. In August 2004, an AFRISTAT balance of payments expert visited Bissau to assess the priority needs for technical assistance and assist the authorities with the preparation of a work plan for improving compilation of balance of payments and international investment position statistics. A technical assistance mission is scheduled by West AFRITAC for the third quarter of calendar 2006.

External debt statistics

74. During the civil war, the computer system processing debt data was severely damaged, and little progress has been made in rehabilitating it. As a result, debt data have not been compiled since mid-1998. The basis for the current external debt database is the 2000 debt sustainability analysis, which the authorities have used to keep track of the debt situation. However, this is an Excel-based database and a more sophisticated system is required to improve day-to-day debt management. Moreover, the Debt Division of the Ministry of Finance faces serious capacity constraints.

Guinea-Bissau: Table of Common Indicators Required for Surveillance

(As of June 14, 2006)

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]
Exchange rates	Current	Current	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]					
Reserve/base money	Feb. 2006	May 2006	M	M	M
Broad money	Feb. 2006	May 2006	M	M	M
Central bank balance sheet	Feb. 2006	May 2006	M	M	M
Consolidated balance sheet of the banking system	Feb. 2006	May 2006	M	M	M
Interest rates[2]	May 2006	June 2006	M	M	M
Consumer price index	Jan. 2005	Apr. 2005	M	M	M
Revenue, expenditure, balance and composition of financing[3] – general government[4]					
Revenue, expenditure, balance and composition of financing[3] – central government					
Stocks of central government and central government-guaranteed debt[5]					
External current account balance	End 2003	Sept. 23, 2005	A	I	I
Exports and imports of goods and services	End 2003	Sept. 23, 2005	A	I	I
GDP/GNP	2005	Apr. 2006	A	I	I
Gross external debt					

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extrabudgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

Guinea-Bissau—External Debt Sustainability Analysis[23]

Guinea-Bissau is a country in severe debt distress. However, assuming that HIPC completion point is achieved by the end of 2009, the risk of debt distress is expected to fall to more moderate levels. Specifically, external debt would be reduced to levels that are sustainable under the baseline scenario, but the country would still be vulnerable to exchange rate depreciation, a reduction in the growth rate or a reduction in the grant content of new loans. The total public debt to GDP ratio remains well above threshold levels even in the baseline scenario, reflecting the weight of capital contributions to WAEMU.

Introduction

75. After reaching the decision point of the HIPC initiative in 2000, Guinea-Bissau failed to maintain macroeconomic stability and progress on the implementation of its poverty reduction strategy. The PRGF-supported program went off track in 2001, reflecting fiscal policy slippages associated with military spending, an increase in the wage bill and political interference in public finance management. The preparation of the full PRSP was delayed as a result of political instability and capacity constraints. In March 2005, the government engaged in an SMP, covering April–December 2005, focused on stabilizing the fiscal situation, including avoiding new domestic arrears, promoting economic growth by rebuilding infrastructure and removing excessive regulation, and improving governance. Progress under the SMP was mixed, with the wage bill and domestic arrears exceeding indicative targets.

76. **In 2006, the government agreed to a new timeline to reengage in programs supported by the IMF and the World Bank, aiming to reach the completion point under the HIPC Initiative by end-2009.** A new SMP to cover 2006 was discussed with the authorities in March, to help the authorities establish a track record of policy implementation and address governance and public expenditure management issues. At end-2006, the government is also expected to finalize its full PRSP in order to start implementing it in 2007. Assuming the emergence of a concerted international assistance effort, Guinea-Bissau would receive support from the IMF under the Emergency Post- Conflict Country Assistance (EPCA) facility. The EPCA should pave the way for a new PRGF supported program by end-2008. The World Bank would complete a public expenditure review update and a fiduciary assessment by mid-2006 and support Guinea-Bissau in FY2007–08 through an Interim Strategy Note, focusing on infrastructure rehabilitation, reforms in the agricultural sectors and in economic management. Guinea-Bissau is expected to reach the completion point in the fourth quarter of 2009.

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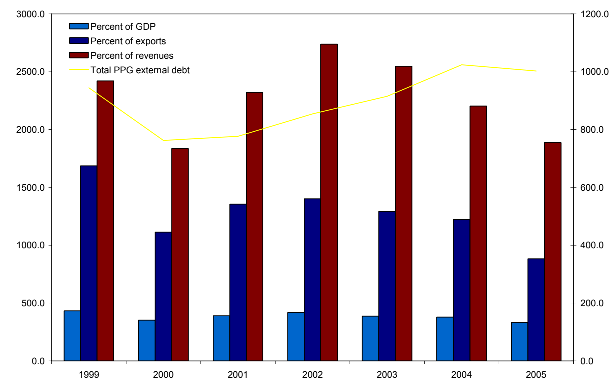
[23] Prepared under the joint debt sustainability framework for low income countries of the IMF and the World Bank. This analysis focuses on public external and domestic debt. Data on private external debt are not available and are therefore excluded from the analysis.

Public debt situation as of end-December 2005

77. **At end-2005, Guinea-Bissau's stock of external public and publicly guaranteed (PPG) external debt amounted to $1,002 million, of which $327 million in arrears.**[24] Multilateral debt amounts to 49 percent of total PPG debt (14 percent is owed to AfDB/AfDF, 29 percent is owed to IDA, 1.2 percent is owed to IMF) and bilateral and commercial amounts to 51 percent (Table 1). The NPV of debt amounts to $745.8 million or 247.3 percent of GDP and 656.9 percent of exports. Despite the concessional nature of most of the PPG external debt, the debt burden indicators far exceed the policy dependent debt thresholds for Guinea-Bissau.[25]

Guinea-Bissau: Stock of debt, 1999-2005



78. **The nominal external debt to GDP ratio has decreased slightly over the last five years from 353 percent at end-2000 to 332 percent at end-2005.** This positive development, however, is not due to a significant increase in the current account balance or in FDI, either of which would reduce the financing needs of the country. Instead, this debt to GDP reduction was due mainly to a strong appreciation of the CFA franc (pegged to the euro) with respect to the dollar, which translated into high growth rates of nominal GDP in U.S. dollar terms, despite low real GDP growth rates.

79. **Nominal public domestic debt amounted to 48 percent of GDP at end-2005.** Nearly 90 percent of this debt corresponds to a required capital contribution to join WAEMU for a total of CFAF 70 billion to be paid over 25 years starting in 2005. The remaining domestic debt is composed of obligations to BCEAO linked to statutory advances (no longer allowed) and to the failure of two banks after the civil war. Domestic arrears are not included in this debt estimate as an audit will be necessary for a fairly accurate estimation of these obligations to be possible.

80. **Since the PRGF went off track, Guinea-Bissau has not benefited from most of the debt relief committed at decision point.** At the decision point in 2000, creditors representing 80 percent of Guinea-Bissau external debt pledged to provide HIPC relief amounting to $790 million ($417 million in NPV terms). Since 2001, Guinea-Bissau has had to service a large share of external debt in full. The IMF suspended the provision of interim

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[24] Bilateral debt data are provided by the authorities, while multilateral debt data are reconciled with creditors.

[25] According to the World Bank Country Policy and Institutions Assessment (CPIA), Guinea Bissau has a poor quality of policies and institutions. The CPIA rating for 2005 is 2.7, on a scale from 1 to 6, below the operational cutoff of 3.25 for poor performers.

relief and the Paris Club declared null and void any debt rescheduling agreements beyond end-2001. Many agreements signed with other multilateral and bilateral creditors have not been implemented because the country failed to remain current on debt service obligations.[26] IDA and the African Development Bank (AfDB) Group continued providing interim relief,[27] but both multilateral banks will reach the statutory ceiling for the delivery of interim relief at end-2007 and end-2006 respectively.[28] Only China and Cuba cancelled all outstanding claims.

