

**International Monetary Fund**

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**Guinea-Bissau:** Letter of Intent, Memorandum of Economic and  
Financial Policies, and Technical Memorandum of Understanding

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June 29, 2005

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The following item is a Letter of Intent and a Memorandum of Economic Policies of the government of Guinea-Bissau. It is being made available on the IMF website by agreement with the member as a service to users of the [IMF website](#). This memorandum describes the policies that Guinea-Bissau is implementing in the framework of a staff-monitored program. A members's staff-monitored program is an informal and flexible instrument for dialogue between the IMF staff and a member on its economic policies. A staff-monitored program is not supported by the use of the Fund's financial resources; nor is it subject to the endorsement of the Executive Board of the IMF.

Bissau, June 29, 2005

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

Dear Mr. de Rato:

1. Guinea-Bissau is trying to overcome the effects of a long period of political instability. Following a civil war in 1998-99 and continuing political instability thereafter, the economy stagnated and the fiscal situation deteriorated, with mounting internal and external arrears. After a coup in 2003 and parliamentary elections in 2004, a new government was nominated in May 2004. The first round of Presidential elections—which constitute the end of the transition period after the coup in 2003—took place on June 19, 2005, and a second round is expected by mid-July.

2. The first priority of our government is to rebuild the administrative capacity of the State, which had virtually collapsed by mid-2003, and to enforce adherence to regulations and laws. The government program for 2004-08, which was approved by parliament in July 2004, also focuses on improving the political situation, including through emphasizing good governance and transparency in government affairs, and on addressing the fiscal and economic problems with the aim of reducing wide-spread poverty in the country. We are working closely with our domestic and external partners to complete the National Poverty Reduction Strategy Paper as soon as possible.

3. The government of Guinea-Bissau has prepared an economic and financial program for 2005 that reflects these policies. 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 to request the start of discussions on a program that can be supported by the Fund under EPCA as soon as possible. Until that time, we request that the staff of the Fund monitor our economic program, which is expected to help us in implementing our policies and in building a track record toward post-conflict assistance.

4. The details of the program for 2005 are included in the attached Memorandum on Economic and Financial Policies (MEFP), which was approved by the Cabinet 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 3 and 4 of the MEFP), as well as on the overall implementation of the program.

Sincerely yours,

/s/

João Fadia  
Minister of Finance

Attachments:

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

## MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES FOR 2005

Bissau, June 29, 2005

### I. INTRODUCTION

1. **Guinea-Bissau has taken the first steps toward addressing the major political and economic problems of recent years.** Initial efforts to overcome the damage of a civil war in 1998-99 failed as political instability continued, ultimately resulting in a coup in September 2003. Based on the proposals for an international partnership agreement by the ECOSOC Ad Hoc Advisory Group for Guinea-Bissau, a transition government started implementing an emergency economic management plan for 2004. Following elections in March 2004, the new government built on this plan by formulating a program for 2004-08 that focuses on promoting political stability, rebuilding a rules-based administration, addressing the severe financial problems and reviving economic activity. This program was approved by parliament in July 2004.
2. **The government is determined to address the deep-seated political and economic problems.** It will take much time and effort to resolve them and Guinea-Bissau will need financial and technical assistance to accomplish this in a manner consistent with social stability. We are confident that the ongoing presidential elections will show broad support for political stability and reform policies, and we are hopeful that this will pave the way for new external assistance. In the meantime, we intend to continue making progress in the most urgent areas, within our serious financial and technical constraints. This memorandum provides an overview of the planned policies and measures during 2005.

### II. BACKGROUND

3. **Despite considerable development potential, Guinea-Bissau remains one of the poorest countries in the world.** Climate and soil provide excellent conditions for rain-fed agriculture and the territorial waters are among the richest for fishing in West Africa. However, per capita GDP, which has declined by about 25 percent since the early 1990s, is estimated at only about US\$200 and Guinea-Bissau ranks among the lowest ten countries on the human development index. More than two-thirds of the population of approximately 1.3 million is living below the poverty line. After independence in 1974, economic policy initially was based on the central-planning model. Reform toward more market-oriented policies started in the mid-1980s and we moved to a multi-party democracy in the early-1990s. However, political and social tensions persisted, reflecting serious governance problems and a sense of exclusion by a large part of the population. This situation culminated in an armed conflict in 1998-99, centered on the capital Bissau, that caused several thousands deaths, displaced most of the city's population and caused wide-spread damage to its infrastructure, and led to the emigration of many of the higher-educated.
4. **Following elections, a new government came to power by early 2000, but political and economic stability proved elusive.** Divisive and erratic policies led to further political tensions and, combined with weak institutions and low technical capacity, to

increased fiscal problems. Under these circumstances, the post-conflict effort, supported by our development partners, came to a halt. By the time of the coup in September 2003, the government administration and public services had virtually collapsed, most public servants had remained unpaid for more than ten months, and economic activity was falling after an initial post-war rebound.

