

Guinea-Bissau: Review of Performance Under the Program Supported by Emergency Post-Conflict Assistance and Request for Second Purchase Under Emergency Post-Conflict Assistance—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Guinea-Bissau

In the context of the review of performance under the program supported by Emergency Post-Conflict Assistance and request for second purchase under Emergency Post-Conflict Assistance, the following documents have been released and are included in this package:

- The staff report for the Review of Performance Under the Program Supported by Emergency Post-Conflict Assistance and Request for Second Purchase Under Emergency Post-Conflict Assistance, prepared by a staff team of the IMF, following discussions that ended on May 22, 2008, 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 10, 2008. 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 Press Release summarizing the views of the Executive Board as discussed during its July 25, 2008 discussion of the staff report that concluded the review.
- 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*
Technical Memorandum of Understanding*
*Also included in the Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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GUINEA-BISSAU

Review of Performance Under the Program Supported by Emergency Post-Conflict Assistance and Request for Second Purchase Under Emergency Post-Conflict Assistance

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

Approved by Robert Sharer and Anthony Boote

July 10, 2008

A mission to review performance on the EPCA-supported program visited Bissau May 8–22, 2008. The team comprised Ms. McAuliffe (head), Ms. Ocampos, Mr. Fernandez, and Ms. Leony (all AFR). The staff team worked closely with an overlapping World Bank mission.

Performance through March was satisfactory. Four of six quantitative indicators were met. The two that were missed (payment of previous years' arrears and new domestic arrears) are expected to be met for the year as a whole. Structural indicators were implemented with a delay on one measure. The authorities also implemented important measures that had not been made program indicators.

The fiscal situation, however, is very tight. Pressures are emerging, especially from the recent surge in world food and fuel prices. Agreement was reached on measures for the rest of 2008 to keep the fiscal framework on track. The authorities are requesting a second EPCA purchase to support these policies, in line with their intention at the time of their request for the first purchase.

A new PRGF arrangement could be discussed later this year if performance on the EPCA-supported program continues to be satisfactory.

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EXECUTIVE SUMMARY

Guinea-Bissau has made progress in stabilizing its fiscal situation under difficult circumstances and is moving steadily to implement structural reforms. Four of six end-March quantitative indicators were met; the other two (payment of previous years' arrears and new domestic arrears) are expected to be met for the year as a whole. All structural indicators were implemented, albeit with some delay.

The fiscal situation remains tight. Pressures are emerging especially from the recent surge in food and fuel prices. The authorities have responded with tariff reductions on rice and fuel imports, which have somewhat alleviated the impact on the urban poor. Understandings were reached on offsetting revenue and expenditure measures to keep the 2008 fiscal program on track. Timely donor support will be critical.

The authorities recognize the importance of accelerating structural fiscal reforms to further build capacity and improve confidence in the economy. The authorities plan to take additional measures by year-end that go beyond commitments already made in the EPCA-supported program. The measures are designed to improve import processing and customs revenue administration and further strengthen treasury management.

Risks to the program are serious but manageable. They include shortfalls or delays in donor disbursements, social instability as food and fuel prices rise, and pressures to exceed budgeted election outlays. The authorities' commitments, including the additional revenue and expenditure measures, would help contain the risks. The authorities are also prepared to take any additional measures needed to safeguard fiscal stability and avoid accumulation of new domestic arrears.

Staff support the authorities' request for a second EPCA purchase. The new purchase would make it possible to further consolidate the solid track record of policy performance, restore administrative capacity, and catalyze even more international support. If performance on the EPCA-supported program remains satisfactory, discussions for a new PRGF arrangement could be initiated later this year.

I. INTRODUCTION

1. **Guinea-Bissau is at a critical juncture.** Its performance on the EPCA-supported program has been good. The fiscal situation improved in the first part of 2008, and it is making progress in advancing structural reforms, particularly in the areas of expenditure control and revenue collection. Donor support has resumed and economic confidence is improving. The political situation has been stable, although recent increases in food and fuel prices could reignite social unrest.

2. **Food and fuel price shocks threaten to derail recent gains.** Rising food and fuel prices are pressuring an already tight fiscal situation, while the impact on the external sector will be a much higher-than-expected current account deficit for 2008 (Box 1). The authorities have responded so far with fiscal measures, including import tax exemptions, that have somewhat alleviated the burden on the urban poor. The authorities have also agreed to offsetting revenue and expenditure measures to preserve the 2008 fiscal program, though timely donor support will be critical. A second EPCA purchase would help Guinea-Bissau absorb the recent pressures on the balance of payments, as well as catalyze even more donor support. It will also support the authorities' efforts to consolidate a track record of sound policy performance and restore administrative capacity, which is necessary to initiate discussions of a new PRGF arrangement.

Box 1. Macroeconomic Effects of Higher Food and Fuel Prices in Guinea-Bissau

Guinea-Bissau has been hard hit by rising international food and fuel prices, reflecting the country's heavy reliance on food and fuel imports. The external current account deficit (excluding official transfers) is now expected to widen to some 17 percent of GDP in 2008 rather than the 12 percent initially estimated, with the larger deficit coming equally from higher food and fuel imports. Food price increases have already led to a sharp increase in overall inflation. There may also be a significant fiscal impact.

Food and Fuel: Weight in Different Sectors, 2007	
a. In the Fiscal Sector: Percent of total taxes	
Duties and Taxes on Imports	46.7
<i>Of which:</i> Rice	4.2
Fuel	9.9
b. In Domestic Prices: Weight in the CPI	
Food and Beverage	59.7
<i>Of which:</i> Bread and Cereals	13.9
Fuel and Transport	5.6
c. In the Trade Balance: Percent of total imports	
Rice	15.9
Other Food	17.5
Fuel	22.6

Poverty impact. Domestic food availability has been adequate so far. Food price increases, however, will hit the urban poor the hardest and thus jeopardize poverty reduction and perhaps reignite social tensions. Fuel price increases will also affect the urban poor through higher public and product transport costs.

Policy response. Since March 2008 all rice imports have been temporarily exempted from taxes,¹ and customs fees have been reduced on rice and diesel imports—using below-market reference prices for taxation purposes.² Compared to program projections, the direct revenue loss from lower tariffs is limited (about CFAF 0.6 billion).³ However, for a fragile post conflict country that at least in the short term has little capacity to raise revenues and is very vulnerable to unexpected resource shortfalls, including donor support, the loss in terms of potential revenue is significant. If reference prices were adjusted to reflect actual import costs and tariffs were kept unchanged, additional tax revenues of some CFAF 1.4 billion from rice imports and CFAF 1 billion from fuel imports could have been collected in 2008. These losses represent about 1 percent of GDP—10 percent of tax revenues—for the year. For the time being, there is limited capacity to replace the tariff reductions with more targeted social safety nets, such as cash transfers. With two-thirds of the population below the poverty line, the fiscal costs of a cash transfer program would be prohibitive in the tight fiscal situation, and there are serious capacity constraints to effectively carry-out this type of program. Over time, the government intends to promote subsistence agriculture, which is the main social safety net for the majority of the population. The authorities are discussing plans for expansion and diversification of agricultural production with the World Bank and other development partners.

¹ Rice imports pay only WAEMU-related taxes (at a rate of about 2.5 percent).

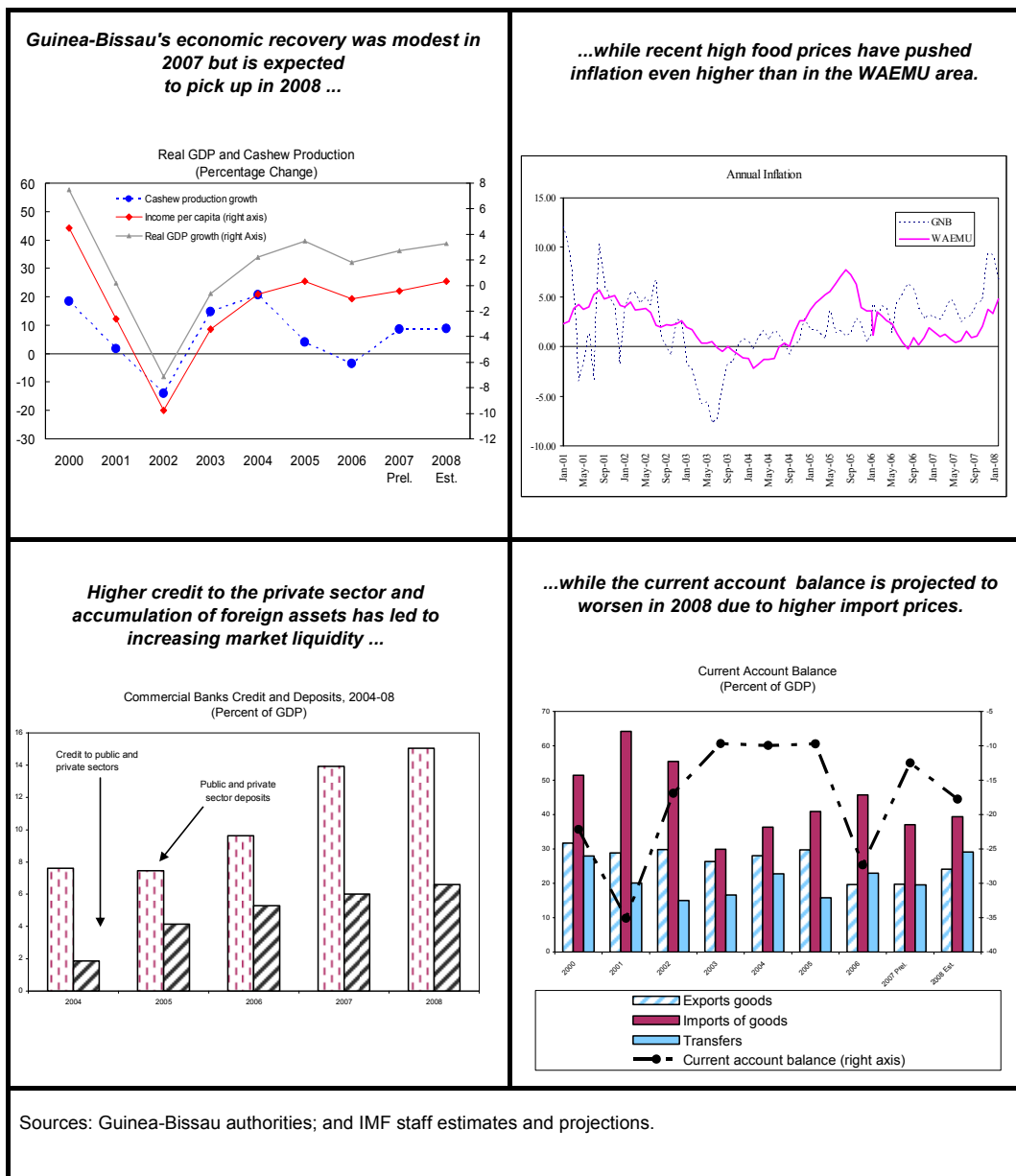
² The reference price for calculating import duties on fuel products has been about 77 percent of the estimated CIF price, while the reference price for rice import duties has remained unchanged from the 2007 level and is well below actual import prices.

³ The program assumed unchanged reference prices for rice and diesel imports for 2008 when making import tax projections.

II. RECENT DEVELOPMENTS AND PROGRAM PERFORMANCE

3. A gradual economic recovery has been underway since 2007, thanks in part to increased agricultural production as normal rains returned (Figure 1 and Table 1). Annual inflation, however, accelerated sharply at the end of 2007 and stayed high in early 2008 driven mainly by the recent surge in international food prices (Box 2). Broad money grew by 25 percent in 2007, somewhat faster than initially projected (Table 2). Central bank accumulation of foreign assets and higher credit to the private sector helped push up domestic liquidity. As expected, the external current account deficit (excluding official current transfers) narrowed to 12.5 percent of GDP in 2007, from 27 percent in 2006, reflecting higher exports of cashews, some from the previous year's stock (Table 3).

Figure 1. Guinea-Bissau: Recent Macroeconomic Developments, 2000 - 08



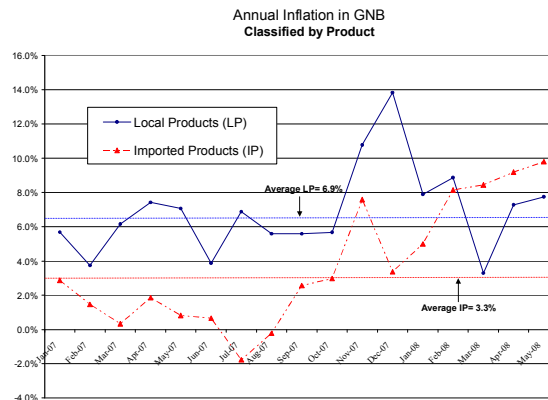
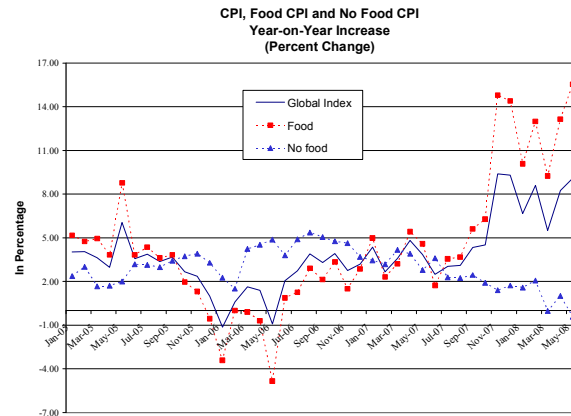
Box 2. Sources of Inflation in Guinea-Bissau

Guinea-Bissau's 12-month inflation rate rose to 9.3 percent by end-2007, from 3.2 percent at end-2006, driven mainly by a 14 percent rise in food prices. Annual inflation has remained high in 2008, at 9.1 percent at end-May, while food prices rose 15.5 percent during the period.