81. **After the decision point, Guinea-Bissau could not service its external debt and accumulated arrears to most of its external creditors.** Since 2001, the country has not repaid any creditor that did not provide interim relief, with the exception of the IMF. The stock of arrears has increased from \$139 million before decision point to \$327 million at end-2005. In the following analysis, arrears are assumed to be cleared through concessional rescheduling before reaching the completion point. However, the HIPC process would be delayed if additional arrears arise to multilateral creditors or if Guinea- Bissau could not agree on a repayment schedule of post-cutoff-date arrears with the Paris Club.

Macroframework

8. Projections for the evolution of external and total public debt and debt service are carried out in a baseline scenario and several alternative scenarios: the baseline scenario assumes that the country stays on track with IMF programs and successfully reengages with the donor community; a historic scenario assumes key variables at their 10-year historical average; and different bound test scenarios, simulating temporary shocks to growth, exports, fiscal revenues, the exchange rate, prices and financial flows.

9. The macroeconomic assumptions underlying the baseline projection scenario up to 2009 are described in detail in Box 1. The baseline assumes that an international concerted assistance effort is in place by end-2006 to help finance urgently needed structural reforms in the public sector. Post-conflict assistance is assumed to be provided by the Fund by end-2006, followed, after two years, by a PRGF. Growth, at 5 percent by 2008, will be sustained by reforms in the electricity sector and investment in infrastructure which would loosen the bottleneck for private investment and sustained exports growth. The current account deficit is

[26] See IMF Country Report 05/93, November 2004, Box 10, for a comprehensive list of debt rescheduling agreements reached by Guinea-Bissau with the creditors as part of the provision of HIPC relief.

[27] Interim relief from IDA amounted to 100 percent of debt service falling due on debt disbursed before end-1999 until October 2003, the expected date of the completion point. Interim relief was decreased to 90 percent of debt service thereafter. The AfDB extended 100 percent debt service relief to end-2006.

[28] IDA could at its discretion extend interim relief to 50 percent of total HIPC relief based on satisfactory progress toward the completion point triggers and performance under an IMF-supported program. The AfDB could raise the interim relief ceiling from 40 percent to 50 percent.

projected initially to deteriorate, but it would be contained by strong export growth and fiscal consolidation in the medium and long term. The primary fiscal balance is initially expected to deteriorate as more resources are assigned to public investment and poverty reduction. In the medium term, however, stronger revenue performance and civil and security service reforms would contain the public sector wage bill and improve the fiscal balance. Public external borrowing at concessional terms would be contained over time, while domestic debt and arrears would be progressively paid down.

10. HIPC Completion Point is assumed by end-2009. Total HIPC debt relief, as established at decision point in 2000, amounts to US$ 413 million in NPV terms and would reduce debt service payments by about 7 percent of GDP per year.

Box 1: Macroeconomic Assumptions Under Baseline Scenario

- GDP growth rate increases from 3.5 percent in 2005 to 5 percent by 2008, and is sustained over the following years.
- GDP deflator is assumed to grow at a rate slightly below CPI inflation, due to expected worsening in the terms of trade. After 2009, both GDP deflator and CPI are assumed to increase at a rate of 2 percent.
- The noninterest current account is assumed to deteriorate over the medium term, reflecting both an increase in foreign-financed investment projects and lower official transfers in the form of budget support. Over the long run, the noninterest current account balance as a proportion of GDP converges back to its 2005 level. Exports are assumed to grow at around 8 percent per year until 2010, driven by steady growth in cashew nut production at least in the medium-term; export growth rate is assumed to decrease to about 6 percent thereafter.
- Foreign direct investment as a ratio of GDP ratio is assumed to remain constant in the medium and long term at the level observed in 2005 (1.3 percent).
- New borrowing will be contracted at highly concessional terms, with the grant element in new disbursements assumed to remain slightly above the 50 percent that was agreed on under the 2006 SMP.
- The primary fiscal deficit is assumed to decrease from 4.5 percent of GDP in 2006 to 1.7 percent by 2010, maintaining this level from then on.
- Total external loan financing is assumed to be 5 percent of GDP per year on average over the next 20 years.

Debt sustainability

11. The sustainability of the current external and total public debt is judged based on various indicative debt and debt service thresholds established for countries with poorly performing economic policies and institutions, and shown in Table 1.

Table 1: Summary of Baseline Debt Sustainability Indicators [1/]

	Indicative Threshold[2/]	2005	2016	2026	Average 2006-24
NPV of debt-to-GDP	30	247.3	35.9	*25.0*	68.8
NPV of debt-to-exports	100	656.9	*86.9*	*62.0*	168.4
NPV of debt-to-revenue	200	1482.3	*171.8*	*130.8*	456.3
Debt service-to-exports	15	43.6	*4.5*	*3.6*	*8.5*
Debt service-to-revenue	25	94	*11.9*	*10.6*	*19.8*

Note: Figures in italics are under the indicative thresholds.
[1/] All debt indicators assume the full delivery of HIPC relief at end-2009 and refer to the NPV of public and publicly guaranteed external debt.
[2/] Threshold over which countries with similar evaluations of policies and institutions would have at least a 25 percent chance of having a prolonged incident of debt distress in the coming year. Guinea-Bissau lies within the bottom quintile of countries ranked by the World Bank's Country Policy and Institutional Assessment Index (CPIA).

12. The simulations presented in Tables 2a, 2b, 3a, 3b and Figures 1 and 2, point to a country currently in severe debt distress, with arrears accruing to multilateral creditors, Paris Club creditors and other official and commercial creditors. Such arrears are projected to be settled by 2009 only if the HIPC process remains on track. Assuming HIPC relief, indicators based on debt and debt service ratios in simulated scenarios point to mixed signals of the risk of debt distress. The NPV of external debt-to-GDP ratio remains above the 30 percent threshold during most of the simulation period in the baseline scenario as well as under the stress test scenarios. In the case of total public debt, the debt to GDP ratio remains well above the threshold levels for the whole period and the ratio to government revenues surpasses the threshold for a significant period, reflecting the weight of capital contribution commitments to WAEMU on top of the external debt burden. On the other hand, the debt service ratios to exports and government revenues quickly fall below threshold levels in the baseline scenario immediately after the HIPC completion point is reached.

13. Alternative scenarios and stress tests indicate that significant exchange rate depreciation, reductions in GDP growth, and a lower grant element of new loans would substantially increase the risk of debt distress. The most severe scenario is that created by the effects of large (30 percent) exchange rate devaluation, which would cause the NPV of external debt to GDP ratio to significantly exceed the 30 percent threshold during the whole projection period.

14. These simulations do not include the additional debt relief that could be obtained from the Multilateral Debt Relief Initiative (MDRI), which would amount, at completion point, to US$77.3 million in net present value, or 21 percent of GDP. In this case, the external debt service to exports ratio would be reduced by an additional 3 percentage points.

Staffs appraisal

15. Since Guinea-Bissau is running arrears, it is automatically rated as in debt distress. Guinea-Bissau's risk of debt distress would be reduced substantially if the HIPC completion point were achieved by end-2009, as hoped for under current arrangements. Continued political stability, sustained adjustment, and reform, and a concerted international assistance effort are key elements for the country to achieve completion point and the associated debt reduction to sustainable levels. Even within this scenario, the country's capacity to sustain reasonable debt burden ratios may be compromised by significant shocks to the nominal exchange rate, the growth rate, or the concessionality of new borrowing.