### III. RECENT PROGRESS

5. **Despite difficult conditions, progress has been made on the political and financial fronts recently.** The persistent political fragility was apparent in the tensions immediately after the parliamentary elections in March 2004 and in the military mutiny in October. However, since then, support for the democratic system has increased, culminating in the unanimous approval by parliament of the budget for 2005 in February of this year. 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. Nevertheless, it will take time and effort to build stable democratic institutions.

6. **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). The preparation of a regular budget for 2005, with technical assistance financed by the UNDP and the EU, was an important step towards normalizing fiscal management. With considerable financial support from the other member countries of the WAEMU (CFAF 7 billion) and donors (CFAF 5 billion), public sector wages for 2004 were paid, albeit with delays. Moreover, long-standing tensions with the unions and the military, resulting from wage differentials and unsustainable wage increases accorded by the previous government, were resolved by harmonizing the salary scales across the public sector starting July 2004.

7. **Despite the progress, the economic situation remains very difficult.** The country's small industrial base was virtually destroyed in the war and other enterprises remain severely undercapitalized because of confiscations and looting during the conflict. Moreover, the infrastructure has further deteriorated and central electricity production has virtually ceased; under the uncertain political situation, new private investment has been minimal in recent years. After a decline of about 1 percent in 2003, the economy rebounded to some extent in 2004, when real GDP grew at an estimated rate of slightly more than 2 percent. Reflecting the monetary and exchange rate policies of the WAEMU, and low domestic demand, inflation remained low in recent years, amounting to less than 1 percent, on average, in 2004.

8. **The fiscal situation is also very problematic.** The combination of low economic activity and weak technical capacity in tax administration has undermined revenue. The expenditure needs to allow a basic operation of the government exceed our resources by far, also reflecting the high claim (almost 70 percent) on revenue of wage payments. Moreover, most interim debt relief under the Initiative for Heavily Indebted Poor Countries (HIPC

Initiative)—except from the World Bank and the African Development Bank (AfDB)—stopped after 2001 because of nonperformance under the program supported under the IMF's Poverty Reduction and Growth Facility (PRGF) for 2000-03. Consequently, non-wage expenditure, including to the social sectors, had to be cut further to far below minimum needs in 2004. Despite this, and emergency budget support amounting to 8 percent of GDP, the budget incurred new domestic arrears of more than 1 percent of GDP, while most external debt service also remained unpaid.

#### IV. OBJECTIVES AND POLICIES FOR 2005

9. **The structural nature and severity of Guinea-Bissau's problems implies that they can only be solved over the medium term and with donor assistance.** We are in the process of finalizing the National Poverty Reduction Strategy Paper (DENARP), which will become the basis of the medium-term economic and social policies. The government intends to seek donor assistance in implementing these policies at a Round Table conference—the first since 2000—which is, in cooperation with the UNDP, tentatively planned for the latter part of 2005.

10. **The policies for 2005 aim at laying the basis for addressing the main economic and fiscal problems.** They draw on the government program for 2004-08 and the draft DENARP and its Action Plan for 2005. The main objectives are to rebuild the administrative capacity of the government and to prepare the ground for improving the economic situation. Within these broad objectives, the program for 2005 focuses on improving the fiscal situation and on strengthening technical capacity in preparing and implementing macroeconomic policies.

11. **Political stability is of overarching importance for attaining the objectives of the program.** Important elements will be the end of the transition period following the ongoing presidential elections and security sector reform, discussions on which have started. These efforts will be supported by good governance and transparency in government affairs, in cooperation with, and assistance from, our international partners.

12. **The macroeconomic framework for 2005 assumes that real GDP will grow by about 2 percent, close to the population growth rate.** Initial reports indicate limited damage from the locust invasion early this year. However, as stated above, it will take time for economic activity to pick up, and higher growth is expected to come only gradually. Reflecting the monetary and exchange rate policies of the WAEMU, inflation is estimated to remain at about 2 percent in 2005.