External vs. domestic factors.

Because Guinea Bissau relies heavily on imports, international price developments explain a large part of domestic price inflation, but recent evidence also points to domestic factors as possible causes of the recent spike in inflation. The trend since 2007 of inflation being higher in Guinea Bissau than in the region as a whole suggests the country's inflation has a large idiosyncratic component. Prices for local goods were also higher than for imported goods throughout 2007. An econometric model estimated by staff shows that while increases in international prices did explain about 70 percent of total inflation in Guinea Bissau for 2005–07, domestic factors (broad money growth) accounted for about 30 percent in the last six months of 2007.

Policy implications. Liquidity growth in recent years has been largely associated with expansionary fiscal policy and heavy reliance on donor support. In future, prudent fiscal policies and close cooperation between fiscal and monetary authorities will be crucial to ensure timely sterilization of budgetary use of donor support and contain liquidity growth.



4. **Fiscal performance in 2007 was weaker than expected.** Unexpectedly high nonregularized expenditures¹ worsened the domestic primary deficit to 10.8 percent of GDP, about 1.5 percent of GDP larger than previously expected (Text Table 1 and Table 4). Measures are being taken to address the shortcomings in expenditure management (see ¶9).

¹ Expenditures that have not progressed through the normal treasury accounting and reporting procedures and are not yet recorded as current expenditures.

Though donor budget support resumed in 2007, the government nonetheless had to reschedule most of the commercial debt that came due in 2007, and sizable domestic arrears accumulated.

Text Table 1. Guinea-Bissau: Central Government Operations, 2005–08
(Percent of GDP)

	2005	2006	2007		2008	
			EPCA Jan-08	Prel.	EPCA Jan-08	Est.
Revenue and grants	30.4	31.5	31.8	31.2	42.3	41.6
Revenue	17.6	19.6	16.1	15.5	20.7	20.0
Tax revenue	11.5	11.5	11.5	10.9	11.4	11.0
Nontax revenue	6.1	8.1	4.6	4.5	9.3	9.0
Grants	12.7	11.9	15.7	15.8	21.6	21.5
<i>of which: Budget support</i>	3.2	6.4	9.8	9.9	13.7	13.9
Expenditure	42.2	41.2	41.6	41.5	41.6	40.9
Current expenditure	27.7	29.0	27.5	27.5	26.3	26.1
<i>Of which: wages and salaries</i>	13.4	12.8	12.8	12.7	11.8	11.3
Capital expenditure and net lending	14.5	12.2	14.1	14.0	15.3	14.8
Overall balance, including grants (commitment)	-11.9	-9.7	-9.7	-10.3	0.7	0.6
Overall balance, excluding grants (commitment)	-24.6	-21.6	-25.4	-26.0	-20.9	-20.9
Overall balance, including grants (cash)	-10.2	-4.7	-6.3	-6.9	0.0	-0.3
Financing	10.2	4.7	6.3	6.9	0.0	0.3
Domestic financing	5.9	-1.1	0.1	0.7	-9.6	-11.2
Foreign financing (net)	4.3	5.8	6.2	6.2	3.6	3.8
<i>Of which: external arrears</i>	8.4	5.4	4.6	4.4	4.0	3.3
debt relief	3.3	3.3	2.2	2.1	0.4	0.3
project and program loans	3.9	5.4	6.8	6.8	6.3	6.0
Gross financing gap (+ = financing needs)	0.0	0.0	0.0	0.0	6.0	7.8
Additional financing		0.0	0.0	0.0	5.9	7.8
Residual financing gap		0.0	0.0	0.0	0.0	0.0
Domestic primary balance	-6.9	-7.5	-9.3	-10.8	-4.1	-4.7
Revenue	17.6	19.6	16.1	15.5	20.7	20.0
Primary expenditure	24.5	27.1	25.8	26.6	24.9	24.7
Current	23.5	25.9	24.5	25.3	23.7	23.6
Capital	1.1	1.2	1.3	1.3	1.2	1.1

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

5. **Fiscal performance improved in early 2008.** Four of six March quantitative indicators were met (domestic primary deficit, government revenues, domestic financing of the budget, and external nonconcessional borrowing) (MEFP² Table 1). The domestic primary deficit for the first quarter was CFAF 3.8 billion, below the program target of CFAF 5.1 billion, because performance on both expenditures and revenues was better than expected. Current expenditures, especially on wages and goods and services, were held below programmed levels by about CFAF 0.6 billion through March, and revenues were

² Appendix: Memorandum of Economic and Financial Policies.

higher by about CFAF 0.5 billion, mainly from higher taxes collected on imports that were delayed from 2007. Corporate taxes have also been higher-than-expected in early 2008, owing in part to improvements in collection procedures, while export taxes have been buoyant, as expected, reflecting a strong cashew campaign. The government is current on 2008 wages through May.

6. The quantitative indicators on payment of previous years' arrears and new domestic arrears were missed but are expected to be met for the year as a whole.

Because the government exceeded the amount of 2007 domestic arrears to be paid in the first quarter of 2008, current payments could not be fully met and new domestic arrears accumulated. The authorities issued a decree to avoid further payment of 2007 domestic arrears (MEFP ¶12) so as to remain within target for the year as a whole.

7. There were also administrative delays in disbursement of budget support in the first quarter.³ These, combined with the overpayment of previous arrears, forced the government to contract new short-term domestic commercial debt backed by the delayed donor disbursements.⁴ Compared to the adjusted March quantitative indicator, the amount of domestic financing was below target. However, the costs associated with commercial borrowing in terms of commissions and interest have budgetary implications for 2008.

8. Fiscal management is being strengthened. The March structural indicators were implemented although there was a slight delay in adopting the fiscal law that introduces better budget classification, in line with WAEMU regulations, and increased transparency and other improvements in the budget system (MEFP Table 2). An audit of domestic arrears for 2000–07 begun in May should facilitate their eventual clearance once additional donor resources are obtained.

9. The authorities are also going beyond the commitments of the EPCA-supported program to address weaknesses in fiscal areas. Besides ceasing to pay previous arrears they are also moving to tighten expenditure controls, open up the flow of information on treasury operations, clean up the payroll database, and identify possible sources of tax revenues (MEFP ¶12 and 13).

III. OUTLOOK AND POLICIES FOR THE REST OF 2008

A. Overview

10. Implementation of the 2008 program is challenging. The spike in inflation and delays in budget support have highlighted the continued fragility of Guinea-Bissau's recent

³ World Bank emergency assistance, the largest expected disbursement in the first quarter of 2008, was delayed due to the time required to process the necessary documents but has since begun to be disbursed.

⁴ The government contracted short-term commercial loans in the first quarter of 2008 amounting to CFAF 4.7 billion at effective annual interest rates of about 15 percent, including fees and commissions. The short-term loans are expected to be repaid in 2008, when the delayed donor support is disbursed.

stabilization gains and its vulnerability to external shocks. In their program for the rest of 2008 (MEFP), the authorities commit themselves to taking the measures necessary to (i) contain inflation; (ii) consolidate recent fiscal gains and safeguard the 2008 fiscal program; and (iii) speed up efforts to reinforce revenue collection, expenditure controls, and accounting. The authorities count on significant amounts of donor financial and technical assistance for 2008. They are requesting a second EPCA purchase to support the program.

11. Guinea-Bissau continues to meet the Fund’s conditions for EPCA support.

Namely, there are (i) indications of sufficient capacity and commitment on the part of the authorities for policy planning and implementation, despite continued disruptions to administrative and institutional capacity resulting from the conflict; (ii) persistent need to meet essential external payments, including payments to multilaterals; and (iii) evidence of continued concerted international support for the authorities’ program.

B. Macroeconomic Outlook

12. Although risks are tilted to the downside, the economic outlook for 2008 remains positive. Real GDP growth is still expected to increase to over 3 percent in 2008, based on a slight increase in cashew production and increasing construction activity. Inflation, on the other hand, is now expected to be higher than expected; given international price projections for food and fuel products, inflation for 2008 would average about 6 percent, compared to the projected 3.3 percent. The external current account deficit will also be higher-than-expected owing to higher food and fuel imports.⁵

C. Fiscal Policy

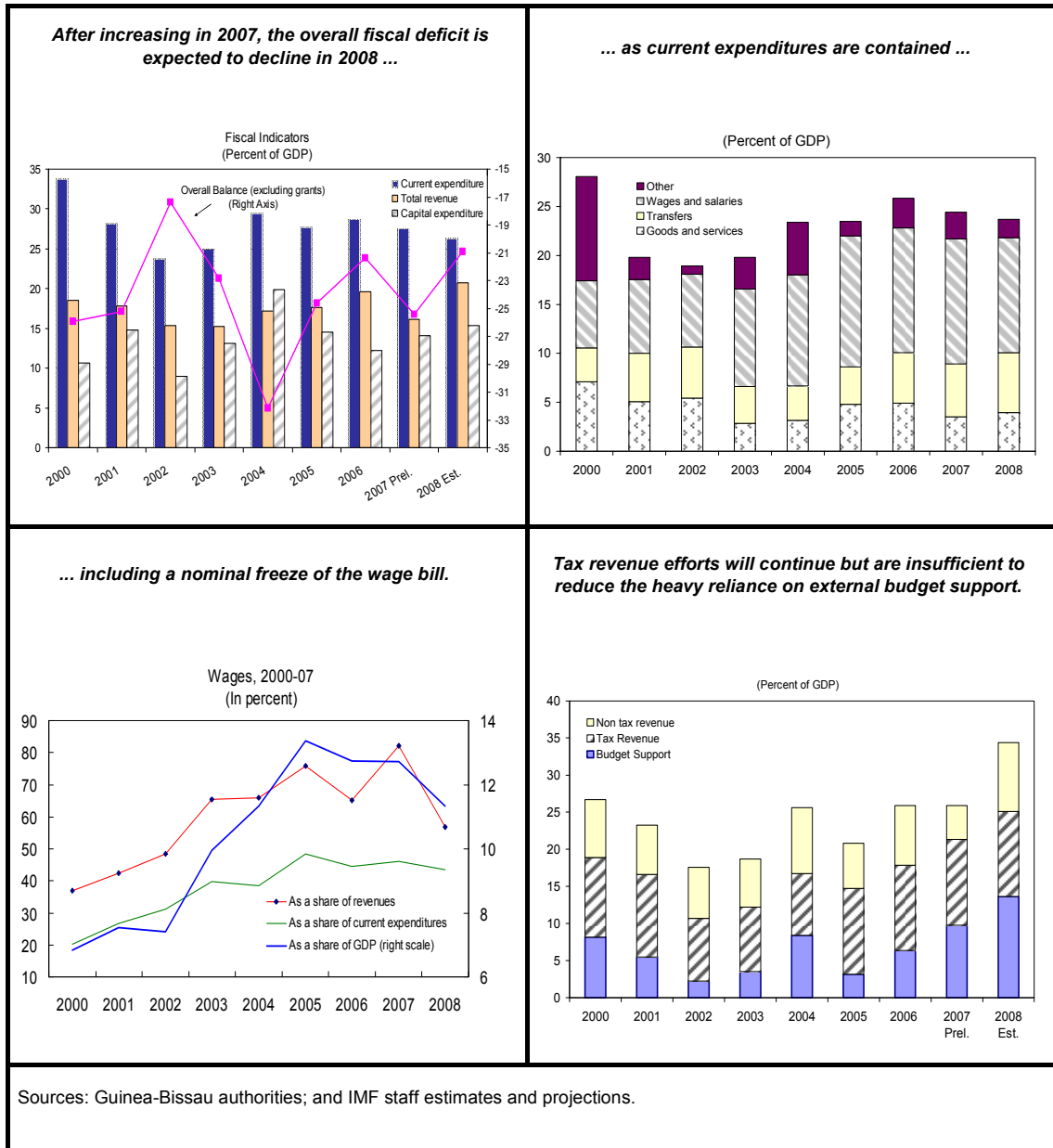
13. The 2008 fiscal program has been updated to take into account recent developments. The revised fiscal program (MEFP ¶19-21) assumes (i) unchanged revenues for the year—direct revenue losses from tax and customs exemptions would be offset by the higher revenues in the first quarter of 2008, while other revenues are expected to perform in line with the program; and (ii) higher domestic primary expenditures (by CFAF 1.3 billion) because of additional spending on elections.⁶ The authorities also intend to maintain the nominal freeze of the wage bill for 2008 and are committed to staying current on wage payments. Labor unions and workers so far are demanding only that current wages are paid on time. As a result, the domestic primary deficit is now estimated to increase to CFAF

⁵ The program assumes a level of external trade deficit that is financed by a large amount of exceptional transfers assumed for 2008, mainly official transfers, which are subject to a high degree of volatility in the timing of their disbursement. The trade deficit is also subject to revision based on international price developments. The remaining external financing gap for 2008 is equivalent to the fiscal financing gap and is assumed to be fully financed, including with EPCA.