Table 2a. Guinea-Bissau: External Debt Sustainability Framework, Baseline Scenario, 2006-2026 1/
(In percent of GDP, unless otherwise indicated)

		Actual					Historical Average 6/	Standard Deviation 6/	Projections									
	#	2001	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
External debt (nominal) 1/	**...**	**390.0**	**417.9**	**387.2**	**378.9**	**332.2**			**317.4**	**296.6**	**276.6**	**118.6**	**107.0**	**96.4**		**54.3**	**13.1**	
o/w public and publicly guaranteed (PPG)	...	390.0	417.9	387.2	378.9	332.2			317.4	296.6	276.6	118.6	107.0	96.4		54.3	13.1	
Change in external debt	...	37.3	27.9	-30.7	-8.2	-46.7			-14.8	-20.8	-20.0	-158.0	-11.6	-10.6		-6.9	-2.5	
Identified net debt-creating flows	...	51.2	-0.2	-55.3	-55.1	-36.0			-10.3	-9.4	-10.3	-10.2	-4.5	-4.0		-2.3	-0.7	
Non-interest current account deficit	**...**	**14.1**	**6.4**	**-2.5**	**-7.3**	**2.9**	**2.3**	**7.4**	**3.7**	**5.9**	**4.9**	**4.4**	**4.0**	**3.9**		**3.3**	**3.3**	3.4
Deficit in balance of goods and services	...	34.3	21.4	14.1	16.2	17.4			19.6	18.4	17.5	16.9	15.2	15.2		15.2	15.1	
Exports	...	28.8	29.8	30.0	30.9	37.6			39.1	40.0	40.8	41.5	42.3	42.2		41.4	40.4	
Imports	...	63.1	51.2	44.1	47.1	55.1			58.7	58.4	58.3	58.5	57.5	57.4		56.5	55.5	
Net current transfers (negative = inflow)	...	-20.1	-15.0	-16.6	-23.5	-14.3	-18.2	3.5	-15.8	-12.5	-12.5	-12.4	-12.4	-12.4		-12.4	-12.4	-12.4
Other current account flows (negative = net inflow)	...	0.0	0.0	0.0	0.0	-0.2			0.0	0.0	-0.1	-0.1	1.2	1.1		0.5	0.6	
Net FDI (negative = inflow)	**...**	**-0.8**	**-1.1**	**-1.5**	**-3.5**	**-3.7**	**-1.8**	**1.4**	**-3.7**	**-3.7**	**-3.7**	**-3.7**	**-3.7**	**-3.7**		**-3.7**	**-3.7**	-3.7
Endogenous debt dynamics 2/	**...**	**37.9**	**-5.5**	**-51.4**	**-44.3**	**-35.2**			**-10.4**	**-11.7**	**-11.6**	**-11.0**	**-4.8**	**-4.3**		**-1.9**	**-0.4**	
Contribution from nominal interest rate	...	8.0	4.3	5.3	4.2	4.2			3.0	2.6	2.4	2.1	0.7	0.7		0.9	0.4	
Contribution from real GDP growth	...	-0.7	27.2	2.3	-7.5	-11.8			-13.4	-14.3	-13.9	-13.1	-5.6	-5.0		-2.9	-0.7	
Contribution from price and exchange rate changes	...	30.7	-37.0	-58.9	-41.0	-27.7			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**...**	**-14.0**	**28.1**	**24.6**	**46.8**	**-10.7**			**-4.5**	**-11.4**	**-9.7**	**-147.8**	**-7.1**	**-6.6**		**-4.6**	**-1.7**	
o/w exceptional financing	...	-21.6	-17.5	-16.6	-16.8	-14.3			-9.9	-7.8	-7.4	-148.2	-3.4	-3.1		-2.2	-0.8	
NPV of external debt 4/	...	...	...	...	...	247.3			239.2	229.8	223.6	145.1	69.4	40.4		35.9	25.0	
In percent of exports	...	...	...	...	...	656.9			611.2	574.3	548.5	349.2	164.0	95.7		86.9	62.0	
NPV of PPG external debt	**...**	**...**	**...**	**...**	**...**	**247.3**			**239.2**	**229.8**	**223.6**	**145.1**	**69.4**	**40.4**		**35.9**	**25.0**	
In percent of exports	...	...	...	...	...	656.9			611.2	574.3	548.5	349.2	164.0	95.7		86.9	62.0	
Debt service-to-exports ratio (in percent)	...	69.1	60.9	64.0	56.6	44.0			31.9	28.6	25.1	21.6	4.5	4.4		4.5	3.6	
PPG debt service-to-exports ratio (in percent)	...	69.1	60.9	64.0	56.6	44.0			31.9	28.6	25.1	21.6	4.5	4.4		4.5	3.6	
Total gross financing need (billions of U.S. dollars)	...	66.1	48.0	35.9	18.2	47.6			56.4	45.3	40.6	36.4	8.8	8.9		8.9	13.2	
Non-interest current account deficit that stabilizes debt ratio	...	-23.1	-21.5	28.3	1.0	49.6			18.5	26.7	24.9	162.4	15.6	14.5		10.2	5.8	
Key macroeconomic assumptions																		
Real GDP growth (in percent)	...	0.2	-7.1	-0.6	2.2	3.5	-0.4	4.1	4.2	4.8	5.0	5.0	5.0	5.0	4.8	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	...	-8.0	10.5	16.4	11.8	7.9	7.7	9.3	-0.4	1.1	1.2	0.9	1.2	1.5	0.9	2.0	2.0	2.0
Effective interest rate (percent) 5/	...	2.1	1.1	1.5	1.3	1.2	1.4	0.3	0.9	0.9	0.8	0.8	0.7	0.7	0.8	1.6	2.5	1.6
Growth of exports of G&S (US dollar terms, in percent)	...	-16.2	6.2	16.2	18.1	35.8	12.0	19.0	7.8	8.3	8.2	8.0	8.3	6.2	7.8	6.7	7.1	6.8
Growth of imports of G&S (US dollar terms, in percent)	...	13.0	-16.7	-0.4	22.2	30.4	9.7	18.7	10.5	5.5	6.0	6.3	4.6	6.2	6.5	6.8	7.1	6.9
Grant element of new public sector borrowing (in percent)		...	...	...	...	...	...	...	56.9	56.9	43.0	51.0	51.1	56.9	52.6	56.9	56.9	56.9
Memorandym item:																		
Nominal GDP (millions of US dollars)	...	199.2	204.3	236.4	270.2	301.6			312.9	331.5	352.1	373.2	396.8	422.8		595.7	1182.9	

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments devided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b. Guinea-Bissau: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006-26
(In percent)