#### **Fiscal policies**

13. **The budget shows an overall financing gap of CFAF 43 billion (28 percent of GDP) for this year.** Revenue is projected to increase as a percentage of GDP, reflecting an improvement in tax revenue from strengthening customs controls (especially on petroleum products and rice). The expenditure estimates remain based on the minimum needs for a basic operation of the government. However, current expenditure is also estimated to be

considerably higher than the outcome for 2004, when expenditure had to be cut sharply below what was needed. Moreover, domestically-financed capital expenditure is budgeted to increase on behalf of the government's commitment to start contributing to the capital of the financial institutions of the WAEMU. Scheduled external debt service amounts to CFAF 36 billion (24 percent of GDP).

14. **Based on the progress made so far, the outlook for new financing is improving.** During a recent meeting in Lisbon, donors pledged additional emergency budget support of CFAF 1.3 billion, to be disbursed through the UNDP-managed Emergency Economic Management Fund, and several donors announced support to cover the costs of the elections (CFAF 2.3 billion). Moreover, substantial budget support (CFAF 12 billion) is expected from the European Union (EU), the World Bank and other donors in the second half of the year. The government also intends to contact the external creditors to seek solutions for the high external debt payments.

15. **Under the circumstances, short-term fiscal policy will aim at avoiding new domestic arrears over the year.** To this end, the government intends to continue day-to-day fiscal management on the basis of a strict cash rationing system, implemented by the Treasury Committee, limiting new expenditure commitments to available resources. The Treasury Committee will be guided by a cash-flow plan for 2005 (Table 1), based on the budget for 2005. In order to increase transparency and donor confidence, the government has requested the UNDP to continue to participate in the Treasury Committee, which invitation has also been extended to other donors.

16. **While the cash rationing system is expected to enable avoiding new arrears on discretionary expenditure items, temporary arrears on non-discretionary items may arise during the year.** The large share in expenditure of wages and other non-discretionary outlays, and the concentration of revenue in the middle of the year, imply that, without additional financing, new arrears (on a commitment basis) on these expenditure categories may arise during the first part of the year. Clearing such arrears will get the highest priority when new financing is found.

17. **In line with the budget, the government does not anticipate the payment of previous years' arrears in 2005, unless specific external financing for their clearance is obtained.**<sup>1</sup> The wage and other domestic arrears have caused much hardship during the last few years. The first task is to avoid additional suffering by avoiding new arrears. Donor assistance will be sought for auditing the outstanding amounts, following which additional foreign financing for their clearance will be requested.

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<sup>1</sup> Some obligations from 2004 were paid, within the complementary budget period for 2004, in January 2005, reflecting administrative delays caused by the receipt of budget support from the WAEMU in late-December 2004.

*Revenue*

18. **The fiscal situation can only improve by increasing revenue and reducing expenditure.** With regard to revenue, recent technical assistance reports from the World Bank and the IMF indicated that, in general, tax rates are not below those in the region and that additional revenue would have to come mainly from better administration, for which there is considerable scope. The main measures are provided in Box 1. The government will also continue its efforts 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; a focal point under the 2004 cooperation agreement with Senegal has been nominated, and the government is seeking donor support for the financing of the necessary equipment.

19. **The government also intends to continue with tax reform.** In the budget for 2005, income tax rates for companies were unified and a minimum tax was introduced for companies that are unable to provide a balance sheet. The government will continue the long-standing policy of reducing export taxes on cashew nuts once tax administration has been strengthened sufficiently to allow the recuperation of the resulting revenue losses through domestic income taxes; in the mean time, 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. Moreover, the process of simplifying the tax system was started in the budget for 2005 with the elimination of several low-yielding taxes. This policy will be continued in close cooperation with measures to improve the investment climate.

20. **The government is also planning measures to protect and increase revenue from the fishing sector.** Fishing licenses—including the contribution from the EU—accounted for one-third of revenue in 2004. However, surveillance of our territorial waters has been minimal in recent years, leading to considerable illegal fishing and a decline in revenue. During June-September 2004, the Ministry for Fisheries suspended issuing licenses to allow a survey of the stock of shrimp, and, with partners' assistance, it intends to finalize the annual resource management plan for the fishing sector for 2005 shortly. Surveillance was stepped up, which will be further improved after the receipt of two new boats, obtained with EU assistance. Moreover, agreements under which fishing licenses are obtained against payments in kind or for settling government obligations were stopped; the single remaining such agreement terminates by end-2005, and a any new agreement will be based on monetary payment only. Furthermore, all fishing agreements will be harmonized. While it may take time for these measures, which are also supported by the World Bank and the AfDB, to lead to higher revenue, the government expects that they will enable concluding a new agreement with the EU after the expiration of the present protocol in June 2006.