⁶ The additional election expenditures relate to arrears from previous elections which were not previously anticipated to be paid in 2008. The election arrears will be audited, as part of the EU audit of all domestic arrears, before they are paid.

8.8 billion (before additional gap-filling fiscal measures), about CFAF 1.3 billion higher than expected but still substantially less than in 2007 (Figure 2). On the financing side, the program assumes higher net bank financing (by about CFAF 3.8 billion), mainly because of higher debt payments to the BCEAO,⁷ offset in part by more donor budget support (by CFAF 1.3 billion). The combined impact of the revisions will be higher gross financing needs by CFAF 3.8 billion.

Figure 2. Guinea-Bissau: Main Fiscal Indicators, 2000 - 08



⁷ Debt owed to the BCEAO has been revised upwards to include payment of 2006 and 2007 arrears that were not previously included in 2008.

D. Financing the Budget

14. To safeguard program objectives, understandings were reached during the mission on measures (about CFAF 5 billion) to fill the additional financing needs (Text Table 2) beyond those agreed under their program supported by the first EPCA purchase. These measures are also needed to compensate for shortfalls in CFA terms of US dollar-denominated external financing, including debt relief. The measures include (MEFP ¶ 24):

- maintaining the expenditure saving already achieved in 2008 (CFAF 0.5 billion);
- expenditure savings of CFAF 0.3 billion from better payroll management;
- recovery of CFAF 0.5 billion in tax arrears;
- additional revenue of CFAF 0.5 billion from customs, sales taxes and nontax (licenses) sources; and
- agreement with the BCEAO to reschedule CFAF 3.2 billion of the higher debt owed to the BCEAO.

To demonstrate their commitment to the additional measures, the authorities have already collected some CFAF 0.2 billion in tax arrears. With these measures, the 2008 program is fully financed⁸ and the authorities can therefore request the second purchase under EPCA.

Text Table 2. Guinea-Bissau: Expected Financing of the 2008 Fiscal Program

	Program 1/ CFAF billion	Update 2/ CFAF billion	US\$ million
Fiscal financing needs	45.3	49.1	115.1
Expected budget support	24.8	26.1	61.3
European Union	3.6	3.6	8.5
World Bank	7.9	8.5	20.0
AfDB	0.8	0.9	2.0
WAEMU	1.5	1.5	3.5
South Africa	5.0	4.7	11.0
Japan	2.0	1.0	2.4
Portugal	1.5	1.3	3.1
Spain	1.5	1.0	2.3
France	0.0	0.7	1.5
Additional regional support	1.0	3.0	7.0
External debt arrears	9.7	8.4	19.6
Additional financing	10.8	14.6	34.2
EPCA	2.8	2.5	5.9
World Bank debt relief	4.2	3.6	8.4
Authorities' measures	3.8	8.5	19.9
Previous measures	3.8	3.5	8.2
Additional measures		5.0	11.7

Source: IMF staff estimates and projections.

1/ EPCA Jan-08 estimates

2/ CFAF per US\$ (EPCA): 495

CFAF per US\$ (Review) 426.6

⁸ Guinea-Bissau will continue to accumulate sizeable payment arrears to sovereign and multilateral creditors (IMF Country Report No. 07/309). The authorities have already informed their external creditors of this situation (IMF Country Report No. 08/4).

15. **The authorities are committed to taking any further measures, if necessary, to find additional financing.** As a last resort, they will reschedule part of the debt owed to domestic commercial banks (about CFAF 10 billion), which is currently scheduled to be paid in full in 2008.

E. Structural Reforms

16. **The government intends to undertake structural measures by year-end that go beyond the commitments made for the EPCA-supported program.** The measures focus on improving import processing and customs revenue collection and firming up treasury management (MEFP ¶ 27). To ensure that the fiscal reforms are effective and sustainable, the EPCA program will continue to be supported with technical assistance from, among others, West AFRITAC and AFRISTAT (MEFP Table 3).

17. **In the monetary area, to better forecast liquidity, the government will work to improve coordination between the Minister of Finance and the monetary authorities.** They will make efforts to ensure timely action to smooth the monetary impact of budgetary use of donor funds to finance government expenditures. The BCEAO will also step up its efforts to sterilize any excess liquidity.

F. Program Monitoring and Risks

18. **The authorities' MEFP contains revised quantitative and structural indicators through December 2008.** A new quantitative indicator sets a ceiling on the amount of nonregularized expenditures. The program also sets out new structural indicators to facilitate policy implementation through 2008.

19. **The main risks to the program are possible shortfalls and further delays in donor disbursements, social instability triggered by rising food and fuel prices, and pressures to exceed budgeted election outlays.** The policy commitments the authorities have made, especially the additional revenue and expenditure measures, should help contain the risks. Paying civil servant wages on time will also help to alleviate social tensions.

IV. MEDIUM-TERM OUTLOOK

20. **To take into account recent food and fuel prices and medium-term prospects, the staff has updated the medium-term scenario (Text Table 3).** The revised scenario assumes that international food and fuel prices will remain high for the next three to five years, although the rate of domestic price inflation is expected to moderate. Real GDP growth could still be sustained at about 3 percent over the medium term, assuming normal rains and an increase in cereal and cashew production. Over the medium term the external current account deficit will be somewhat higher than originally projected. The fiscal position is still expected to improve, assuming better fiscal controls and higher revenue.

Text Table 3. Guinea-Bissau: Medium Term Scenario

	2005	2006	2007	2008		2009	2010
			Prel.	EPCA Jan-08	Est.	Proj.	Proj.
(Annual percentage change, unless otherwise indicated)							
National accounts and prices							
Real GDP at market prices	3.5	1.8	2.7	3.3	3.3	3.2	3.4
Real GDP per capita	0.3	-1.1	-0.4	0.3	0.3	0.2	0.4
Consumer price index (annual average)	3.4	2.0	4.6	3.3	6.3	3.0	2.5
Consumer price index (end of period)	1.0	3.2	9.3	2.4	3.5	2.5	2.5
(Percent of GDP, unless otherwise indicated)							
Investments and savings							
Gross investment	14.6	12.2	14.0	15.8	15.3	14.2	14.5
Of which: government investment	14.1	10.8	13.3	13.9	13.5	12.9	12.9
Gross national savings	9.5	0.9	12.4	22.7	20.9	15.8	16.1
Government finances							
Budgetary revenue	17.6	19.6	15.5	20.7	20.0	18.4	18.4
Total domestic primary expenditure	24.5	27.1	26.2	24.9	24.7	21.7	21.0
Domestic primary balance	-6.9	-7.5	-10.8	-4.1	-4.7	-3.2	-2.6
Overall balance (commitment basis)							
Including grants	-11.9	-9.7	-10.2	0.7	0.6	-3.7	-3.4
Excluding grants	-24.6	-21.6	-26.0	-20.9	-20.9	-18.4	-17.7
Overall balance, including grants (cash basis)	-10.2	-4.6	-6.9	0.0	-0.3	-3.0	-3.6
Financing	10.2	4.6	6.9	0.0	0.3	3.0	3.6
Domestic and Foreign Financing	10.2	4.6	6.9	-6.0	-7.4	3.0	5.7
Additional Financing	0.0	0.0	0.0	5.9	7.8	0.0	0.0
Residual Financing gap (+ = financing needs)	0.0	0.0	0.0	0.0	0.0	-0.1	-2.1
External current account (including official current transfers)	-5.1	-13.9	-2.2	7.0	4.5	-5.0	-4.4
Excluding official current transfers	-9.7	-27.3	-12.5	-12.0	-17.8	-16.3	-15.1
Nominal stock of external debt, including arrears	440.6	436.3	384.8	505.4	325.0	254.6	165.5

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

V. STAFF APPRAISAL

21. **Guinea-Bissau has made steady progress in fiscal stabilization under difficult circumstances, and its policies are moving steadily in the right direction.** The government's revenue and expenditure efforts yielded encouraging results in the first part of 2008 and the primary fiscal deficit was kept below target through March.

22. **Considering recent pressures, keeping the 2008 fiscal program on track will be challenging.** The authorities need to fully implement the planned revenue and expenditure measures and resist pressures for additional spending on the coming parliamentary elections. The authorities also need to remain current on civil servant wages in order to minimize the social impact of the recent food and fuel prices. Timely disbursement of external concessional assistance will also be critical to avoid new domestic arrears or further recourse to high-cost borrowing from commercial banks. The authorities should continue to seek even greater donor assistance on highly concessional terms, preferably grants, particularly considering the food and fuel shocks.

23. **The recent measures to reduce import tariffs is an appropriate short term response to higher food and fuel prices.** Tariff reductions help mitigate price increases while also reducing inefficient trade distortions. It is also well-targeted as it focuses on the imports most important to the poor, namely rice. Over the longer-term, given the limited capacity to implement targeted social safety nets, the authorities need to focus on raising

domestic agricultural production, especially subsistence agriculture. The authorities also need to focus on measures to boost revenues without relying on import tariffs.

24. **Recent progress on structural reforms to strengthen fiscal management is encouraging.** Staff supports the Guinea Bissau's continuing efforts to strengthen customs administration and improve treasury operations. In particular, ensuring that all expenditure commitments are regularized within 48 hours, in line with established procedures, is crucial to restore confidence in how the economy is managed. The authorities should also ensure that the audit of domestic arrears is finalized as soon as possible and seek external assistance for their clearance. That would also help alleviate social tensions.

25. **Guinea-Bissau continues to meet the requirements for Fund EPCA.** Help in meeting current external payments is urgently needed, particularly given recent food and fuel price shocks. Yet despite the difficult circumstances, the country's recent progress demonstrates that the authorities have the capacity to implement the program. They are determined to establish the track record necessary for a PRGF-supported program and for reaching the HIPC Initiative completion point. Assuming, therefore, that policy implementation may be even better in the coming months, discussions for a new PRGF arrangement might be possible later this year. Recognizing that a second EPCA purchase could help consolidate the recent gains, absorb the recent heightened strains on the balance of payments, and catalyze even greater international support, staff recommends approval of the authorities' request for the second EPCA purchase.

Table 1. Guinea-Bissau: Selected Economic and Financial Indicators, 2005-10

	2005	2006	2007 Prel.	2008 EPCA Jan-08	Est.	2009 Proj.	2010 Proj.
(Annual percentage change, unless otherwise indicated)							
National accounts and prices							
Real GDP at market prices	3.5	1.8	2.7	3.3	3.3	3.2	3.4
Real GDP per capita ¹	0.3	-1.1	-0.4	0.3	0.3	0.2	0.4
GDP deflator	7.7	-0.5	4.2	3.3	5.8	2.9	2.5
Consumer price index (annual average)	3.4	2.0	4.6	3.3	6.3	3.0	2.5
Consumer price index (end of period)	1.0	3.2	9.3	2.4	3.5	2.5	2.5
External sector							
Exports, f.o.b. (based on US\$ values)	18.2	-32.5	17.3	-4.0	49.8	8.6	8.6
Imports, f.o.b. (based on US\$ values)	25.7	14.0	-5.2	5.3	51.3	6.6	6.4
Export volume	0.2	-17.7	14.1	-7.3	17.2	5.6	6.1
Import volume	14.1	5.8	-14.4	4.4	7.0	6.2	6.1
Terms of trade (deterioration = -)	7.1	-23.8	-7.2	3.6	10.8	2.8	2.9
Real effective exchange rate (depreciation = -)	-1.8
Nominal exchange rate (CFA F per US\$; average)	526.6	522.4	478.6	498.4	478.6	426.6	426.6
Government finances							
Domestic revenue (excluding grants)	14.1	12.4	-15.4	36.6	41.3	-2.1	5.9
Total expenditure	-4.7	-1.3	7.9	6.6	7.7	-4.3	3.9
Current expenditure	4.7	5.8	1.7	1.9	3.7	-6.4	2.7
Capital expenditure	-18.7	-14.8	22.6	16.1	15.4	-0.6	5.9
Money and credit²							
Credit to government (net)	1.8	-0.5	3.2	-15.2	-14.0	-2.3	-1.8
Credit to the rest of the economy	2.6	5.6	7.5	3.2	3.0	2.6	2.4
Broad money	20.6	5.3	25.5	8.3	20.7	8.5	6.8
Velocity (GDP/broad money)	3.0	2.9	2.5	2.6	2.2	2.2	2.2
(Percent of GDP, unless otherwise indicated)							
Investments and savings							
Gross investment	14.6	12.2	14.0	15.8	15.3	14.2	14.5
Of which: government investment	14.1	10.8	13.3	13.9	13.5	12.9	12.9
Gross domestic savings	-2.3	-19.0	-4.3	-4.9	-5.6	-2.1	-1.4
Of which: government savings	-16.7	-17.4	-20.4	-12.6	-12.6	-13.0	-12.2
Gross national savings	9.5	0.9	12.4	22.7	20.9	15.8	16.1
Government finances							
Budgetary revenue	17.6	19.6	15.5	20.7	20.0	18.4	18.4
Total domestic primary expenditure	24.5	27.1	26.2	24.9	24.7	21.7	21.0
Domestic primary balance	-6.9	-7.5	-10.8	-4.1	-4.7	-3.2	-2.6
Overall balance (commitment basis)							
Including grants	-11.9	-9.7	-10.3	0.7	0.6	-3.7	-3.4
Excluding grants	-24.6	-21.6	-26.0	-20.9	-20.9	-18.4	-17.7
External current account (including official current transfers)							
Excluding official current transfers	-5.1	-13.9	-2.2	7.0	4.5	-5.0	-4.4
Excluding official transfers (other than fishing licenses)	-9.7	-27.3	-12.5	-12.0	-17.8	-16.3	-15.1
Excluding official transfers (other than fishing licenses)	-6.7	-24.4	-12.5	-6.6	-11.7	-13.5	-12.3
Net present value of external debt/exports of goods and nonfactor services (percent)							
	788.5	683.2	607.5	505.4	428.4	407.1	186.2
Nominal stock of external debt, including arrears							
	440.6	436.3	384.8	389.2	325.0	254.6	165.5
Memorandum items (US\$ millions unless otherwise indicated)							
Current account balance (including official current transfers)	-15.3	-42.8	-7.5	25.6	17.1	-20.3	-18.7
Overall balance of payments	-21.0	-19.1	11.6	-32.1	-38.4	0.6	-0.8
Nominal GDP at market prices (CFAF billions)	158.8	160.8	172.1	182.5	187.9	199.6	211.4
Nominal stock of external debt (end of period; excluding arrears)	1002.1	993.3	1012.7	1038.3	1040.0	1077.1	820.2
Nominal stock of external arrears, end of period	327.0	349.8	371.0	392.0	392.0	113.8	0.0

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

¹ Projections based on population growth of 2.5 percent per year.² Change in percent of beginning-of-period stock of broad money.