		Projections						
	2006	2007	2008	2009	2010	2011	**2016**	2026
NPV of debt-to-GDP ratio								
Baseline	239	230	224	145	69	40	**36**	25
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	239	226	217	136	63	35	**32**	24
A2. New public sector loans on less favorable terms in 2007-26 2/	239	231	227	150	75	47	**47**	38
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	239	252	270	175	84	49	**43**	30
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	239	232	231	152	76	47	**42**	27
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	239	236	236	153	73	43	**38**	26
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	239	230	225	146	70	41	**37**	25
B5. Combination of B1-B4 using one-half standard deviation shocks	239	242	249	162	78	45	**40**	28
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	239	327	318	206	99	57	**51**	36
NPV of debt-to-exports ratio								
Baseline	611	574	548	349	164	96	**87**	62
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	611	565	533	328	148	83	**76**	61
A2. New public sector loans on less favorable terms in 2007-26 2/	611	578	556	360	178	112	**114**	94
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	611	574	548	349	164	96	**87**	62
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	611	677	768	497	245	152	**137**	92
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	611	574	548	349	164	96	**87**	62
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	611	575	551	351	166	98	**89**	63
B5. Combination of B1-B4 using one-half standard deviation shocks	611	606	613	391	184	108	**98**	70
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	611	574	548	349	164	96	**87**	62
Debt service-to-exports ratio								
Baseline	32	29	25	22	4	4	**4**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	32	28	25	21	4	4	**4**	3
A2. New public sector loans on less favorable terms in 2007-26 2/	32	29	25	22	5	6	**5**	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	32	29	25	22	4	4	**4**	4
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	32	33	34	30	6	6	**7**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	32	29	25	22	4	4	**4**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	32	29	25	22	4	4	**5**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	32	30	28	24	5	5	**5**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	32	29	25	22	4	4	**4**	4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	55	55	55	55	55	55	**55**	55

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3a.Country: Public Sector Debt Sustainability Framework, Baseline Scenario, 2003-2026
(In percent of GDP, unless otherwise indicated)

	Actual							Estimate	Projections								
	2001	2002	2003	2004	2005	Historical Average 5/	Standard Deviation 5/	2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
Public sector debt 1/	445.8	475.1	444.9	433.0	379.8			360.1	336.1	313.2	152.6	139.0	126.5		75.6	23.8	
o/w foreign-currency denominated	390.0	417.9	387.2	378.9	332.2			317.4	296.6	276.6	118.6	107.0	96.4		54.3	13.1	
Change in public sector debt	40.0	29.3	-30.2	-11.9	-53.2			-19.6	-24.0	-22.9	-160.6	-13.6	-12.6		-8.4	-3.2	
Identified debt-creating flows	31.7	-60.0	-59.9	-46.0	7.6			-35.6	-21.0	-20.4	-160.7	-8.8	-8.2		-5.1	-0.7	
Primary deficit	3.4	6.5	10.0	8.9	7.8	7.0	2.4	4.5	4.2	4.2	3.4	1.7	1.7	3.3	1.7	1.6	1.7
Revenue and grants	31.3	21.4	22.9	34.4	26.0			32.1	28.6	28.9	29.0	29.0	28.9		28.2	27.0	
of which : grants	14.5	6.1	7.7	17.2	8.4			11.4	8.7	8.7	8.6	8.6	8.6		8.4	8.0	
Primary (noninterest) expenditure	34.6	27.9	32.9	43.3	33.9			36.6	32.8	33.1	32.4	30.8	30.6		29.9	28.6	
Automatic debt dynamics	50.4	-47.4	-52.0	-38.3	12.9			-29.9	-17.4	-17.1	-15.5	-7.1	-6.8		-4.5	-1.5	
Contribution from interest rate/growth differential	1.6	29.3	1.7	-14.2	-23.9			-21.8	-18.2	-18.0	-17.7	-7.8	-7.2		-4.3	-1.4	
of which : contribution from average real interest rate	2.4	-5.0	-1.3	-4.6	-9.4			-6.5	-3.8	-3.6	-3.4	-0.7	-0.8		-0.7	-0.2	
of which : contribution from real GDP growth	-0.8	34.3	3.0	-9.6	-14.5			-15.2	-14.4	-14.4	-14.3	-7.0	-6.4		-3.6	-1.2	
Contribution from real exchange rate depreciation	48.8	-76.7	-53.7	-24.1	36.8			-8.1	0.9	1.0	2.1	0.7	0.3		...	...	
Other identified debt-creating flows	-22.1	-19.1	-17.9	-16.6	-13.1			-10.3	-7.9	-7.5	-148.5	-3.4	-3.1		-2.2	-0.8	
Privatization receipts (negative)	-1.3	-0.3	0.0	0.0	-0.1			-0.3	-0.1	-0.1	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-20.8	-18.8	-17.9	-16.6	-13.0			-10.0	-7.8	-7.4	-148.5	-3.4	-3.1		-2.2	-0.8	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	8.3	89.3	29.8	34.1	-60.9			16.0	-3.0	-2.6	0.0	-4.8	-4.3		-3.3	-2.6	
NPV of public sector debt	...	...	...	...	308.6			281.9	269.4	260.2	179.0	101.4	70.4		57.3	35.8	
o/w foreign-currency denominated	...	...	...	...	261.1			239.2	229.8	223.6	145.1	69.4	40.4		35.9	25.0	
o/w external	...	...	...	...	261.1			239.2	229.8	223.6	145.1	69.4	40.4		35.9	25.0	
NPV of contingent liabilities (not included in public sector debt)	...	...	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	23.7	25.2	29.5	28.3	24.2			22.8	15.8	14.6	12.4	4.8	4.5		3.6	3.0	
NPV of public sector debt-to-revenue ratio (in percent) 3/	...	...	...	...	1185.7			877.8	943.3	900.7	618.3	349.5	243.9		203.1	132.4	
o/w external	...	...	...	...	1003.1			744.8	804.8	773.9	501.0	239.2	139.8		127.5	92.7	
Debt service-to-revenue ratio (in percent) 3/ 4/	64.9	87.4	85.0	56.4	63.0			39.0	40.6	35.8	31.0	10.5	9.8		6.9	5.3	
Primary deficit that stabilizes the debt-to-GDP ratio			40.2	20.8	61.1			24.2	28.2	27.2	164.1	15.3	14.3		10.1	4.8	
Key macroeconomic and fiscal assumptions																	
Real GDP growth (in percent)	0.2	-7.1	-0.6	2.2	3.5	-0.4	4.1	4.2	4.2	4.5	4.8	4.8	4.8	4.5	4.5	4.5	4.5
Average nominal interest rate on forex debt (in percent)	2.2	1.1	1.2	1.1	1.1	1.3	0.5	0.9	0.9	0.8	0.8	0.7	0.7	0.8	1.6	2.5	1.6
Average real interest rate on domestic currency debt (in percent)	6.1	-3.7	3.4	1.6	-6.6	0.2	5.2	-4.1	-1.1	-1.0	-0.9	2.3	1.6	-0.5	-2.0	-2.9	-1.8
Real exchange rate depreciation (in percent, + indicates depreciation)	13.9	-18.4	-12.9	-6.4	10.2	-2.7	14.2	-2.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	-5.1	4.8	-2.8	1.7	7.7	1.3	5.2	4.7	1.5	1.3	1.0	1.3	1.7	1.9	2.5	2.5	2.5
Growth of real primary spending (deflated by GDP deflator, in percent)	-10.3	-25.3	17.3	34.4	-19.0	-0.6	25.4	12.7	-6.8	5.6	2.4	-0.5	4.3	2.9	4.0	4.5	4.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	…	…	56.9	56.9	43.0	51.0	51.1	56.9	52.6	56.9	56.9	...