### **Box 1. Main Measures to Enhance Revenue Administration**

In order to strengthen revenue administration, the government intends to:

- Implement, with immediate effect, a stop on all netting out of tax liabilities against government liabilities, and enforce daily channeling of tax receipts (weekly for offices outside Bissau) in the treasury account at the BCEAO.
- Establish a directorate for large enterprises, which will provide a single access point for all taxes of the largest tax payers, by July 2005.
- Complete updating the tax payer master file, by end-2005.
- Request technical assistance with preparing a single tax code, under which low-yielding taxes will be eliminated.
- Continue preparations for the application of the West African Accounting System (SYSCOA), with a view to implement the system on an experimental basis in 2006, and obligatory in 2007.
- Request technical assistance with the computerization of tax payment procedures, starting with the directorate for large enterprises, and with the preparation of a revenue nomenclature and accounting system.
- Limit exemptions for import taxes to those provided under international conventions and existing laws; exemptions will be authorized only by the Minister of Finance.
- Transfer the collection of customs duties and taxes to the Office of Customs in the port of Bissau, by end-June 2005.
- Request technical and financial assistance for upgrading the automated customs system to ASYCUDA++ and for improving customs statistics by restoring the Eurotrace system.
- Strengthen customs controls, including by preparing an updated database with indicative prices, by July 2005.

Apply a banderole system for alcoholic beverages and cigarettes, and possibly other products, by July 2005.

#### *Expenditure*

21. **The key element in reducing expenditure is personnel costs.** At about 70 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. During the 1990s, Guinea-Bissau made considerable progress in reducing excessive public sector staffing under a donor-financed retrenchment program. However, the program

was not completed at the time the war erupted. Moreover, hiring policies loosened after the war and total public employees increased from about 17,900 in 1997 to an estimated 21,000 by end-2003. 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 and para-military is estimated to have remained considerably above the pre-war level.

22. **The reduction in personnel costs has to be implemented in the context of a comprehensive medium-term public sector reform program.** This reform will be based on a Public Sector Reform Law, which is under preparation; a steering committee, chaired by the Prime Minister and including representatives of the labor unions, employers organizations, civil society, was 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. Nevertheless, a number of measures have already been taken, including (i) the imposition of a freeze on new hiring and promotions; (ii) a census of the civil service, the results of which are now being compared with the payroll maintained by the Ministry of Finance; (iii) a census of the para-military for Bissau, which will be extended to the rest of the country once donor-financing is received; (iv) the identification of about 400 employees that have exceeded the mandatory retirement age—these employees will be retired during 2005. During the year, the government also intends to conduct a census of the military—in preparation for a military reform program—and identify the contractual workers, which will be incorporated in the civil service or laid off.

23. **Measures will be taken to further strengthen expenditure management.** First, 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. 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 restructuring of the Budget Department will be completed during 2005; the budget for 2006 will be prepared in line with the existing regulations and established timetable.

24. **Moreover, to strengthen its organization, a new institutional law for the Ministry of Finance will be submitted, together with those for the other ministries, to the Council of Ministers during 2005.** In addition to the recent creation of a Research Department, the new law will establish a Directorate-general for Financial Control. This unit will be responsible for internal control, ensuring that all financial operations are conducted in line with the legal provisions before their implementation, and for centralizing accounting data.

#### *Debt*

25. **The budget is also 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; this debt amounts to CFAF 70 billion (45 percent of GDP), which we are committed to pay over 25 years, starting June 2005.<sup>2</sup> 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 reduce these payments in 2005; a longer-term solution will be sought at the time of the Round Table conference.

26. **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, we will undertake every effort to remain current on debt service, especially to those creditors that can provide new assistance. Moreover, we 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 was destroyed during the civil war; we are in the process of rebuilding the database and strengthening debt management, with technical assistance from Debt Relief International.

27. **The disruptions of the 1998-99 conflict have also led to substantial claims by foreign contractors.** Two claims, related to the port of Bissau and the building of a bridge, amount to a total of € 15.5 million (7 percent of GDP). Discussions with our international partners are underway to seek solutions for these claims that will not affect the budget.

### **Structural reform**

28. **The pace of fiscal reform will depend on simultaneous progress in other areas, including in stabilizing the political situation, repairing damage from the war, and improving the investment climate and promoting growth.** 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.