Table 2. Guinea-Bissau: Monetary Survey, 2005–10

	2005	2006	2007	2008	2009	2010
			Prel.	Est.	Proj.	Proj.
(CFAF billion)						
Total assets	52.4	55.2	69.2	83.6	90.6	97.4
Net foreign assets	36.7	43.2	51.5	59.6	64.8	68.7
Central bank	36.9	33.9	44.4	51.6	57.9	62.9
Deposit money banks	-0.2	9.3	7.1	8.0	6.8	5.8
Net domestic assets	15.7	12.0	17.8	24.0	25.9	28.7
Net domestic credit	15.9	18.6	23.9	17.4	17.6	18.8
Net claims on government	12.5	12.3	13.5	4.9	2.9	1.9
Net claims on central government	12.5	12.3	13.5	4.9	2.9	1.9
Central bank	13.2	12.4	10.4	7.6	7.0	6.2
Claims	13.9	13.0	10.8	7.6	7.0	6.2
Advances to the treasury	8.4	7.6	5.6	2.8	2.3	1.7
Statutory limit	1.9	1.6	1.4	1.1	1.2	1.2
Use of Fund credit	6.3	4.1	2.2	1.2	0.5	0.0
Other advances	0.2	2.0	2.0	0.5	0.5	0.5
Consolidated loans	5.5	5.4	5.3	4.9	4.7	4.5
Deposits	-0.7	-0.6	-0.4	0.0	0.0	0.0
Deposit money banks	-0.7	-0.1	3.1	-2.8	-4.1	-4.3
Claims	3.0	3.6	7.6	1.1	0.0	0.0
Deposits	-3.7	-3.7	-4.5	-3.8	-4.1	-4.3
Credit to the economy	3.4	6.3	10.5	12.6	14.7	16.9
Other items (net)	-0.2	-6.7	-6.2	6.5	8.2	9.9
Liabilities	52.4	55.0	69.2	83.6	90.6	96.8
Broad money	52.4	55.0	69.2	83.6	90.6	96.8
Local currency	52.4	55.0	69.2	83.6	90.6	96.8
Currency in circulation	40.5	39.7	43.8	54.1	57.3	60.2
Demand deposits and quasi-money	11.8	15.3	25.4	29.5	33.3	36.6
Demand deposits	11.0	13.5	20.6	24.0	27.1	29.8
Quasi-money	0.8	1.9	4.8	5.5	6.2	6.8
(Annual change as percent of beginning-of-period money stock, unless otherwise indicated)						
Net foreign assets	9.5	12.4	15.1	11.7	6.2	4.4
Net domestic assets	11.1	-7.1	10.5	8.9	-15.4	0.7
Domestic credit	8.9	5.3	9.6	-9.4	0.3	0.7
Credit to the government	1.8	-0.5	3.2	-14.0	-2.3	-1.8
Credit to the economy (percent)	2.6	5.6	7.5	3.0	2.6	2.4
Other items (net)	2.1	-12.4	0.9	18.3	2.0	1.8
Broad money	20.6	5.3	25.5	20.7	8.5	6.8
Velocity (GDP/M2)	3.0	2.9	2.5	2.2	2.1	2.1

Sources: BCEAO, and IMF staff estimates and projections.

Table 3. Guinea-Bissau: Balance of Payments, 2005–10

	2005	2006	2007	2008		2009	2010
				EPCA	Est. ¹	Proj.	Proj.
(CFAF billions)							
Goods and services	-35.9	-64.6	-42.9	-37.7	-43.9	-44.7	-45.4
Goods	-17.8	-41.9	-29.9	-23.7	-28.7	-29.8	-30.6
Exports, f.o.b	47.2	31.6	34.0	44.3	45.3	49.2	53.4
Of which: cashew nuts	44.7	29.0	31.2	40.2	42.6	46.3	50.3
Imports, f.o.b	-65.0	-73.5	-63.9	-68.0	-74.1	-79.0	-84.0
Of which: food products	-20.8	-24.5	-18.0	--	-21.3	-22.7	-24.2
Of which: petroleum products	-13.1	-15.2	-12.7	--	-20.2	-21.5	-22.9
Of which: other	-31.1	-33.8	-33.1	--	-32.6	-34.8	-37.0
Services (net)	-18.1	-22.7	-13.1	-14.0	-15.2	-15.0	-14.8
Credit	2.6	6.7	6.1	6.6	6.2	6.4	6.5
Debit	-20.7	-29.4	-19.2	-20.5	-21.3	-21.3	-21.3
Income (interest scheduled)	-6.3	-4.9	-3.2	-4.0	-3.5	-3.2	-3.3
Current transfers (net)	25.0	36.8	33.6	54.5	54.7	39.3	40.7
Official ²	12.1	21.6	17.0	34.6	36.0	19.4	19.7
Of which: balance of payments support grants	5.1	10.2	17.0	24.8	26.1	14.6	14.6
EU fishing compensation	4.8	4.8	0.0	9.8	9.8	4.8	5.0
Private	12.9	15.3	16.6	19.9	18.7	19.9	21.1
Of which: fishing license fees	2.8	2.4	2.5	3.4	3.4	3.6	3.8
Current account	-17.1	-32.7	-12.5	12.7	7.3	-8.7	-8.0
Including official transfers	-24.5	-49.5	-29.6	-12.0	-18.8	-23.3	-22.6
Excluding official transfers and interest payments	-18.2	-44.6	-26.3	-8.0	-15.4	-20.1	-19.3
Capital and financial balance	-3.0	12.4	9.1	-28.7	-23.7	8.9	7.6
Capital account ³	23.7	17.6	12.2	16.6	16.4	17.0	18.0
Financial account	-26.7	-5.1	-3.1	-45.3	-40.1	-8.0	-10.3
Official medium- and long-term disbursements	6.2	8.8	11.6	11.4	11.4	12.1	12.8
Balance of payments support	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Projects	6.2	8.8	11.6	11.4	11.4	12.1	12.8
Scheduled amortization	-18.0	-13.4	-12.2	-12.8	-11.1	-10.3	-9.6
Treasury bills and regional financing	10.0	-1.1	-1.3	-8.5	-8.5	0.0	0.0
Commercial bank net foreign assets	5.9	-10.0	2.3	-2.4	-1.0	1.0	1.0
Private net foreign assets and errors and omissions	-30.7	10.6	-3.6	-32.9	-30.9	-10.9	-14.6
Overall balance	-20.2	-20.3	-3.4	-15.9	-16.4	0.3	-0.3
Financing	20.2	20.3	3.4	15.9	16.4	-0.3	0.3
Net foreign assets (increase -) ⁴	-10.3	3.0	-10.5	-5.3	-7.2	-7.4	-5.0
Of which: net IMF credits	-1.1	-2.2	-0.2	-0.9	-1.0	-0.7	1.3
purchases and loans	0.0	0.0	0.0	0.0	0.0	0.0	2.0
repurchases and repayments	-1.1	-2.2	-0.2	-0.9	-1.0	-0.7	-0.7
Debt relief	5.3	5.4	3.6	0.7	0.6	0.6	9.6
Change in debt-service arrears (decrease -)	17.2	11.9	10.2	9.7	8.4	6.9	0.0
Gross financing gap	0	0	0	10.8	14.6	-0.4	-4.5
<i>Memorandum items</i>							
Export volume growth (percent)	0.2	-17.7	14.1	-7.3	17.2	5.6	6.1
Import volume growth (percent)	14.1	5.8	-14.4	4.4	7.0	6.2	6.1
Scheduled debt service							
Percent of exports and service credits	48.9	47.8	38.3	33.2	28.3	24.2	21.5
Percent of total government revenue	87.1	58.2	57.7	44.9	38.8	36.6	33.0
Current account balance (percent of GDP)							
Including official transfers	-5.1	-13.9	-2.2	7.0	4.5	-5.0	-4.4
Excluding official transfers	-9.7	-27.3	-12.5	-12.0	-17.8	-16.3	-15.1
Stock of external arrears, end of period	157.2	169.1	179.3	189.4	187.6	194.5	194.5
Overall balance (percent of GDP)	-12.7	-12.6	-2.0	-8.7	-8.7	0.1	-0.2
Gross financing gap (percent of GDP)	0.0	0.0	0.0	5.9	7.8	-0.2	-2.1

Sources: BCEAO and IMF staff estimates and projections.

¹Based on updated staff projections for 2008.²Includes food aid and technical assistance to projects.³Excludes the financing gap, which BCEAO includes in the capital account.⁴Excludes 2008 EPCA drawings.

Table 4. Guinea-Bissau: Central Government Operations, 2005–08

(CFAF billions)

	2005	2006	2007		2008	
			EPCA Jan-08	Prel.	EPCA Jan-08	Est.
Revenue and grants	48.2	50.6	54.3	53.8	76.7	78.1
Revenue	28.0	31.5	27.5	26.6	37.6	37.6
Tax revenue	18.3	18.5	19.7	18.8	20.8	20.8
Nontax revenue	9.6	13.0	7.8	7.8	16.9	16.9
Grants	20.2	19.1	26.8	27.2	39.1	40.5
<i>Of which: expected budget support</i>	5.1	10.2	16.7	17.0	24.8	26.1
Total expenditure	67.1	66.2	70.9	71.4	75.5	76.9
Current expenditure	44.0	46.6	46.8	47.4	47.7	49.1
Wages and salaries	21.3	20.5	21.8	21.9	21.3	21.3
Goods and services	7.6	7.9	6.0	6.2	7.1	7.1
Transfers	6.1	8.3	9.3	9.4	11.2	11.2
Other current expenditures	2.4	4.9	4.7	6.0	3.3	4.6
Scheduled interest	6.7	5.0	5.1	3.9	4.7	4.8
Capital expenditure and net lending	23.1	19.7	24.0	24.1	27.8	27.8
Public investment program	22.4	17.4	23.0	23.1	24.7	24.7
Domestically financed	1.1	0.4	1.2	1.3	1.2	1.2
Foreign financed	21.4	17.0	21.8	21.8	23.5	23.5
Other capital expenditure	0.6	2.3	1.0	1.0	3.1	3.1
Domestically financed	0.6	1.6	1.0	1.0	0.9	0.9
Foreign financed (including DRRP)	0.0	0.7	0.0	0.0	2.2	2.2
Overall balance, including grants (commitment)	-18.9	-15.6	-16.6	-17.7	1.2	1.2
Overall balance, excluding grants (commitment)	-39.1	-34.8	-43.4	-44.8	-37.9	-39.3
Net domestic arrears	-0.1	5.5	3.0	4.2	-3.6	-3.6
Accumulation current year	4.2	7.9	6.6	7.8	0.0	0.0
Payment previous years	-4.3	-2.3	-3.6	-3.6	-3.6	-3.6
External interest arrears current year	3.8	3.2	2.8	2.7	2.4	2.1
Float and statistical discrepancies	-1.0	-0.6	0.1	-1.1	0.0	-0.3
Overall balance, including grants (cash)	-16.2	-7.5	-10.7	-11.9	0.0	-0.6
Financing	16.2	7.5	10.7	11.9	0.0	0.6
Domestic financing	9.3	-1.8	0.1	1.2	-17.3	-21.1
Bank financing	9.2	-0.5	1.2	2.3	-17.3	-21.1
<i>Of which: domestic banks</i>	-0.3	1.6	4.9	5.0	-7.2	-7.9
regional financing (including T-bills)	10.0	-1.1	-1.3	-1.3	-8.5	-8.5
BCEAO	-0.5	-1.1	-2.4	-1.4	-1.7	-4.7
Nonbank financing	0.2	-1.3	-1.1	-1.1	0.0	0.0
Foreign financing (net)	6.9	9.3	10.7	10.7	6.5	7.1
Disbursements	6.2	8.8	11.6	11.6	11.4	11.4
Projects	6.2	8.8	11.6	11.6	11.4	11.4
Programs	0.0	0.0	0.0	0.0	0.0	0.0
Amortization (scheduled)	-18.0	-13.4	-12.7	-12.2	-12.8	-11.1
External arrears	13.4	8.7	7.9	7.6	7.3	6.3
Debt relief	5.3	5.4	3.8	3.6	0.7	0.6
Gross financing gap (+ = financing needs)	0.0	0.0	0.0	0.0	10.8	14.6
Additional financing ^{1/}		0.0	0.0	0.0	10.8	14.6
Residual financing gap		0.0	0.0	0.0	0.0	0.0
Domestic primary balance	-11.0	-12.1	-16.5	-19.1	-7.5	-8.8
Revenue	28.0	31.5	27.5	26.6	37.6	37.6
Primary expenditure	39.0	43.5	44.0	45.7	45.1	46.4
Current	37.3	41.6	41.8	43.5	43.0	44.3
Capital	1.7	2.0	2.2	2.3	2.1	2.1

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

^{1/} In 2008 includes World Bank debt relief, EPCA, and authorities' measures to fill the financing gap.