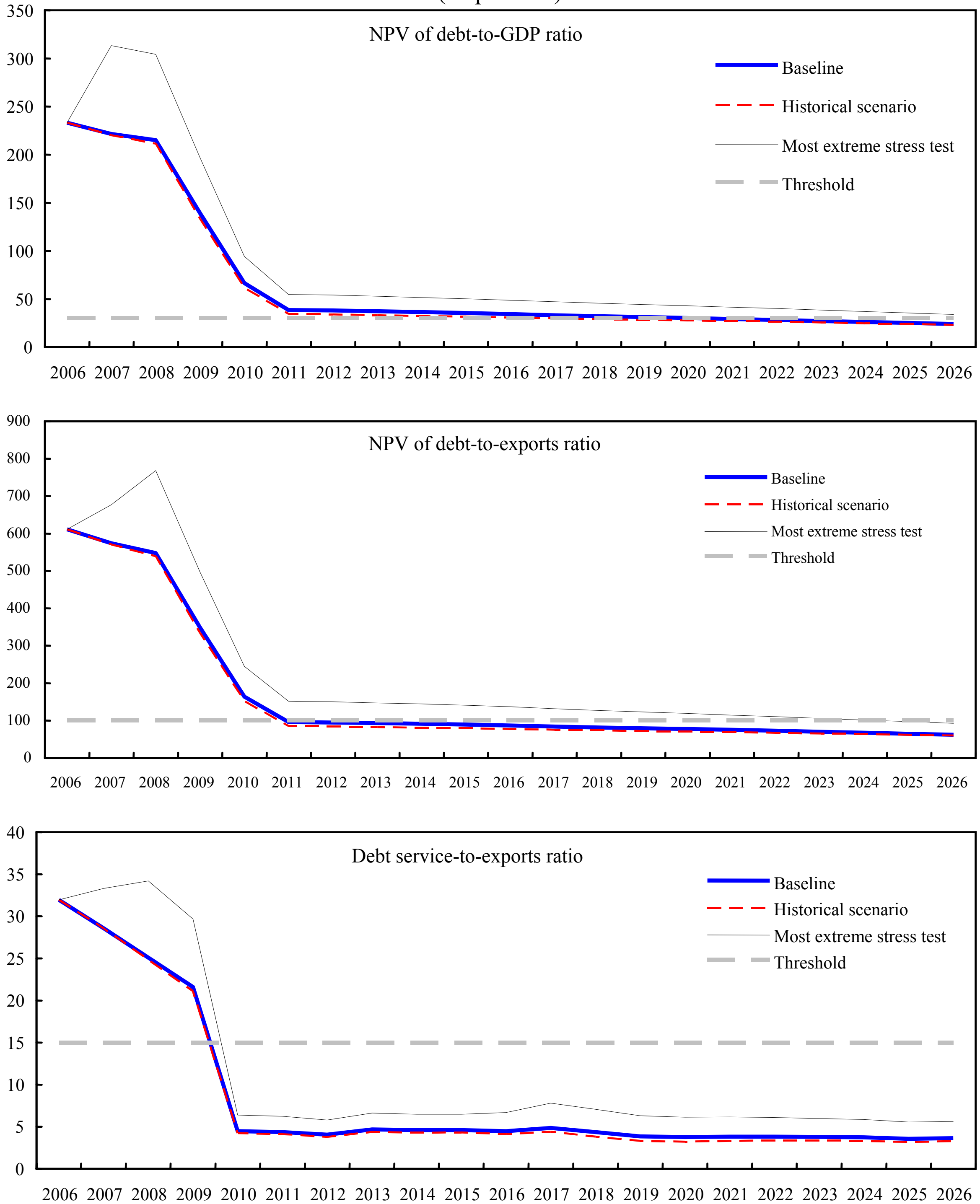
Sources: Country authorities; and staff estimates and projections.
1/ Defined as public external and domestic debt of the central government, inclusive of publicly guaranteed debt of SOEs.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues including grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3b.Country: Sensitivity Analysis for Key Indicators of Public Debt 2006–26

	Projections							
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of Debt-to-GDP Ratio								
Baseline	282	269	260	179	101	70	57	36
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	282	283	288	210	129	98	112	131
A2. Primary balance is unchanged from 2006	282	270	260	180	103	74	66	53
A3. Permanently lower GDP growth 1/	282	272	265	184	106	75	67	58
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007–08	282	295	313	218	127	92	83	67
B2. Primary balance is at historical average minus one standard deviations in 2007–08	282	272	265	184	106	75	61	38
B3. Combination of B1–B2 using one half standard deviation shocks	282	289	301	207	118	81	63	34
B4. One-time 30 percent real depreciation in 2007	282	370	360	306	195	149	123	79
B5. 10 percent of GDP increase in other debt-creating flows in 2007	282	274	265	183	106	75	61	38
NPV of Debt-to-Revenue Ratio 2/								
Baseline	878	943	901	618	349	244	203	132
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	878	977	967	694	418	314	337	328
A2. Primary balance is unchanged from 2006	878	944	902	621	356	255	234	196
A3. Permanently lower GDP growth 1/	878	949	913	632	361	256	231	202
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007–08	878	1004	1024	712	414	300	279	235
B2. Primary balance is at historical average minus one standard deviations in 2007–08	878	951	917	634	365	259	216	140
B3. Combination of B1–B2 using one half standard deviation shocks	878	992	998	686	389	271	215	119
B4. One-time 30 percent real depreciation in 2007	878	1297	1246	1058	671	517	438	293
B5. 10 percent of GDP increase in other debt-creating flows in 2007	878	959	916	633	364	258	216	140
Debt Service-to-Revenue Ratio 2/								
Baseline	39	41	36	31	10	10	7	5
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	39	42	38	34	12	12	10	13
A2. Primary balance is unchanged from 2006	39	41	36	31	11	10	7	7
A3. Permanently lower GDP growth 1/	39	41	36	32	11	10	8	7
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007–08	39	43	40	35	12	11	9	9
B2. Primary balance is at historical average minus one standard deviations in 2007–08	39	41	36	31	11	10	7	6
B3. Combination of B1–B2 using one half standard deviation shocks	39	42	39	34	12	11	8	5
B4. One-time 30 percent real depreciation in 2007	39	43	39	34	12	11	8	6
B5. 10 percent of GDP increase in other debt-creating flows in 2007	39	41	36	31	11	10	8	6