29. **The government was elected on the basis of a platform emphasizing good governance.** The first step in this direction was the reapplication of rules and regulations in government operations. This will need to be followed by strengthening the political and democratic institutions, including on a local level, and measures to increase the efficiency

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<sup>2</sup> This amount may further increase following discussions on capital contributions to the West African Development Bank (BOAD).

and effectiveness of the government administration. With donor assistance, the judiciary system will be strengthened. To improve transparency in public finances, the Ministry of Finance is planning to publish monthly a summary table on fiscal developments, starting before July 2005. More generally, the National Committee for Social Cooperation—which is chaired by the Prime Minister and includes trade unions and employer organizations—was revived, and will meet regularly to discuss economic developments and reform policies.

**30. 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 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. Moreover, the donor-financed program to clear arrears from the war-period was only partially implemented, severely restricting the capacity of the private sector to make new investments. The results of the arrears-clearance financed by the World Bank in 2004 are under review. Following this, donor-assistance will be requested for auditing the remaining arrears, after which financing will be sought for their clearance.

**31. The rehabilitation efforts will be supported by policies to improve the investment climate.** The starting point of these policies is the Action Plan for Simplifying Procedures for Trade and Investment, prepared under the World Bank-financed project for the Rehabilitation and Development of the Private Sector (PRDSP), which is expected to be implemented before July 2005. Important elements of this plan are (i) a review of the Investment Code, which is expected to be completed by end-2005; (ii) elimination of most license (fee) requirements for the industrial and commercial sector, including for imports and exports. Any remaining license requirements, intended solely for statistical purposes, will be limited to a small number of strategic goods and to specific cases involving issues of national health, education and the protection and management of natural resources; license fees will be set at the level of actual processing costs; (iii) identification 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, with a view to eliminate them; and (iv) the simplification of the fiscal system to promote private sector activity. Labor laws will be brought in line with the provisions of the Organization for the Harmonization of Trade Legislation in Africa (OHADA). The government is also seeking financing to assist the private sector in building capacity in cashew nut processing. In all these areas, we intend to cooperate closely with the social partners.

**32. The promotion of regional integration is a cornerstone of economic policy.** The accession to the WAEMU in 1997 was shortly thereafter followed by the civil war, and Guinea-Bissau made little progress in bringing macroeconomic indicators in line with those of the region. Nevertheless, the government remains committed to the implementation of policies required to meet the objectives under the WAEMU's Convergence, Growth and Solidarity Pact.

33. **Social policies aim at strengthening health and education.** 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 receives support in these areas from the World Bank and other donors.

34. **The government will also continue efforts to strengthen the financial system, which currently consists of one commercial bank.** A first success in this regard has been the recent opening of a branch of the Regional Solidarity Bank (BRS)—which will focus on the financing of micro-projects—and the likely establishment, by end-2005, of two new commercial banks. 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.

#### V. CAPACITY BUILDING AND TECHNICAL ASSISTANCE

35. **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, we will request donor assistance for the preparation of a comprehensive country technical assistance plan to identify priority areas.

36. **A key element is to strengthen the Ministry of Finance to improve management of our scarce resources.** 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 2); the highest priority is assistance to the Budget and Customs Departments. Short-term missions are reaching the limits of absorption capacity, and we are 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. Since buildings and equipment were damaged or destroyed during the civil war, assistance will need to include funds for rehabilitating offices.

37. **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 for 2005, which should become the common framework for donor-assistance, as discussed in the recent meeting with development partners in Lisbon. Moreover, while the Ministry of Foreign Affairs will remain responsible

for overall relations with donors, the government has established a special unit in the Ministry of Finance to coordinate donor assistance.

## VI. PROGRAM FINANCING

38. **The domestic transactions of the government are fully financed, but external payment arrears will continue.** Budget support has been received through the EEMF (0.7 percent of GDP) and for the elections (1.5 percent of GDP). Disbursements under new budget support under preparation by the World Bank and the EU (7.2 percent of GDP) and from other donors (0.4 percent of GDP), are expected to start by August 2005. Moreover, the government intends to reschedule part of the debt to the demobilization project (which is, following a payment scheduled for June, adequately financed) (0.4 percent of GDP) and capital contributions to the WAEMU institutions (0.9 percent of GDP). While this would allow avoiding new domestic arrears over the year as a whole, the government expects to incur new external arrears equivalent to 18 percent of GDP in 2005.

## VII. PROGRAM MONITORING

39. **The monitoring of progress with implementing the program outlined above will be based on the quantitative and structural indicators provided in Tables 3 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 indicators relate to the strengthening of tax administration and collection, and improving transparency in public finance developments. We will provide all necessary data to monitor the program as indicated in the technical memorandum of understanding.