Table 4. Guinea-Bissau: Central Government Operations, 2005–08 (concluded)
(Percent of GDP)

	2005	2006	2007		2008	
			EPCA Jan-08	Prel.	EPCA Jan-08	Est.
Revenue and grants	30.4	31.5	31.8	31.2	42.3	41.6
Revenue	17.6	19.6	16.1	15.5	20.7	20.0
Tax revenue	11.5	11.5	11.5	10.9	11.4	11.0
Nontax revenue	6.1	8.1	4.6	4.5	9.3	9.0
Grants	12.7	11.9	15.7	15.8	21.6	21.5
Budget support	3.2	6.4	9.8	9.9	13.7	13.9
Projects	9.6	5.6	5.9	5.9	7.9	7.6
Expenditure	42.2	41.2	41.6	41.5	41.6	40.9
Current expenditure	27.7	29.0	27.5	27.5	26.3	26.1
<i>Of which:</i> wages and salaries	13.4	12.8	12.8	12.7	11.8	11.3
interest	4.2	3.1	3.0	2.3	2.6	2.6
Capital expenditure and net lending	14.5	12.2	14.1	14.0	15.3	14.8
Public investment program	14.1	10.8	13.5	13.4	13.6	13.1
Other capital expenditure	0.4	1.4	0.6	0.6	1.7	1.6
Overall balance, including grants (commitment)	-11.9	-9.7	-9.7	-10.3	0.7	0.6
Overall balance, excluding grants (commitment)	-24.6	-21.6	-25.4	-26.0	-20.9	-20.9
Overall balance, including grants (cash)	-10.2	-4.7	-6.3	-6.9	0.0	-0.3
Financing	10.2	4.7	6.3	6.9	0.0	0.3
Domestic financing	5.9	-1.1	0.1	0.7	-9.6	-11.2
Foreign financing (net)	4.3	5.8	6.2	6.2	3.6	3.8
<i>Of which:</i> external arrears	8.4	5.4	4.6	4.4	4.0	3.3
debt relief	3.3	3.3	2.2	2.1	0.4	0.3
project and program loans	3.9	5.4	6.8	6.8	6.3	6.0
Gross financing gap (+ = financing needs)	0.0	0.0	0.0	0.0	6.0	7.8
Additional financing		0.0	0.0	0.0	5.9	7.8
Residual financing gap		0.0	0.0	0.0	0.0	0.0
Domestic primary balance	-6.9	-7.5	-9.3	-10.8	-4.1	-4.7
Revenue	17.6	19.6	16.1	15.5	20.7	20.0
Primary expenditure	24.5	27.1	25.8	26.6	24.9	24.7
Current	23.5	25.9	24.5	25.3	23.7	23.6
Capital	1.1	1.2	1.3	1.3	1.2	1.1

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

Table 5. Guinea-Bissau: Indicators of Capacity to Repay the Fund, 2007-13 1/

	2007	2008	2009	2010	2011	2012	2013
				Projections			
Fund obligations based on existing credit							
(in millions of SDRs)							
Principal	2.17	1.26	1.02	1.02	0.67	0.89	0.22
Charges and interest	0.07	0.11	0.12	0.11	0.10	0.07	0.04
Fund obligations based on existing and prospective credit 1/							
(in millions of SDRs)							
Principal	2.17	1.26	1.02	1.02	0.89	1.78	0.89
Charges and interest	0.07	0.14	0.19	0.19	0.18	0.12	0.05
Total obligations based on existing and prospective credit 1/							
(in millions of SDRs)							
In billions of CFAF	1.6	1.0	0.8	0.8	0.7	1.3	0.6
In percent of government revenue	6.0	2.5	2.2	2.1	1.8	2.9	1.4
In percent of exports of goods and services	4.7	2.1	1.7	1.5	1.3	2.1	1.0
In percent of debt service 2/	8.8	5.5	5.2	5.6	5.5	10.1	5.1
In percent of GDP	0.9	0.5	0.4	0.4	0.3	0.6	0.3
In percent of quota	15.8	9.8	8.5	8.5	7.5	13.4	6.6
Outstanding Fund credit 1/							
(in millions of SDRs)							
In billions of CFAF	2.3	3.8	3.1	2.4	1.8	0.6	0.0
In percent of government revenue	8.7	10.1	8.5	6.2	4.4	1.4	0.0
In percent of exports of goods and services	6.8	8.4	6.4	4.5	3.2	1.0	0.0
In percent of debt service 2/	13.0	22.1	19.7	16.3	13.6	4.8	-
In percent of GDP	1.4	2.1	1.6	1.2	0.8	0.3	0.0
In percent of quota	23.1	39.3	32.2	25.0	18.7	6.3	0.0
Memorandum items (billions of CFAF)							
Charges and interest, after assumed subsidies 3/	0.07	0.05	0.06	0.06	0.06	0.05	0.04
Nominal GDP (in billions of CFAF)	170	183	195	207	219	232	246
Exports of goods and services (in billions of CFAF)	34	45	49	53	58	62	67
Government revenue (in billions of CFAF)	27	38	37	39	41	44	47
Debt service (in billions of CFAF) 2/	17.9	17.3	15.9	14.9	13.3	12.7	12.4
CFAF/SDR (period average)	709	684	684	683	682	680	680
Quota (in SDR)	14.2	14.2	14.2	14.2	14.2	14.2	14.2

Sources: IMF staff estimates and projections.

1/ Includes the envisaged second EPCA purchase of SDR 1.775 million (12.5 percent of quota) in July 2008. No subsidization of EPCA purchase is assumed.

2/ Total debt service includes IMF repurchases and repayments.

3/ Assuming that the rate of charge on EPCA purchase is subsidized down to 0.5 percent per annum plus adjustment for deferred charges. Subsidization is subject to the availability of subsidy resources.

APPENDIX I

Bissau, May 22, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

1. The attached Memorandum of Economic and Financial Policies (MEFP) sets out the objectives and policies that the government of Guinea Bissau intends to pursue for the remainder of 2008. They are consistent with the objectives of the program of economic and financial policies supported by the IMF's Emergency Post-Conflict Assistance (EPCA) approved in January. Under the EPCA-supported program, the Government of Guinea Bissau has taken steps to stabilize an extremely difficult fiscal position, accelerate implementation of structural reforms, and improve financial relations with its international partners. The government's program is an important step toward meeting the country's medium-term objectives of reviving growth, reducing poverty, and achieving fiscal and external sustainability. Our economic reform efforts are being supported by the international community, including both traditional and nontraditional donors.
2. The fiscal situation has improved in the first part of 2008 after weaker than expected performance in 2007, and major progress is being made to advance structural reforms to strengthen fiscal management. Although real GDP growth was subdued in 2007, it is expected to improve in 2008. Annual inflation accelerated sharply at end-2007 and remained high in early 2008, driven mainly by the recent surge in international prices for food and oil.
3. Performance on the EPCA-supported program has been generally good. By the end of March 2008, four of six quantitative indicators were met. We expect that the two that were not met (payment of previous years' arrears and new domestic arrears) will be met for the year as a whole. The structural indicators for end-March were met; despite a delay on one measure, it was met on May 19, 2008.
4. Guinea Bissau's fiscal situation, however, remains very tight, and pressures are emerging, especially from the recent surge in world food and fuel prices. The government is nevertheless determined to take the measures necessary to maintain fiscal stability for the rest of the year and avoid accumulating new domestic arrears for the year as a whole. Our 2008 program envisages an acceleration of critical structural reforms, particularly in the areas of public expenditure management and revenue collection. These are key conditions for improving confidence in economic management and securing additional donor support.
5. In support of the government's objectives and policies, we are requesting a second purchase of the EPCA in an amount equivalent to SDR 1.775 (12.5 percent of quota). We

believe that the policies and measures set forth in the MEFP are adequate for achieving the objectives of the EPCA program, but we will take any further measures that may become appropriate for that purpose. In such cases, and before implementing any policies that might adversely affect the program, we will consult the Fund.

6. To assist the Fund in assessing progress on the program, we will continue to regularly provide information as detailed in the attached Technical Memorandum of Understanding (TMU). Moreover, we invite the staff of the Fund to continue to review our performance in the program quarterly, on the basis of the revised quantitative and structural indicators (Tables 1 and 2 of the MEFP) as well as overall implementation of the program.

Sincerely yours,

/s/

Issufo Sanhá
Minister of Finance

Attachments:

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

ATTACHMENT I

GUINEA BISSAU

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

Bissau, May 22, 2008

I. INTRODUCTION

1. **This Memorandum of Economic and Financial Policies (MEFP) supplements that of January 2008 and our Letter of Intent dated January 9, 2008.** It describes (i) performance on the EPCA-supported program through March 2008; (ii) economic developments in 2007 and early 2008; and (iii) the government's economic program for the remainder of this year. The policies set forth in this MEFP should help the government stay the course and achieve the objectives of the EPCA-supported program.

II. RECENT DEVELOPMENTS AND PROGRAM PERFORMANCE

2. **Economic activity in 2007 was subdued, as expected, with real GDP growth at just 2.7 percent.** The 2007 performance reflected mainly much lower production of rice and other cereals due to late and inadequate rains. This was partially compensated for by an increase in production and exports of cashew nuts following normalization of marketing arrangements.

3. **Annual inflation accelerated sharply at end-2007 and remained high in early 2008 driven mainly by the surge in international prices for food and oil.** The 12-month inflation rate rose to 9.3 percent at end-2007, from 3.2 percent at end-2006, and has remained high in 2008.

4. **Monetary conditions remained stable in 2007.** Broad money growth reached 25 percent, faster than initially projected. The accumulation of foreign assets by the central bank accounted for about 75 percent of the total increase. There was also a significant increase in credit to the private sector in 2007, equivalent to 29 percent of the increase in broad money growth as the domestic banking sector became more involved in the financing of the cashew nuts campaign. As expected, the external current account deficit (excluding official current transfers) narrowed to 12.5 percent of GDP, from 27 percent in 2006, reflecting higher exports of cashews.

5. **Despite efforts to improve revenue collection, fiscal performance was weaker than expected in 2007.** Tax revenues did improve markedly in the second half of 2007, after the government implemented its emergency fiscal program.⁹ However, this was not enough to offset higher expenditures, including a large amount of nonregularized expenditures, owing to continued weaknesses in expenditure management and control. As a result, the

⁹ Minimum Program for Restoration of Fiscal Stability, May 2007.

domestic primary balance worsened to CFAF 19.1 billion (10.8 percent of GDP) in 2007, from CFAF 12 billion (7.5 percent of GDP) in 2006. Measures are being taken to better control expenditures (¶ 12).

6. Fiscal performance improved in early 2008 and progress is being made to advance structural reforms, especially in fiscal management. Performance on the EPCA-supported program was generally good. By the end of March, four of six quantitative indicators were met (domestic primary deficit, government revenues, domestic financing of the budget, and external nonconcessional borrowing) (Table 1). The quantitative indicators on payment of previous years' arrears and new domestic arrears were missed but the target for the year as a whole is achievable. The structural indicators for end-March were met with a delay on one measure (Table 2).

7. Improved control of expenditure commitments on both wages and goods and services kept domestic primary expenditures below target by some CFAF [0.6] billion for the first quarter of 2008. Total revenues were higher than programmed by some CFAF 0.5 billion, reflecting mainly unexpectedly high tax revenues. Nontax revenues were in line with the program, although fishing revenues were lower than expected. The domestic primary deficit for the first quarter of 2008 was CFAF 3.8 billion, below the program target of CFAF 5.1 billion.

8. On the financing side, the government paid down more of 2007 domestic arrears than planned. The EPCA program allowed for a portion of 2007 domestic arrears (about CFAF 3.6 billion) to be repaid in 2008. The authorities, however, repaid most of this amount in the first quarter (mainly related to wages and medical and education supplies), during the legal complementary period for fulfilling previous year expenditure commitments, and thus exceeded the amount programmed for that period by about CFAF 2 billion. As a consequence, some new domestic arrears accumulated, exceeding the adjusted quantitative indicator for end-March. The authorities have since taken measures to avoid any further payment of 2007 domestic arrears (¶ 12) so as to remain within the target for the year as a whole.