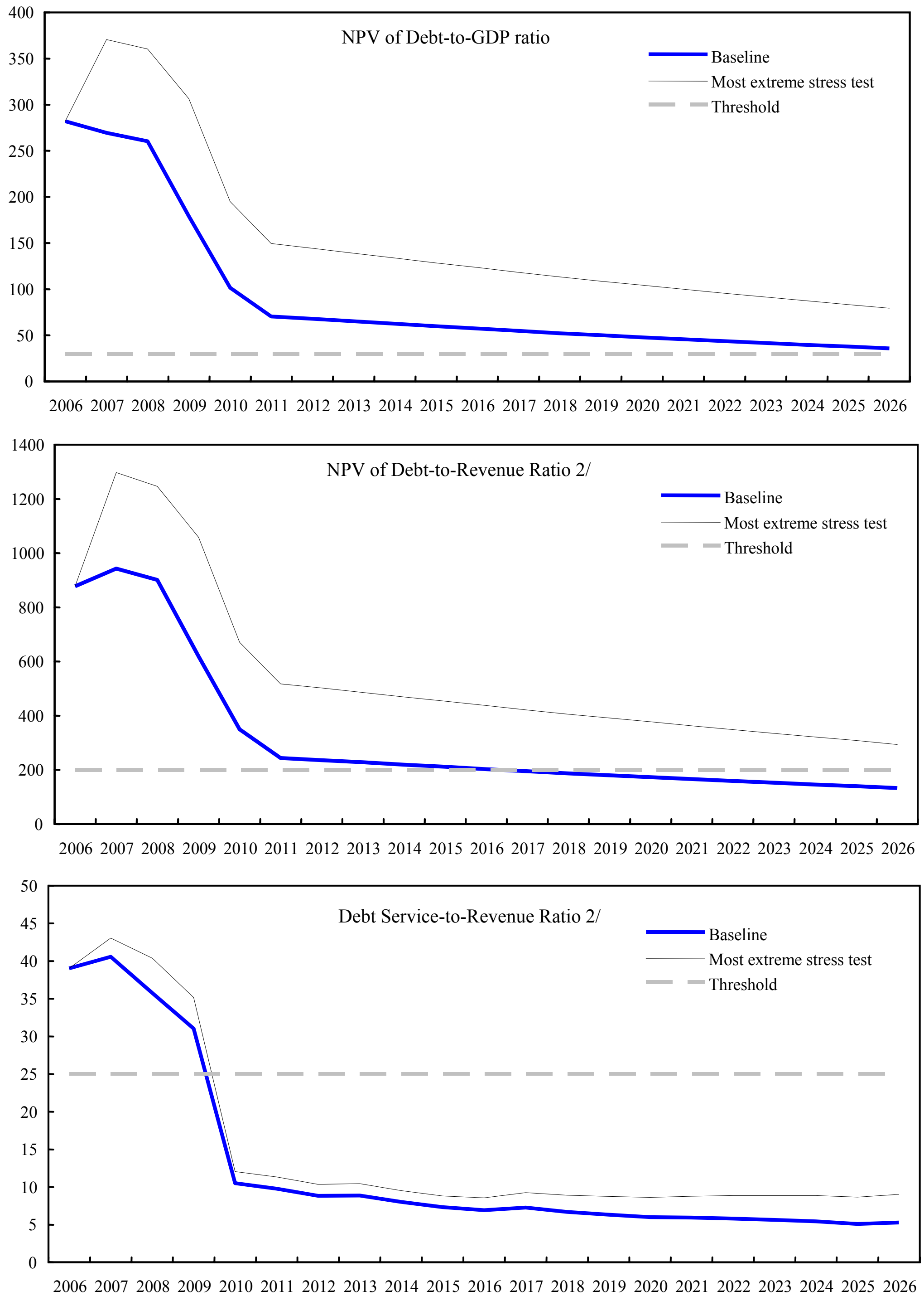
Sources: Guinea-Bissau authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).
2/ Revenues are defined inclusive of grants.

Figure 1. Guinea-Bissau: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006–26
(In percent)



Source: IMF staff projections and simulations.

Figure 2. Guinea-Bissau: Indicators of Public Debt Under Alternative Scenarios, 2006–26 1/



Source: IMF staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2016.
2/ Revenue including grants.

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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with Guinea-Bissau

On July 31, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Guinea-Bissau.[1]

Background

A devastating armed civil conflict during 1998-99 and the ensuing prolonged political instability and governance deficiencies took a heavy toll on Guinea-Bissau's economy. The physical infrastructure was destroyed, the economy stagnated, government administrative capacity virtually collapsed, social conditions worsened and poverty increased. For most of the post-conflict period, economic activity remained sluggish with real per capita GDP declining by an annual average of 2 percent until 2005. The fiscal situation deteriorated sharply and external assistance dwindled, leading to mounting wages arrears and unsustainable external debt position.

Since mid-2004, Guinea-Bissau has made important strides in overcoming the effects of this protracted period of instability that ended in mid-2003 with a coup. Parliamentary elections were held in March 2004 and Presidential elections in July 2005. The process of rebuilding the administration and addressing the country's economic problems has begun in earnest. Efforts have also been made to improve budget preparation and tax administration, which has allowed for a significant increase in tax revenues.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Economic activity in 2005 was stronger than expected. Real GDP growth is estimated to have rebounded from an average of 0.5 percent for 2003–04 to 3.5 percent in 2005, driven by good agricultural performance and despite sluggish activity in other sectors. Average consumer price inflation rose to 3.4 percent from 0.8 percent in 2004 as a result of higher import prices of oil and rice. Notwithstanding the strong growth in exports, the external current account worsened in 2005 because of a large increase in imports and a drop in official transfers and private remittances. The fiscal balance improved, but cash flow problems persisted throughout the year. The fiscal deficit (including grants) was lower than budgeted at 12 percent of GDP, compared to 15 percent in 2004, but new domestic arrears accumulated.

Formal financial intermediation was very limited during 2005 even by regional standards, with total deposits amounting to only 8 percent of GDP. Although the only local bank has been increasing its financing of the cashew harvest, average outstanding claims to the private sector during 2005 did not exceed 2.2 percent of GDP; average credit to the government amounted to 1.3 percent of GDP. As elsewhere in the region, the bank is very liquid. The lack of profitable projects has left it with excess reserves that can be used to meet the seasonal needs of the private sector and the government.

Guinea-Bissau's external debt remains unsustainable and can only be resolved through the HIPC Initiative. After most interim debt relief was suspended, external debt service obligations, except those to multilateral creditors, fell into arrears. Total external public debt including arrears amounted to 332 percent of GDP in 2005; scheduled annual external debt service was about 16.4 percent of GDP.

For 2006, real GDP growth is projected at 4.2 percent and CPI inflation at about 2 percent, barring any major supply shocks. The balance of payments deficit is projected to reach 15.4 percent of GDP, which would be financed by donor support, accumulation of arrears, and debt relief. The fiscal program aims at achieving a domestic primary deficit of 3.7 percent of GDP that would avoid the accumulation of domestic arrears. The achievement of this fiscal objective would require progress in keeping current spending in check and intensifying revenue mobilization, but cash flow difficulties could arise if external budget support is delayed.

Progress on structural reform over the past year has been slow, reflecting serious technical capacity constraints and delays in obtaining technical assistance, and the changes in government. The structural reform process is being given a new momentum with an action plan for implementing the long-overdue civil service reform, the security sector reform, private sector development initiatives, and measures to rehabilitate roads, electricity, and water infrastructure.

Executive Board Assessment

Executive Directors noted that Guinea-Bissau has made major strides in overcoming the effects of a long period of political upheaval and were encouraged by the positive turn of economic and financial developments, amid signs of a return to political stability. Directors commended in particular the progress made in rebuilding the administration and restoring fiscal control. Directors concurred that the main challenges now are to consolidate peace and political stability and to lay the foundation for sustainable high growth and significant poverty reduction. This will require Guinea-Bissau to achieve fiscal and debt sustainability and to deepen structural reforms.

Directors noted the favorable macroeconomic outlook and underscored that the strength and timing of the economic recovery would hinge critically on political stability, disciplined fiscal policy, an acceleration of structural reform to promote private sector developments, and the resumption of external financial assistance.

Directors welcomed the authorities' policy framework that was supported by a new staff-monitored program (SMP). They noted that with steadfast commitment to its policy objectives, Guinea-Bissau's prospects for economic recovery and the resumption of external financing appear promising. Directors emphasized that the new SMP would enable Guinea-Bissau to move to emergency post-conflict assistance as soon as concerted international assistance is in place. They advised the authorities to use this opportunity to articulate a medium-term strategy that would aim at achieving fiscal and debt sustainability and bringing about substantive progress toward the MDGs.

Directors observed that the fiscal program for 2006 makes progress in moving Guinea-Bissau toward fiscal sustainability. Nonetheless, they noted that determined efforts will be needed to strengthen revenue mobilization and to keep current spending in check. To this end, they emphasized the need to widen the tax base, reduce exemptions, effectively monitor spending from the commitment stage, and strictly adhere to a monthly cash flow plan consistent with spending priorities. They also noted with concern the continued slippages in the wage bill, which had contributed to the accumulation of domestic arrears in 2005.