Table 1. Guinea-Bissau--Treasury cash-flow plan 2005  
(in millions of CFAF)

	Jan Prov.	Feb Prov.	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Budget Cash-flow 1/
	Projections												
Revenue and grants	1,563	974	1,806	4,696	1,894	3,909	2,710	3,121	2,061	1,454	1,857	2,912	28,957
Revenue	1,229	974	1,417	4,605	1,894	3,909	2,710	1,809	2,061	1,454	1,857	2,912	26,831
Taxes	931	777	800	708	1,277	1,482	1,811	1,198	1,341	901	1,204	1,850	14,280
Non-tax revenue	298	197	617	3,897	617	2,427	899	611	720	553	653	1,062	12,551
Grants	334	0	389	91	0	0	0	1,312	0	0	0	0	2,126
Budget-support grants	334	0	389	91	0	0	0	1,312	0	0	0	0	2,126
Expenditure	2,700	2,562	2,967	3,883	3,072	4,678	3,329	3,054	3,829	3,233	2,942	3,904	40,153
Current expenditure	2,686	2,552	2,766	3,682	2,871	3,780	3,113	2,838	2,917	3,017	2,726	2,992	35,938
Personnel expenditure	1,532	1,602	1,642	1,642	1,642	1,642	1,642	1,642	1,642	1,642	1,642	1,630	19,541
Goods and services	276	316	327	468	468	468	533	533	533	533	533	675	5,665
Transfers	527	302	466	716	466	466	740	490	490	739	490	489	6,379
Other current expenditure	352	332	236	835	285	1,087	198	173	166	89	51	80	3,885
Interest	0	0	95	20	10	117	0	0	85	14	9	118	468
Dom. financed capital exp.	14	10	201	201	201	898	216	216	913	216	216	912	4,215
<i>Of which:</i> Capital contributions BCEAO/AMAO	0	0	0	0	0	697	0	0	697	0	0	697	2,090
Overall balance (commitment basis)	-1,137	-1,588	-1,161	813	-1,178	-769	-619	67	-1,768	-1,779	-1,085	-992	-11,196
Arrears current year	1,625	1,566	-1,375	-1,816	0	0	0	0	0	0	0	0	0
Float and statistical difference	76	-86	11	0	0	0	0	0	0	0	0	0	0
Overall balance (cash basis)	564	-108	-2,526	-1,003	-1,178	-769	-619	67	-1,768	-1,779	-1,085	-992	-11,196
Financing	-564	108	2,525	-29	-22	-278	-198	-3,479	-658	-1,263	-42	-380	-4,279
Domestic financing	-434	233	2,546	0	0	-261	-198	-3,479	-655	-1,200	0	-261	-3,709
Bank financing	1,544	233	2,546	0	0	-261	-198	-3,479	-455	-1,200	0	-261	-1,531
BCEAO	344	233	-454	0	0	-261	-198	-479	-455	0	0	-261	-1,531
Commercial banks	1,200	0	3,000	0	0	0	0	-3,000	0	-1,200	0	0	0
Non-bank financing	-1,978	0	0	0	0	0	0	0	-200	0	0	0	-2,178
External financing	-130	-125	-20	-29	-22	-17	0	0	-2	-63	-42	-120	-570
Financing gap (gap = -)	0	0	0	-1,032	-1,200	-1,047	-817	-3,412	-2,426	-3,042	-1,127	-1,373	-15,475
Additional financing anticipated 2/	0	0	0	1,248	984	1,707	4,884	945	1,641	1,568	1,127	1,373	15,476
Remaining financing gap (gap = -)	0	0	0	216	-216	660	4,067	-2,468	-785	-1,474	0	0	0
Cumulative 3/	0	0	0	216	0	660	4,727	2,259	1,474	0	0	0	

Source: Ministry of Finance; IMF staff estimates and projections.

1/ Approved budget minus offsetting revenue/financing and expenditure items plus arrears paid in January 2005.

2/ Corresponds to resources expected from the World Bank (US\$10 million), UNDP Emergency Economic Management Fund (€ 1.5 million), European Union (€ 9.2 million of which € 2 million have already been included in the budget), and other donors (€ 1 million). Moreover, the authorities intend to reschedule part of the debt to the demobilization project account (CFAF 0.6 billion) and the payment for capital contributions to the financial institutions of the WAEMU (CFAF 1.4 billion) pending which these payments would go into arrears. Funding for the elections, provided by multiple donors, is also included and amounts to CFAF 2.3 billion.

3/ Monthly treasury surpluses will be deposited in the treasury account at the BCEAO for use in subsequent months.