9. At the same time, budget support expected in the first quarter of 2008 (about CFAF 7 billion), mainly from the World Bank, was not disbursed as scheduled for administrative reasons but are expected in the coming period. In the circumstances, to make up for financing shortfalls, the government resorted to contracting new short-term domestic commercial debt backed by the expected donor disbursements. Compared to the adjusted quantitative indicator for end-March, the amount of domestic financing was below target, but the costs associated with commercial borrowing in terms of commissions and interest have budgetary implications for 2008.¹⁰

¹⁰ The government contracted short-term commercial loans in the first quarter of 2008 amounting to CFAF 4.7 billion at effective annual interest rates of about 15 percent, including fees and commissions. Part of the principal of the debt (CFAF 2.2 billion) has already been repaid plus a cost (interest and fees) of CFAF 100 million. The rest of the principal (CFAF 2.5 billion) is expected to be repaid in June when World Bank support is disbursed, plus an additional estimated cost of CFAF 156 million.

10. **The government has announced import tax exemptions in response to the food and fuel price pressures.** Since March, all rice imports have been temporarily exempted from taxes. The government also established reference prices to calculate import duties for rice and diesel imports that are much lower than actual import prices. These measures are expected to alleviate some of the impact of higher import prices, particularly for rice, the main staple, on the most vulnerable groups, especially the urban poor, but will have a fiscal cost in terms of lost revenue for the year as a whole (see below).

11. **Structural reforms to improve fiscal revenue collection and expenditure management have continued, with some delays.** The Ministry of Finance created an Information Technology (IT) Department and began training staff (as expected for end-March). The Council of Ministers in May approved a new legal framework for the state budget classification system in line with WAEMU regulations (somewhat delayed compared to the program target of end-March). In May the authorities also launched an audit of domestic arrears for 2000–2007 (a structural indicator for end-April); the EU is paying the international firm that is conducting the audit.

12. **The government has taken a number of other significant actions to address weaknesses in the fiscal areas, including issuing decrees to:**

- Cease payment of outstanding 2007 domestic arrears as of March 12.
- Mandate that all expenditures should be paid only through the Treasury account at the BCEAO.
- Outlaw the payment of any extrabudgetary expenditures unless they are previously authorized by the Minister of Finance and the Prime Minister, and regularize them within 48 hours.
- Transfer to the BCEAO any remaining funds in Treasury accounts in commercial banks.

13. **The government has also made notable progress in other areas to further improve fiscal management.** The Ministry of Finance is currently installing new software to improve accounting and information flows of all Treasury operations (a structural indicator for end-June). The Ministry of Finance and the Ministry of Public Administration are on the final steps to merge the two payroll databases (a structural indicator for end-September). The government has also launched a financial audit, financed by the UNDP, of all government agencies that collect revenues, including state agencies (customs, fisheries, and mining); public enterprises (EAGB, APGB, and FISCAP); and parastatals (Guinetel, Guinea telecom, phosphate and petroleum companies, and ICGB). The audit will, among other things, confirm that levels transferred to the Treasury correspond to regulations, and identify areas where tax collection is currently below potential. The government is committed to adopt as soon as possible recommendations to capture potential revenues.

III. ECONOMIC POLICIES FOR THE REMAINDER OF 2008

14. **The outlook for 2008 remains positive despite the macroeconomic challenges posed by recent developments.** The government is committed to taking the measures

necessary to maintain fiscal and economic stability for the remainder of 2008, contain inflationary pressures, and avoid accumulation of new domestic arrears for the year as a whole. We recognize that achieving these objectives will require vigorous and timely implementation of agreed policy measures and close cooperation between fiscal and monetary authorities. The government will continue to make every effort to speed up structural reforms, particularly in the areas of public expenditure management and revenue collection.

A. Macroeconomic Outlook

15. **Real GDP growth is still expected to increase to over 3 percent in 2008, from 2.7 percent in 2007, which is markedly above the average of 2.2 percent for the last four years.** A return of normal rains, a slight increase in cashew production, and increasing construction, mainly due to public works, is expected to underpin economic expansion in 2008.

16. **Inflation, on the other hand, is now expected to be higher in 2008 than previously projected assuming continued high food and fuel prices.** Given current international price projections for food and fuel products, inflation would average about 7 percent in 2008, compared to the initial projection of 3.3 percent. Unpredictably high import prices for food and fuel will also affect the country's external position; the external current account deficit (excluding official transfers) is now expected to widen to 17 percent of GDP in 2008, compared to the 12 percent initially projected.

B. Fiscal Policy

17. **The 2008 fiscal framework will remain very tight.** A number of factors are adding pressure, such as (i) revenue loss from import tax exemptions; (ii) additional spending on coming elections; (iii) higher costs of domestic financing associated with the new borrowing in 2008 and higher than expected debt owed to the BCEAO; and (iv) losses in the CFA value of U.S. dollar-denominated external support, though these are partially offset by lower debt service on dollar-denominated debt.

18. **Despite the pressures the government remains committed to reducing the domestic primary deficit to CFAF 8.8 billion (4.7 percent of GDP) in 2008 (before additional gap-filling fiscal measures), slightly higher than the deficit of CFAF 7.5 billion (4.1 percent of GDP) initially expected but still a substantial decline from 2007.** For the remainder of the year, the government is determined to keep domestic expenditures within available resources, both domestic and external.

19. **The larger deficit reflects mainly higher domestic primary expenditures (by CFAF 1.3 billion, 0.7 percent of GDP), reflecting mainly the cost of additional election expenditures.** Specifically, the revised expenditure framework reflects the following:

- Election expenditures will be higher by CFAF 1.3 billion because of payment of arrears from previous elections.¹¹
- The government will maintain its nominal freeze of the 2008 wage bill at CFAF 21.3 billion (before additional gap-filling fiscal measures). We also intend to consolidate the wage bill database to remove duplications in salary and pension payments for the same individual. The recent census of military personnel will also allow for more accurate payment of wages to military, which may result in budgetary savings.
- The government will strictly control nonwage discretionary outlays by adhering to the procedures requiring that expenditures be paid only through the Treasury account at the BCEAO. We government will also ensure that any nonaccounted or nonregularized expenditures will be regularized within 48 hours so that they are fully reflected in the expenditures tables of the National Direction of Budget at the end of each month.

20. **In other current expenditures, total interest costs should stay in line with program projections.** Higher domestic interest will be offset by lower interest on external borrowing denominated in U.S. dollars.

21. **The government intends to hold total revenues at CFAF 37.6 billion (20 percent of GDP) for 2008 as a whole.** A number of offsetting factors are expected to impact 2008 revenue performance:

- **Import duties are expected to fall short of projections by some CFAF 0.6 billion (0.3 percent of GDP) because of the tax exemptions on rice imports.**¹²
- **The shortfall in revenue from rice imports will be offset by the strong collection of non-import-tax revenues;** tax revenues have already over performed by some CFAF 0.5 billion (0.3 percent of GDP) in the first quarter of the year and are expected to remain strong for the remainder of 2008.
- **Nontax revenues are expected to remain unchanged at CFAF 16.9 billion for 2008.** The government will work to improve collection of fishing penalties and fishing licenses.

22. **Budget support identified for 2008 is now estimated at CFAF 26.1 billion, some CFAF 1.3 billion higher than expected.** The government confirmed with Guinea-Bissau's

¹¹ These arrears from previous elections will be included in the EU audit of all domestic arrears now underway.

¹² Program projections of import tax revenues assumed reference prices used to calculate import duties on rice that are unchanged from 2007. The revised estimates, therefore, reflect only the shortfall related to tax exemptions. Revised projections assuming reference prices in line with actual import costs would yield substantially higher revenues for 2008.

external partners the amounts and timing of disbursements pledged for the remainder of 2008. The estimated budget support for 2008 includes new support from both traditional and nontraditional donors that more than compensates for shortfalls in some expected pledges and for losses in the CFA value of U.S. dollar-denominated support.

23. **Domestic financing costs will be higher than the program expected (by CFAF 3.8 billion), reflecting mainly higher debt owed to the BCEAO in 2008.**¹³ There are also some shortfalls in CFA terms compared to program expectations related to both external debt relief and the EPCA purchase.

24. **As a result of all these developments there remains a financing gap of some CFAF 5 billion for 2008.** Among measures to fill the gap are the following:

- (i) Reduce expenditures by CFAF 0.5 billion by ensuring that the expenditure savings already achieved in the first quarter are translated into permanent cuts for the year as a whole.
- (ii) To achieve expenditure savings of CFAF 0.3 billion, consolidate the government payroll database and remove duplications in salary and pension payments paid to the same civil servant.
- (iii) Raise additional revenue (CFAF 0.5 billion) from customs, sales taxes, and non-tax revenues (licenses).
- (iv) Recover tax arrears of CFAF 1.2 billion, including CFAF 0.7 billion already budgeted and CFAF 0.5 billion in additional efforts.
- (v) Reschedule debt owed to the BCEAO in 2008 (CFAF 3.2 billion).

25. With these additional fiscal efforts (the above revenue and expenditure efforts total CFAF 2.5 billion), the domestic primary deficit should decline to CFAF 6.3 billion for 2008 (3.3 percent of GDP).¹⁴

26. **These measures, along with the second EPCA purchase (SDR 1.775 million), should fully cover the financing gap and allow Guinea-Bissau to avoid accumulating domestic arrears for 2008 as a whole, a key fiscal objective.** To the extent of any shortfalls in external financing in 2008, the government is committed to making further efforts to reschedule domestic debt to the extent possible. The government also intends to hold later this year a meeting to follow up on the November 2006 Round Table Conference to mobilize partners to support its development program, especially security sector and civil service reforms. If donor budget grants exceed the amount needed to finance the fiscal gap, priority will be given to using the resources to fully repay commercial debt, treasury bills, and

¹³ Debt owed to the BCEAO has been revised upward to include payment of 2006 and 2007 arrears that were not previously assumed to be paid in 2008.

¹⁴ Revised quantitative indicator for end-2008.

audited domestic arrears, and to increase priority spending in social sectors above budgeted levels, in consultation with the Fund.

C. Structural Reforms in 2008

27. **The government intends to undertake additional structural policies in the fiscal area for the remainder of 2008.** These measures go beyond the commitments made already for the EPCA-supported program and focus on further strengthening revenue collection and improving public expenditure management. The additional measures planned:

- (i) Upgrade the automated customs systems to ASYCUDA++ (Automated System for Custom Administration).
- (ii) Sign a contract with a pre-shipment inspection agency (*Audit Contrôle Expertise*).
- (iii) Revitalize the PNG Committee of the BCEAO and Ministry of Finance with weekly meetings to reconcile Treasury operations with BCEAO and domestic banks.

28. **To the extent that inflationary pressures in Guinea Bissau reflect the increase in liquidity since 2007, the BCEAO will step up its efforts to sterilize excess liquidity in the market.** The government will also work to improve coordination between the Minister of Finance and the BCEAO to improve the latter's liquidity forecasting and ensure timely action to smooth the monetary impact of use of donor funds to finance government expenditures.

D. Capacity Building and Technical Assistance

29. **Capacity building remains a key complement to fiscal reform if we are to ensure that reform is effective and sustainable.** Technical assistance needs continue in all areas of public financial management and in macroeconomic statistics (Table 3). The highest priority continues to be assistance to the Customs, Treasury, and Tax Departments and the debt unit. The IMF West AFRITAC and AFRISTAT are providing technical support to strengthen public financial management and tax collection, as well as improve statistics. The European Union and the World Bank, through its support to low-income countries under stress (LICUS), are also assisting with these reforms.

E. Program Monitoring

30. **Monitoring of progress on the EPCA-supported program for the remainder of 2008 will be based on revised quantitative and structural indicators (see Tables 1 and 2).** The quantitative indicators are (i) a floor on government revenue (tax and nontax); (ii) a ceiling on the domestic primary deficit; (iii) a ceiling on domestic financing of the budget; (iv) no new domestic arrears; (v) a ceiling on payment of previous arrears; (vi) no short- or long-term nonconcessional external borrowing; and (vii) a ceiling on nonregularized expenditures (new indicator). The quantitative indicators are based on the revised monthly

treasury cash flow plan for 2008 (Table 4).¹⁵ Specific definitions and explanations are contained in the annexed Technical Memorandum of Understanding (TMU). The government will provide, on a timely basis, all necessary data to monitor the program, as indicated in the TMU.

31. To demonstrate their commitment to the success of the program, the government intends to take the following measures before August: (i) collect at least CFAF 300 million in tax arrears; (ii) regularize all nonaccounted expenditures for 2007 through April 2008 so that they are fully reflected in the expenditures tables of the National Direction of Budget; (iii) sign a contract with Audit Contrôle Expertise; and (iv) revitalize the PNG Committee of the BCEAO and Ministry of Finance with weekly meetings.

¹⁵ The monthly cash flow plan also serves as an informal indicative framework for regular assessment of EPCA performance.