Directors welcomed the authorities' launch of a long-overdue civil service reform aimed at achieving a durable reduction in the excessive wage bill. They nevertheless emphasized that the authorities should put in place a donor-supported program to support the integration of retrenched workers into the private sector, so as to maintain social stability. Directors also noted that careful implementation of the planned security sector reform, with the assistance of development partners, should also remove a major constraint on Guinea-Bissau's development agenda.

Directors agreed that membership in the WAEMU has served Guinea-Bissau well, particularly by keeping inflation low. They judged the current level of the real effective exchange rate to be broadly appropriate, but underscored that Guinea-Bissau's external competitiveness would need to be enhanced through further progress on the structural reform agenda. Directors encouraged the authorities to accelerate the implementation of measures to rehabilitate the electricity company, roads and other infrastructure, and to enhance the investment climate. Directors cautioned that these reforms need to be prioritized and managed carefully to ensure that limited technical capacity is not overstretched.

Directors urged the authorities to put in place a strategy to address domestic and external arrears through judicious use of fiscal resources, debt relief, and donor assistance. They advised the authorities to launch a complete audit of domestic arrears and seek external resources to help clear these arrears. Regarding the external debt service arrears, Directors called on the authorities to continue servicing multilateral debt to preserve their eligibility for the Multilateral Debt Relief Initiative once they reach the HIPC completion point, and to embark promptly on discussions with creditors to resolve the external debt problem.

Directors noted the severe debt distress of Guinea-Bissau and underscored that the mobilization of external assistance will be key to the success of the authorities' reform efforts and the achievement of external sustainability. Although debt distress is expected to fall to moderate levels if the HIPC completion point is reached, Directors stressed that new assistance should be provided on highly concessional terms, preferably in the form of grants, to reduce the debt burden.

Directors welcomed the progress made in the preparation of the PRSP through a broad-based consultation process. They called on the authorities to strengthen Guinea-Bissau's statistical system to increase transparency and to allow effective surveillance and monitoring of progress toward the Millennium Development Goals.

Guinea-Bissau: Selected Economic Indicators

	2002	2003	2004	2005	2006
Real GDP at market prices (annual percent change)	-7.1	-0.6	2.2	3.5	4.2
Real GDP per capita (annual percent change)	-9.9	-3.6	-0.8	0.2	1.6
Consumer price index (average, annual percent change)	3.3	1.6	0.8	3.4	2.2
Budgetary revenue (in percent of GDP)	15.3	15.2	17.2	17.6	20.3
Total domestic primary expenditure (in percent of GDP)	19.4	20.2	24.8	24.5	24.0
Domestic primary balance (in percent of GDP)	-4.2	-5.0	-7.6	-6.9	-3.7
Overall fiscal balance including grants (commitment basis, in percent of GDP)	-11.3	-15.6	-15.0	-12.1	-12.1
External current account (in percent if GDP)	-10.7	-2.8	3.1	-7.1	-5.1
Balance of payments deficit (percent of GDP)	-7.6	-48.3	-3.6	-7.7	-15.4
External public debt (percent of GDP)	417.9	387.2	378.9	332.2	317.4

Sources: Guinea-Bissau authorities; and IMF staff estimates.

Statement by Damian Ondo Mañe, Executive Director on Guinea-Bissau
July 31, 2006

On behalf of my Guinea-Bissau's authorities, I would like to thank staff for the candid and helpful discussions held during the recent Article IV consultations and Fund management for its continuous support. The comprehensive staff report and the Selected Issues paper offer a useful guidance to my authorities for advancing economic and structural reforms. My authorities are also grateful for the support received from development partners, including the Fund to help stabilize the political and macroeconomic environment. They also appreciate that agreement was reached with staff to monitor their program for another year.

Since our last Board discussion on Guinea-Bissau in November 2004, significant political and social progress has taken place, including the improvement of the country's political stability and security, following the parliamentary and presidential elections held in 2004 and 2005; the finalization of the demobilization, reinsertion and reintegration operations in 2005, which led to the reintegration of approximately 3,000 ex-combatants; and the appointment of a new government in December 2005. My authorities are appreciative of the international mediation from the regional institutions (ECOWAS, WAEMU, and WADB) in February 2006, which led to the agreement among all political parties.

With the improvement in security, my authorities were able to organize the sixth Summit of the Community of Portuguese-Speaking Countries (CPLP) in Bissau in mid-July 2006 aimed at consolidating the ties that link these countries in the areas of cooperation, coordination, the international arena and raising the community's profile. The meeting welcomed the stabilization of political situation in Guinea-Bissau. Heads of State agreed on the need for a regular follow-up of the member states' internal situation, aimed at identifying constraints and reinforcing CPLP capacity to settle conflicts, marshal humanitarian aid and consolidate institutions. To consolidate the peace process, which is an essential pillar for the new government to implement its comprehensive economic program and to reduce poverty in Guinea-Bissau, my authorities are fully committed to maintain a constructive dialogue with all the national actors, including business and trade unions, as well as civil society partners.

The implementation of the 2005 SMP, covering the period of April-December 2005, focused on stabilizing the fiscal situation, including avoiding new domestic arrears, promoting economic growth and improving governance. Despite difficulties with regard to structural reforms, due to technical and institutional capacity constraints, delays in obtaining external financial assistance and change in government, the implementation of this program helped the authorities to make progress in stabilizing the macroeconomic environment. In order to consolidate the progress achieved in the 2005 SMP and stabilize the macroeconomic environment, my authorities are implementing a new SMP, covering the period of April-December 2006. They are committed to pursue further the adjustment process and the building of institutional capacity, in order to establish a strong track record of program implementation, which they expect will pave the way for Fund support under the Emergency Post-Conflict Assistance (EPCA). The SMP should also enable Guinea-Bissau to build a track record for consideration of a new PRGF-supported program and eventual debt relief. However, the tasks ahead represent a daunting challenge that Guinea-Bissau cannot meet without a timely and adequate support from the international community in terms of technical and financial assistance.

Recent Economic and Financial Developments

Guinea-Bissau's macroeconomic performance in 2005 was strong, driven by favorable developments in agriculture. Real GDP is estimated to have grown by 3.5 percent in 2005, due to a good performance of cashew nut and grains harvest. However, activity in other sectors, such as industry and tourism, remained weak, owing to lack of basic facilities. Moreover, for the first time since 2001, GDP per capita recorded a slight increase. As a result of good cereal production, the 12-month inflation declined to 1 percent by December 2005.

In the fiscal area, the performance was robust in 2005, as a result of stronger-than-programmed tax revenues and lower non-wage expenditures. Moreover, the domestic primary fiscal balance on a commitment basis also improved. However, cash flows problems persisted, due in part to shortfalls in external assistance. On the revenue side, tax revenue increased significantly, as customs revenue collections benefited from the large increase of imports and the improvement in customs administration through the verification of imports shipped by land at the destination instead of border and the required prepayment of export taxes before shipment. Furthermore, tax administration was reinforced with the creation of a Large-Taxpayers Unit and the simplification of tax regime.

On the expenditure side, efforts were made to improve budget preparation through centralizing the authorization for expenditure commitments in the Ministry of Finance and closing all government bank accounts outside the central bank (BCEAO). A Treasury Committee was appointed to reconcile accounts between the Budget Department, the Treasury, and the BCEAO, in order to maintain a better fiscal control.