Table 2. Technical Assistance Needs of the Ministry of Finance

Department	Area	Long-term	Short-term	(Possible) provider
Cabinet Minister	Macro-fiscal advisor	X 1/		(IMF)
Budget	Budget Advisor	X 2/		UNDP
	Expert expenditure management	X		(EU—July 05?)
	Expert expenditure management	X		(EU—July 05?)
	Accounting system	X		(France)
	Computerization expenditure accounts	X 2/		France/EU
Treasury	Advisor to the Treasurer	X		BCEAO
	Advisor		X	
Tax Department	Expert Tax Code		X (3-6 months)	(Portugal)
	Computerization 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
Micro-finance	Advisor		X	(West-AFRITAC)
Conjuncture	Advisor fiscal analysis	X		
Planning	National accounts advisor	X		
	Implementation System National Accounts 1993		X	IMF/AFRISTAT

1/ TA requested and under consideration.

2/ TA in place.

3/ First mission conducted in January 2005.



Table 3: Guinea-Bissau--Quantitative Indicators Staff Monitored Program 2005.  
(in CFAF billions) 1/

	End-March (prov.)	End-June	End-September	End-December
Domestic financing of the budget 2/	2.3	2.1	-2.2	-3.7
Domestic primary budget deficit (commitment basis) 2/	4.5	5.6	9.1	12.9
Revenue 3/	3.6	14.0	20.6	26.8
Wage bill 4/	5.0	10.2	15.4	20.5
Accumulation of domestic arrears 5/	1.8	0.0	0.0	0.0
External public debt, maturities <= 1 year	0.0	0.0	0.0	0.0
External non-concessional public debt, maturities > 1 year	0.0	0.0	0.0	0.0

1/ Cumulative from January 1, 2005. The definition of the aggregates is provided in the technical memorandum of understanding.

2/ Ceiling. If the actual amount of external budgetary assistance, falls short of program forecasts, the ceilings will be increased for the full amount of the shortfall. The programmed amounts of external assistance are (on a cumulative basis) CFAF 4.1 billion by end-June 2005, CFAF 12.1 billion by end-September 2005 and CFAF 15.6 billion by end-December 2005.

3/ Floor.

4/ Ceiling. Wage bill includes food for the military and disbursements to parliament.

5/ Ceiling.

Table 4. Guinea Bissau: Structural Indicators Under the Staff Monitored Program for the Period April 1, 2005—December 31, 2005

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<b>Structural indicators</b>	
Establishment of a large taxpayers unit within the ministry of finance.	End-June 2005
Implement banderole system for alcoholic beverages and cigarettes	End-June 2005
Transfer the collection of customs duties and taxes to the Office of Customs in the port of Bissau	End-June 2005
Complete discussions with all Ministries and other budgetary units on the budget for 2006	End-September 2005
Approval by the Council of Ministers of the Organic Law of the Ministry of Economy and Finance	End-September 2005
Rehabilitation of the taxpayer master file.	End-December 2005
Implementation of the new organizational chart of the Customs Department.	End-December 2005
Implementation of censuses of the military and para-military.	End-December 2005
Reconciliation of changes in the treasury accounts at the BCEAO with expenditure authorized by the treasury committee, and immediate liquidation of such expenditure.	Continuous
Collect full amount of taxes due on (i) imports of petroleum products through the port in Bissau; (ii) rice imports; and (iii) cashew nuts exports.	Continuous

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**TECHNICAL MEMORANDUM OF UNDERSTANDING FOR THE STAFF-MONITORED PROGRAM  
FOR 2005**

Bissau, June 29, 2005

1. This memorandum describes the definitions of the quantitative and structural indicators for the staff monitored program (SMP) for 2005 (Tables 3 and 4 of the Memorandum on Economic and Financial Policies (MEFP) as agreed 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.

**I. QUANTITATIVE INDICATORS AND ADJUSTORS**

**A. Quantitative indicators**

2. The quantitative indicators (Table 3 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;
  - 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-June, end-September, and end-December 2005, and their values are cumulative from January 1, 2005.

**Definitions and computation**

3. **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.
4. **For the SMP, government revenue includes all tax and non-tax receipts and excludes external grants.** The cash-flow estimates are based on the revenue estimates in the approved budget for 2005, which are adjusted for certain revenue items that are not paid in

cash or that are offset by corresponding expenditure or financing items. They concern: (i) revenue for fishing licenses from the company CONAPEMAC (CFAF 897 million, offset in external debt); and (ii) the revenue from the European Union that is earmarked for the fishing project (CFAF 1,476 million, offset in domestically-financed capital expenditure).