Table 1. Guinea-Bissau: Quantitative Indicators for the Emergency Post-Conflict Assistance for 2008
 Quarterly Targets 1/
 (Cumulative, CFAF millions)

	2008								
	End-Mar.			End-Jun.		End-Sep.		End-Dec.	
	Prog	Prog. Adj.	Actual	Prog	Prog. Rev.	Prog	Prog. Rev.	Prog	Prog. Rev.
1. Government Revenues 2/	4,226.6	4,226.6	4,609.9	10,413.9	11,388.7	17,824.3	19,162.1	23,130.4	24,580.3
Tax revenues (direct and indirect taxes (01.00.00 and 02.00.00))	3,635.0		4,116.8	9,230.7	9,993.5	16,049.5	16,483.3	20,764.0	20,753.9
Recovery of tax arrears and additional revenue effort					252.2		903.9		1,460.0
Fishing licenses (03.01.01)	591.6		493.1	1,183.2	1,143.0	1,774.8	1,774.8	2,366.4	2,366.4
2. Domestic primary deficit (commitment basis) 3/	-5,050.0	-5,050.0	-3,841.5	-4,861.7	-2,683.0	-3,522.1	-1,352.8	-7,463.7	-6,282
3. Domestic financing of the budget 4/	-238.7	5,865.8	2,094.3	-7,445.7	-5,053.0	-7,684.3	-7,398.7	-17,331.6	-15,036
4. New domestic arrears 5/	0.0	3,771.5	4,549.8	0.0		0.0		0.0	0.0
5. Payment of previous years arrears 6/	1,772.0	1,772.0	3,456.8	3,600.0		3,600.0		3,600.0	3,600.0
6. External nonconcessional public borrowing, maturity > 1 year	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
7. Non regularized expenditures (DNTs)			573.5		-596.4		200.0		200.0

1/ Cumulative from January 1 of the corresponding year. The definition of the aggregates is provided in the Technical Memorandum of Understanding (TMU).

2/ Floor. Defined as direct taxes (01.00.00) plus indirect taxes (02.00.00) plus fishing licenses (03.01.01).

3/ Ceiling. If the disbursed amounts of EU fishing compensation are lower (higher) than programmed, the ceiling will be increased (lowered). For the programmed quarterly amounts of EU fishing compensation for 2008 see the TMU (¶ 11).

4/ Ceiling. If the actual amount of external budgetary assistance (including EU fishing compensation) falls short of program forecasts, the ceiling will be increased for the full amount of the shortfall. For the programmed quarterly amounts of external assistance (including EU fishing compensation) in 2008 see the TMU (¶ 11).

5/ Ceiling. At end-March, end-June and end-September, stock of accounts payables (rest-a-payer); at end-December, accounts payables accumulated during the current year (2008) and still outstanding one month after the end of the year in the case of wages and other personnel expenditures (including pensions) and three months after the end of the year, in the case of non personnel expenditures. The ceiling on the accumulation of new domestic arrears will be adjusted in line with available domestic financing of the budget. In particular, if the government is not able to increase (decrease) the domestic financing of the budget by the full amount of the shortfall (excess) in external budget support, the ceiling in the accumulation of new domestic arrears will be adjusted upward (downward) by that difference.

6/ Ceiling. Includes arrears in wages, transfers, and goods and services previous to 2008 and outstanding as of January 1, 2008. If external financing specifically targeted to clear arrears is available, the ceiling will be increased for the full amount of the funds available.

Table 2. Guinea-Bissau: Structural Benchmarks Under the
Emergency Post-Conflict Assistance
January 1, 2008—December 31, 2008

	Target date	Status
Submit to Parliament the government budget fully consistent with the fiscal framework presented in this MEFP.	End-November 2007	Done
Secure financing assurances from donors to fully cover the 2008 fiscal financing requirements.	End-November 2007	Done
Approve and adopt by Council of Ministers legal framework for new state budget classification system in line with WAEMU regulations.	End-March 2008	Met with delay; approved in May.
Create an Information Technology (IT) Department in Ministry of Finance and start training staff.	End-March 2008	Done
Launch financial audit, by a reputable international firm, of domestic arrears for 2000-07. ¹⁶	End-April 2008	Met with delay; audit launched in May 2008.
Regularize all nonaccounted expenditures for end-2007 and end-April 2008 so that they are fully reflected in the expenditure tables of the National Direction of Budget.	End-May 2008	Met with delay; expenditures regularized as of July 10
Sign a contract with a pre-shipment inspection agency (Audit Contrôle Expertise).	End-June 2008	Done
Revitalize the PNG Committee of the BCEAO and Ministry of Finance with weekly meetings to reconcile Treasury operations with BCEAO and domestic banks.	End-June 2008	Done
Improve accounting and information flows of all Treasury transactions, including nonregularized expenditures (within 48 hours) and bank financing.	End-June 2008	In progress
Collect at least CFAF 300 million in tax arrears.	End-July 2008	
Install new software for payroll and personnel management in order to merge the payroll databases of the Ministry of Finance and Ministry of Public	End-September 2008	

¹⁶ Audit financed by the European Union.

Table 2. Guinea-Bissau: Structural Benchmarks Under the
Emergency Post-Conflict Assistance
January 1, 2008—December 31, 2008

	Target date	Status
Administration.		
Implement an integrated management system for public accounts, linking data flows between customs (DGA), the tax department (DGCI), the budget office (DGO), and the Treasury	End-December 2008	
Upgrade the automated custom systems to ASYCUDA++ (Automated System for Customs Administrations).	End-December 2008	

Table 3. Technical Assistance Needs of the Ministry of Finance

Department	Area	Long-term	Short-term	(Possible) Provider
Minister's Cabinet	Macrofiscal advisor	X ¹		(WB LICUS/IMF) ²
Budget	Expert public finance	X		(EU)
	Expert computer systems	X		(EU)
	Computerization expenditure accounts	X ²		EU
	Public financial management		X	IMF/FAD
Treasury	Advisor to the Treasurer	X		WB LICUS ²
	Accounting system	X		(France)
Tax Department	Expert on tax code		X	(Portugal/IDB)
	Computerization of revenue accounting	X		
	Advisor Directorate of Large Enterprises		X (6 months)	(West AFRITAC)
Customs	Expert to review organic law of customs	X		IDB/WB LICUS ²
	Customs advisor	X		
	Advisor implementing ASYCUDA ++			AfDB
External debt	Debt management		X ³	DRI/IDB/West AFRITAC
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.

Table 4. Guinea-Bissau: Treasury Cash-Flow Plan 2008
(CFAF millions)

	Jan.	Feb.	Mar.	Q1		Q2		Q3		Q4		Jan-Dec	Jan-Dec
	Act/Proj	Act/Proj	Act/Proj	EPCA	Act/Proj	EPCA	Proj.	EPCA	Proj.	EPCA	Proj.	EPCA	Proj.
A. Revenue and grants	2,202	3,489	1,556	9,810	7,248	14,766	16,757	17,676	15,380	9,249	12,658	51,501	52,043
Revenue	2,025	2,989	1,556	5,998	6,571	11,462	11,967	12,726	12,488	7,445	6,588	37,631	37,613
Taxes	1,713	1,239	1,165	3,635	4,117	5,596	5,877	6,819	6,490	4,714	4,271	20,764	20,754
Nontax revenue	312	1,750	391	2,363	2,454	5,866	6,090	5,907	5,998	2,730	2,318	16,867	16,859
Expected budget support	177	500	0	3,812	677	3,304	4,791	4,950	2,893	1,804	6,069	13,869	14,430
B. Expenditure	4,025	3,137	3,183	11,594	10,344	11,920	12,714	11,785	12,790	12,032	13,222	47,331	49,070
Current expenditure	3,882	2,980	3,171	11,297	10,033	11,398	12,235	11,150	12,140	11,397	12,573	45,242	46,981
Wages and salaries	1,735	1,732	1,782	5,330	5,250	5,330	5,467	5,330	5,302	5,330	5,302	21,322	21,322
Goods and services	446	254	317	1,784	1,017	1,784	1,924	1,784	2,097	1,784	2,097	7,134	7,134
Transfers	1,219	715	716	2,806	2,650	2,806	2,762	2,806	2,906	2,806	2,906	11,224	11,224
Other current expenditure	120	200	292	832	612	832	1,116	832	1,450	832	1,450	3,327	4,627
<i>Of which: Restitutions + Incentives + Others</i>	120	0	288	608	408	608	604	608	710	608	710	2,432	2,432
Interest on domestic and foreign debt	362	80	64	546	505	646	966	399	386	645	818	2,236	2,675
Interest on domestic and regional debt	80	10	56	172	146	172	607	172	185	172	402	690	1,340
Interest on foreign debt	282	70	8	373	360	474	360	226	200	473	416	1,546	1,335
Capital expenditure (domestically financed)	143	156	11	297	311	522	479	635	649	635	649	2,089	2,089
C. Extrabudgetary expenditures (DNT + tax compensations)			574	0	574	0	-574	0	0	0	0	0	0
D. Overall domestic balance: A - (B+C)	-1,822	353	-2,200	-1,784	-3,670	2,846	4,616	5,891	2,591	-2,783	-564	4,170	2,973
E. Payment of domestic arrears and complementary period	0	0	3,457	1,772	3,457	1,828	143	0	0	0	0	3,600	3,600
2007: complementary period + rest			3,457	1,772	3,457	1,828	143	0	0	0	0	3,600	3,600
F. Overall domestic balance (cash basis) D-E	-1,822	353	-5,657	-3,556	-7,127	1,018	4,473	5,891	2,591	-2,783	-564	570	-627
Financing	1,822	-353	5,657	3,556	7,127	-1,018	-4,473	-5,891	-2,591	2,783	564	-570	627
Domestic financing	0	0	2,094	-239	2,094	-5,483	-5,423	-239	-5,546	-2,907	-3,728	-8,868	-12,603
Bank financing	0	0	2,094	-239	2,094	-5,483	-5,423	-239	-5,546	-2,907	-3,728	-8,868	-12,603
BCEAO	0	0	0	-239	0	-239	-958	-239	-2,037	-990	-1,674	-1,706	-4,668
Commercial banks	0	0	2,094	0	2,094	-5,244	-4,465	0	-3,509	-1,917	-2,055	-7,161	-7,934
Nonbank financing (incl. privatization)	0	0	0	0	0	0	0	0	0	0	0	0	0
T-bills and regional commercial banks (net)	0	0	0	0	0	-1,724	-1,724	0	0	-6,740	-6,740	-8,464	-8,464
Amortization of external debt	-847	-133	-35	-1,020	-1,015	-1,630	-1,303	-388	-425	-1,882	-1,556	-4,920	-4,299
Financing requirements (+ = financing needs flow)	2,669	-220	3,597	4,815	6,047	7,819	3,977	-5,264	3,380	14,312	12,589	21,682	25,993
Additional identified budget support	0	0	0	2,970	0	6,233	2,442	849	5,441	849	3,785	10,900	11,668
EPCA	1,251			1,386	1,251	0	0	1,386	1,251	0	0	2,772	2,502
World Bank debt relief	81	128	34	284	243	1,810	1,547	284	243	1,810	1,547	4,188	3,579
Authorities' measures	0	0	4	175	4	175	177	175	260	3,329	3,090	3,854	3,531
Recovery of tax arrears	0	0	4	175	4	175	177	175	260	175	260	700	700
T-bills rescheduling	0	0	0	0	0	0	0	0	0	3,154	2,831	3,154	2,831
Additional Authorities' measures						186		4,187		627		5,000	
Additional recovery of tax arrears						0		430		70		500	
Additional revenue efforts (including exploration licenses)						71		214		214		500	
Expenditure savings						43		129		129		300	
Expenditure reduction						71		214		214		500	
BCEAO debt rescheduling								3,200				3,200	
Financing gap (flow) (+ = financing needs)	1,338	-348	3,560	0	4,550	-398	-374	-7,958	-8,001	8,356	3,540	0	-286
Financing gap (+ = financing needs accumulated stock)	1,338	990	4,550	0	4,550	-399	4,176	-8,356	-3,826	0	-286		

ATTACHMENT II
TECHNICAL MEMORANDUM OF UNDERSTANDING

Bissau, May 22, 2008

1. This memorandum describes the definitions of the quantitative indicators for the Program for 2008 to be supported by Emergency Post-Conflict Assistance (EPCA) (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.

I. QUANTITATIVE INDICATORS AND ADJUSTORS

A. Quantitative Indicators

2. The quantitative indicators are the following:
- a. cumulative floors on government revenue
 - b. cumulative ceilings on the domestic primary fiscal deficit (on a commitment basis)
 - c. cumulative ceilings on the change in net domestic financing of the budget
 - d. cumulative ceiling on new domestic arrears of the government, including wage arrears
 - e. ceiling on payments of previous years domestic arrears (before 2008)
 - f. cumulative ceilings on new nonconcessional external debt contracted or guaranteed by the government
 - g. cumulative ceiling on the amount of nonregularized expenditures

Quantitative indicators have been set for end-June, end-September, and end-December 2008, and their values are cumulative from January 1, 2008. Indicative targets for new nonconcessional external debt are continuous.

Definitions and computation

3. **For EPCA purposes, the government is defined as the central government of Guinea-Bissau.** This definition excludes public entities with autonomous legal personality whose budget is not included in the central government budget.
4. For the targeted ceiling presented in Table 1, government revenues include direct taxes, indirect taxes, and fishing licenses, as well as negotiated recovery of tax arrears and additional revenue efforts. The cash flow estimates are based on tax revenue and fishing license income originally programmed for 2008.