Although the country's financial system is thin, the recent opening of two regional banks in December 2005 and early 2006 augurs well for ensuring a return of confidence in Guinea-Bissau. As elsewhere in the region, the banking system is very liquid. Efforts are underway to encourage financial intermediation.

As regards the external sector, Guinea-Bissau achieved important earnings from cashew, the main export crop, stemming from a substantial rise in world prices and further expansion in production. However, export revenue did not compensate for the large increase in import and a drop in private remittances, such that the external current account deficit widened. With regard to the debt issue, Guinea-Bissau's external debt remains a heavy burden on the country's limited finances. Despite their scarce resources, my authorities are committed to normalize relations with all external creditors. It is in this perspective that they will continue to make efforts to remain current on the payment of external debt service to multilateral creditors, so as to preserve the eligibility to debt relief.

Performance under the 2005 SMP

Under the last SMP, the authorities took encouraging steps to stabilize the macroeconomic situation, and progress was made in implementing structural measures. In particular, on the fiscal front, the targets for revenue, domestic financing and the domestic primary budget deficit were observed. However, the indicative targets for the wage bill for the year as a whole were not met and domestic arrears level was surpassed, due to some adverse factors beyond the authorities' control. Also, faced with delays in budget support from the World Bank and the EU, the government contracted commercial debt, which allowed to clear part of domestic arrears in 2005.

On the structural front, 6 out of the 10 structural benchmarks were met. Among these are: the establishment of a Large-Taxpayers Unit within the Ministry of Finance; the transfer of the collection of customs duties and taxes to the office of Customs in the port of Bissau; the completion of discussions with all ministries and other budgetary units on the budget for 2006; the rehabilitation of the taxpayer master file; the reconciliation of changes in the treasury accounts at the BCEAO with expenditure authorized by the Treasury Committee; and the collection of full amount due on imports of petroleum products and rice and cashew nut exports. The indicative targets missed or partially met were related to the implementation of banderole system for alcoholic beverage and cigarettes; the approval by the Council of Ministers of the Organic law of the Ministry of Economy and finance; the implementation of the new organizational chart of the Customs Department and the implementation of censuses of the military and paramilitary. In their reform efforts, my authorities will take the necessary steps to meet these targets.

On governance and transparency, the Ministry of Finance has started in July 2005 to publish on a monthly basis, a summary table on fiscal developments. Promoting good governance will remain a cornerstone of government policies.

Macroeconomic and Structural Policies for 2006

The authorities are aware of the need to consolidate the peace process and political stability, which are necessary to maintain macroeconomic stability and implement deeper structural reforms. The program for 2006 is part of a broader medium-term's government program for 2006-09, in line with the draft Poverty Reduction Strategy. Policies for 2006 aim at improving the country's fiscal position, through better tax and public expenditure management. The program also puts forward macroeconomic policies and structural reforms that will be key for improving the investment climate, reducing poverty in Guinea-Bissau and making progress towards the MDGs. The macroeconomic framework underlying the 2006 SMP lies on the achievement of real GDP growth of 4.2 percent, higher than the population growth rate; and an average annual inflation rate close to 2 percent, in line with the WAEMU convergence criterion.

Fiscal Policy and Reforms in 2006

Prudent fiscal policies will be pursued. On the revenue side, the authorities are committed to boost revenues through better enforcement of fishing rights fees, payments of licenses by cell phone operations and continued improvement of customs administration controls. Measures will also be considered to move faster with the planned reforms to simplify the tax system, widen the tax base, and combat tax evasion. The process of simplifying the tax system started with the elimination of several low-yielding taxes in the budget for 2005. Corporate income tax rates were already unified and a minimum tax was introduced for companies that are unable to provide a balance sheet. The authorities intend also to strengthen corporate taxes by asking cashew nut exporters to pay their taxes in advance. Moreover, custom exemptions, which represent nearly 40 percent of total custom revenue, will be reduced by putting an end to discretionary exemptions.

On the expenditure side, given the importance that the authorities attach to poverty reduction in their policy agenda, they are determined to reining in discretionary spending to free resources needed to meet the social needs in the areas of health and education and to improve basic infrastructure. My authorities hope that the implementation of the first phase of the civil service reform and the reform of the security sector will help to contain the wage bill. The authorities intend to further strengthen the public expenditure management and prevent the accumulation of domestic payments arrears. In this regard, they will make use of the framework of a day-to-day fiscal management on the basis of a strict cash management system. The Treasury Committee, in which the UNDP and the EU were allowed to participate as observers, will be in charge of implementing the cash flow plan. To ensure a strict control of the budget, the Ministry of Finance will prepare on a regular basis a report comparing the budget and actual expenditure by main budget category. The authorities are also determined to further strengthen budgetary control procedures and increase transparency and donor confidence.

Monetary Policy and Financial Sector Reform

Monetary policy will continue to be conducted at the regional level by the BCEAO, which aims to maintain price stability and strengthen the external position. Although Guinea-Bissau is estimated to have missed convergence indicators established under the WAEMU's Pact of Convergence, Stability, Growth and Solidarity, the authorities remain committed to this pact.

On the financial sector, efforts will be pursued to strengthen the system. Guinea-Bissau had recourse to the regional market for short-term government paper for the first time in October 2005, as the Treasury issued a six-month treasury bill that was mostly subscribed by banks outside Guinea-Bissau. Over the medium-term, my authorities are planning to issue treasury bills for liquidity purposes and thus, help to support financial market development in the region.

Structural Reforms

My authorities are aware of the key problems facing the country. They are committed to address structural weaknesses in key sectors of the economy, with the view of improving efficiency, revitalizing the private sector and limiting potential cost on future budgets. They are also committed to reforming the public administration, undertaking actions concerning privatization and energy reform, and promoting good governance. My authorities share the view that the successful implementation of the reform agenda over the medium-term would require considerable technical assistance. In their efforts to improve the investment climate, Guinea-Bissau has recently joined the MIGA.

Debt Issue

Guinea-Bissau has an unsustainable external debt position. It is the intention of the authorities to maintain a close dialogue with the Fund to implement the needed policies, and work closely with creditors, so that the country can receive support under the PRGF, and also move to the completion point under the HIPC Initiative. In the meantime, the authorities will make every effort to remain current on debt service to multilateral creditors.

Poverty Reduction Strategy

The authorities are cognizant of the need to improve social indicators and make progress towards the Millennium Development Goals (MDGs). Work on the preparation of a final PRSP is underway, with the participation of all stakeholders, including the civil society. The assistance from donors will remain crucial to help the country implement policies envisaged in the document.

Conclusion

My authorities have made significant efforts to restore peace and political stability since the country emerged from a prolonged conflict situation. Support from their development partners, including the Fund, has been critical in this process. Under the 2005 SMP, as a result of improved political situation, the country was able to stabilize its macroeconomic environment and to make some headway on the structural front. Under the 2006 SMP, it is my authorities' intention to pursue their adjustment efforts to consolidate the progress achieved so far. They remain firmly committed to the adjustment process, which they view as critical to achieving the medium-term fiscal and debt sustainability and addressing the poverty situation facing Guinea-Bissau. The progress achieved up to date is encouraging and reflects the authorities' firm commitment to restore financial discipline. However, the authorites' efforts need to be complemented by a strong support from the international community. I, therefore, call on donors to provide Guinea-Bissau with timely and adequate technical and financial assistance, so that the country can make steady progress towards more robust and sustained growth, poverty alleviation, and the achievement of the MDGs.