5. **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 para-military, and encompasses the budget categories 01.01.00 (gross wages) and 01.02.00 (bonuses and subsidies); (ii) payments for food for the military and para-military (budget category 02.02.04); and (iii) all transfers to the National Assembly (budget category 03.02.01). The quarterly targets are given in Table 1 below.

Table 1. Quarterly Targets for the Broadly Defined Wage Bill, 2005  
(Cumulative, in billions of CFAF)

	Mar.	Jun.	Sep.	Dec.
Wages (01.01.00)	4.5	8.9	13.4	17.9
Bonuses and subsidies (01.02.00)	0.1	0.2	0.4	0.5
Food for the military and paramilitary (02.02.04)	0.2	0.5	0.9	1.2
Transfers to Parliament (03.02.01)	0.3	0.5	0.8	1.0
Total wage bill under the SMP target	5.0	10.2	15.4	20.5

Source: Budget 2005.

6. **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 paragraph 4 of this TMU and domestic primary expenditure on a commitment basis. The latter consist of current expenditure plus domestically-financed capital expenditure (corrected for the EU-financed expenditure for the fishing project), excluding all interest payments and externally financed capital expenditure. 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 quarterly domestic primary balances for 2005 are provided in Table 2 below.

	Mar.	Jun.	Sep.	Dec.
Revenue	3.6	14.0	20.6	26.8
Current expenditure	-8.0	-18.3	-27.2	-35.9
Domestically financed capital expen.	-0.2	-1.5	-2.9	-4.2
Minus: interest	0.1	0.2	0.3	0.5
Balance	-4.5	-5.6	-9.1	-12.9

Source: Table 1, MEFP.

7. **New domestic payments arrears of the government are calculated as the difference between payments due on commitments engaged since January 1, 2005 and actual payments made on those commitments.** Government commitments due include all expenditure for which commitment vouchers have been approved by the Ministry of Finance, non-discretionary expenditure (such as wages and salaries, pensions, utilities, and other expenditures for which commitments are automatic and not at the discretion of the government, including domestic debt).

8. **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 non-bank financing encompasses changes in debt owed to projects, privatization receipts, and repayments of previous years' arrears, as well as any other domestic financial debt held outside the banking sector, other than arrears, that may arise. Table 3 provides the details.

Table 3. Estimates of Domestic Financing by Quarter, 2005  
(In billions of CFAF)

	Mar.	Jun.	Sep.	Dec.
	cumulative change			
Domestic financing	2.3	2.1	-2.2	-3.7
Bank financing	4.3	4.1	0.0	-1.5
BCEAO	0.1	-0.1	-1.2	-1.5
Treasury accounts	0.6	0.6	0.6	0.6
Advances	0.5	0.5	0.0	0.0
Consolidated debt	-0.1	-0.1	-0.2	-0.2
Debt ex-BCN	0.0	0.0	0.0	0.0
Debt ex-BCGB	0.0	0.0	-0.1	-0.1
IMF	-0.8	-1.0	-1.6	-1.7
Commercial bank(s)	4.2	4.2	1.2	0.0
Non-bank financing	-2.0	-2.0	-2.2	-2.2
PDRRI	0.0	0.0	-0.2	-0.8
Privatization receipts	0.0	0.0	0.0	0.6
Arrears/float previous years	-2.0	-2.0	-2.0	-2.0

Source: Table 1, MEFP.

9. **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 (Decision No. 12274-00/85) 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 lessor 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 from 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.

10. **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 paragraph 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

11. 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 3.9 billion in April 2005 and CFAF 2.4 billion in June 2005.
  - **The floors on the domestic primary fiscal balance (on a commitment basis) will be adjusted in line with the adjustment in revenue.** Moreover, the floor on the domestic primary deficit will be lowered in case of higher budget support than programmed, for the full amount of the excess. The programs assumes budget support of (cumulative from January 1, 2005) CFAF 0.7 billion by end-March 2005, CFAF 2.1 billion by end-June 2005; CFAF 10.1 billion by end-September 2005, and CFAF 15.4 billion by end-December 2005.

## II. PROGRAM MONITORING

12. **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 (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 table providing the end-of-period stock of domestic arrears accumulated during the program period, by budget category (wages, goods and services, etc.; within four weeks after the end of the month);



- The amount, interest rate and term of new external debt (concessional or not) contracted or guaranteed by the government (within four weeks after the end of the month);
- Disbursements of budget support grants and loans, by donor (within 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 5 of the MEFP (within two weeks after the end of the month).

**13. 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.**

**14. 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.**