Table 1. Quarterly Targets for Government Revenues
and Other Current Expenditures, 2008
(Cumulative, CFAF millions)

	Mar. Actual	Jun. Prog. Rev.	Sept. Prog. Rev.	Dec. Prog. Rev.
1. Government Revenues	4,609.9	11,388.7	19,162.1	24,580.3
Tax revenues (direct, 01.00.00, and indirect, 02.00.00, taxes)	4,116.8	9,993.5	16,483.3	20,753.9
Recovery of tax arrears and additional revenue effort		252.2	903.9	1,460.0
Fishing licenses (03.01.01)	493.1	1,143.0	1,774.8	2,366.4

Source: Cash Flow 2008 revised

5. **The domestic primary fiscal deficit on a commitment basis is based on the cash flow estimates provided in Table 4 of the MEFP.** It is calculated as the difference between government revenue and domestic primary expenditure on a commitment basis. Government revenue includes all tax and nontax receipts and excludes external grants. Domestic primary expenditure consists of current expenditure plus domestically financed capital expenditure, excluding all interest payments and externally financed capital expenditures. 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 domestic primary balances for the program period are provided in Table 2.

Table 2. Estimates of the Quarterly Domestic Primary Balance, New Domestic Arrears, and Payment of Previous Years' Arrears, 2008
(Cumulative, CFAF millions)

	Mar. Actual	Jun. Prog. Rev.	Sept. Prog. Rev.	Dec. Prog. Rev.
1. Total domestic primary deficit	-3,842	-3,049	-2,966	-8,782
Revenue	6,571	18,537	31,025	37,613
Domestic primary expenditure	10,412	21,587	33,991	46,395
Authorities' measures (higher revenues + lower expenditures)	0	366	1,613	2,500
2. New domestic arrears	4,550	0	0	0
Wages and other expenditures on personnel (including pensions)	--	0	0	0
Nonpersonnel expenditures	--	0	0	0
3. Nonregularized expenditures (DNTs)	574	200	200	200
4. Payment of previous years' domestic arrears	3,457	3,600	3,600	3,600

Source: Table 4, MEFP

6. **New domestic arrears of the government are defined as follows:**

(i) At end-March, end-June, and end-September, the stock of account payables (*rest-a-payer*).

(ii) At end-December, as accounts payables accumulated during 2008 and still outstanding one month after December 31 in the case of wages and salaries (including pensions), and three months after in the case of goods and services and transfers.

The targets for the program period are presented in Table 2.

7. **Nonregistered expenditures are defined as follows:** any Treasury outlay (including nontitularized expenditures, restitutions, etc.) not accounted for and therefore not reflected in the expenditures tables presented by the National Direction of Budget.

8. **Previous year's domestic arrears are defined as arrears in wages, transfers, and goods and services** outstanding as of January 1, 2008. The targets for the program period are presented in Table 2. The program allows for partial payment of expenditure commitments related to 2007 that are still outstanding as of January 1, 2008, up to a maximum of CFAF 3.6 billion (see MEFP ¶ 14).

9. **Net domestic financing of the budget is defined on the basis of the cash flow estimates in Table 4 of the MEFP.** Bank financing consists of net changes in the balances of the treasury accounts at the BCEAO and at commercial banks (excluding balances in those accounts that are not available for budget financing, such as accounts that are held under double signature arrangements with donors) and the outstanding amounts of loans, including T-bills, from the BCEAO and commercial banks (local and regional). Domestic nonbank financing encompasses privatization receipts and any other domestic financial debt held outside the banking sector, other than new domestic arrears as defined above, that may arise. Table 3 provides the details.

Table 3. Estimates of Domestic Financing by Quarter, 2008
(Cumulative, CFAF millions)

	Mar. Actual	Jun. Prog. Rev.	Sept. Prog. Rev.	Dec. Prog. Rev.
Domestic financing	2,094	-5,053	-7,399	-15,036
Bank financing	2,094	-5,053	-7,399	-15,036
BCEAO	0	-958	-2,995	-4,668
BCEAO rescheduling	0	0	3,200	3,200
Commercial bank(s) (including regional banks)	2,094	-2,371	-5,880	-7,934
Regional Commercial banks and Treasury bills	0	-1,724	-1,724	-8,464
T-bills rescheduling	0	0	0	2,831
Non bank financing	0	0	0	0

Source: Table 2, MEFP

10. **The indicators for external debt are cumulative ceilings on new nonconcessional external debt contracted or guaranteed by the government.** External debt is defined as debt held by creditors outside the WAEMU region. For EPCA purposes, the definitions of “debt” and “concessional borrowing” are as follows:

a. The indicator for external borrowing 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, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services that 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 interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being (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, i.e., 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, i.e., 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 purposes 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 that cover the operation, repair, or maintenance of the property. Under this definition of debt, arrears, penalties, and judicially awarded damages arising from the failure to make payment on 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 EPCA, 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 date the loan is contracted, 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 10-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.

11. **The concept of government for the purposes of the indicators on external debt is broader than the one used for the budget aggregates; it includes 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

12. The following adjusters will be in effect:

The ceilings on domestic primary fiscal deficit will be adjusted upward (downward) for any shortfall (excess) in E.U. fishing compensation:¹⁷

- **The ceiling on the domestic primary deficit (on a commitment basis) will be increased (lowered) in case of lower (higher) than programmed disbursement of E.U. fishing compensation, for the full amount of the shortfall (excess).** The program assumes the following amounts of E.U. fishing compensation (cumulative from January 1, 2008): by end-March CFAF 0 billions; by end-June CFAF 4.9 billions; by end-September CFAF 9.8 billions; and by end December CFAF 9.8 billion.

The ceilings on domestic financing and on new domestic arrears will be adjusted upward (downward) for any shortfall (excess) in external budgetary assistance (including E.U. fishing compensation),

- **The ceiling on domestic financing will be adjusted in line with the amount of external budget support (including E.U. fishing compensation).** In particular, the ceiling will be increased (lowered) in the case of shortfall (excess) in external budget support, by the full amount of the shortfall (excess). The program assumes the following amounts of external budgetary assistance (including E.U. fishing compensation) (cumulative from January 1, 2008): by end-June CFAF 15.7 billions; by end-September CFAF 26.04 billions; and by end December CFAF 35.8 billion.
- **The ceiling on the accumulation of new domestic arrears will be adjusted in line with available domestic financing of the budget.** In particular, if the government is not able to increase (decrease) the domestic financing of the budget by the full amount of the shortfall (excess) in external support, the ceiling on the accumulation of new domestic arrears of nonpersonnel expenditures will be adjusted upward (downward) by that difference.

II. PROGRAM MONITORING

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

- 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);

¹⁷ For the purposes of the TMU, the CFAF/US\$ exchange rate was updated to 426,6 and the CFAF/Euro exchange rate is 656.

- Data on any extrabudgetary expenditure (not included above), including:
 - (i) incentives to tax collectors; (ii) restitutions to collecting agencies; and (iii) any other retentions operated by collecting agencies (DGA, DGCI, Fishing Ministry, etc.) (monthly, two weeks after the end of the month);
- Tables on nonregularized expenditures (DNT) (monthly, two weeks after the end of the month);
- Table on accounts payable broken down by budget category (wages, goods and services, transfers, other) (monthly, two weeks after the end of the month);
- Previous years' domestic arrears (including 2007): stock and clearance, broken down by budget category (wages, goods and services, transfers, other) (monthly, two weeks after the end of the month);
- The monetary survey, the balance sheet of the central bank, and the balance sheet of the commercial banks (monthly, within six weeks after the end of the month);
- A table with data on Treasury/Central Government outstanding loans (including short-term advances) from and deposits in local and regional commercial banks (monthly, two weeks after the end of the month);
- Treasury Committee monthly reports (monthly, within 10 days after the end of the month);
- 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 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 3 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.

14. **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.**

15. The above data will be provided to the economist at the local office of the IMF in Bissau (Mr. Fonseca) for transfer to the African Department of the IMF in Washington.



Press Release No. 08/183
FOR IMMEDIATE RELEASE
July 28, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US\$2.9 Million Disbursement Under Emergency Post-Conflict Assistance for Guinea-Bissau

The Executive Board of the International Monetary Fund (IMF) has approved a disbursement in an amount equivalent to SDR 1.775 million (about US\$2.9 million) under the Emergency Post-Conflict Assistance (EPCA) for Guinea-Bissau approved on January 28, 2008 (see [Press Release No. 08/11](#)). The assistance supports the authorities' 2008 economic program and is the second and final purchase under the EPCA.

EPCA is designed to promote a strengthening of administrative and institutional capacity, which will be necessary to sustain economic recovery and a higher level of financial assistance. The IMF's support through EPCA formed a key part of a concerted international effort to provide financial assistance to Guinea-Bissau.

Following the Executive Board's discussion of Guinea-Bissau's performance under the EPCA-supported program on July 25, 2008, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

“Guinea-Bissau's has made significant progress in macroeconomic stabilization and structural reforms, in an adverse external environment. Meeting the challenges resulting from sharp increases in international food and fuel prices will require continued efforts to maintain macroeconomic stability, strengthen institutional capacity, and boost production, particularly in the agricultural sector.

“The reduction in tariffs on rice and fuel imports to address the social consequences of price increases was appropriate in light of capacity constraints. However, meeting fiscal objectives for 2008 will depend on steps to offset the impact of these measures on the budget, including the comprehensive implementation of the targeted revenue and expenditure policies. The timely payment of civil servant wages is also important. Strong policy implementation would enhance prospects for the timely disbursement of external concessional assistance, and help

support the authorities' efforts to avoid further recourse to high-cost borrowing from commercial banks and the accumulation of new domestic arrears.

“Recent progress on structural reforms to strengthen fiscal management is welcome. The authorities are encouraged to continue to strengthen expenditure management, including by ensuring that all expenditure commitments are promptly regularized. At the same time, the pace of fiscal reforms needs to accelerate to further build capacity and improve confidence in the economy. Planned additional measures under the program include improvements in import processing and customs administration and a further strengthening of treasury management.

“Continued strong engagement of the international community along with strong policy implementation will be essential for the success of the EPCA-supported program. In light of Guinea Bissau's debt burden, the authorities should seek assistance from donors on highly concessional terms, preferably grants,” Mr. Portugal said.

For additional information on emergency assistance by the IMF, see:

<http://www.imf.org/external/np/exr/facts/conflict.htm>

**Statement by Laurean Rutayisire, Executive Director for Guinea-Bissau
July 25, 2008**

1. On behalf of my Bissau-Guinean authorities, I would like to thank staff for the fruitful discussions held during their recent visit to Bissau. The report tabled for Board's discussion represents a candid assessment of the country's current economic situation, the good progress made by my authorities in the implementation of their EPCA-supported program. The report outlines also the daunting challenges Guinea-Bissau continues to face, including in relation to the current unfavorable international environment of food and oil price increases. The policy advice therein are supportive to the authorities' continued efforts to put the country's public finances back on a more sustainable path, and build capacity for implementation of policies that promote stability, strong and sustainable economic growth and poverty reduction.

I. Recent developments

2. The authorities' strong commitment to succeed in implementing their EPCA-supported program has led to good performance. The progress made since the second half of 2007 in strengthening expenditure control and revenue collection helped improve the fiscal situation, although the fiscal policy stance remains very tight. Four out of six quantitative indicators for end-March 2008 – relating to domestic primary deficit, government revenues, domestic financing of the budget and external nonconcessional borrowing - were met, some by large margins. The two missed targets, namely the payment of previous years' arrears and new domestic arrears, will be met at the end of the year for the year-target as a whole. On the structural reform side, measures set for end-March 2008 were also met albeit with a delay on one measure due to capacity constraints.

3. Along with the strengthening of the fiscal and economic management and the continuing stability of the political situation, donor support resumed and economic confidence improved. This, together with increased agricultural production resulting from the back-to-normal rains, contributed to the gradual economic recovery observed since 2007. Real GDP grew at 2.7 percent in 2007 and is projected to grow by 3 percent in 2008. In addition, the external current deficit narrowed, reflecting higher exports of cashews following the implementation of the liberalized cashew-pricing policy since 2007.

4. Nonetheless, given the heavy weight of food and fuel imports over total imports (56 percent in 2007), and the estimated contribution of their prices in overall inflation in Guinea-Bissau, the recent surge in food and fuel prices on the international markets seriously threatens to derail the still fragile stabilization gains. Already, inflation has sharply increased and pressures on the fiscal and external current accounts are mounting as consequences. In addition, in light of the still limited capacity for policy implementation stemming from years of instability and the widespread poverty, the range of policy options at government disposal to allow the economy adjust to the shocks while protecting vulnerable population is very

narrow. This calls for more and timely donor support. This Board's approval of a second EPCA purchase will help catalyze donor assistance, in addition to contributing to cover the mounting balance-of-payments needs. Thus, I call on the Board support to my Bissau-Guinean's requests for the completion of the first review under the current EPCA and for a second purchase under this facility.

II. Policy agenda for the remainder of 2008 and beyond

5. Albeit the significant challenges that still lie ahead, including those relating to managing the socio-economic consequences of the current shocks, my authorities are strongly committed to keep the momentum of policies and reforms towards a successful implementation of their EPCA-supported program. This will give way to further restoring confidence in their macroeconomic management, improving domestic and external credibility, and building the necessary track record for consideration of a PRGF-supported program by the end of this year.

6. The **2008 fiscal framework** has been re-calibrated to take into consideration the new environment and the additional spending needs, such as those related to the upcoming legislative elections, while achieving a substantially improved fiscal stance compared to 2007. Importantly, the government remains committed to maintain nominal freeze of the wage bill, to strictly control non-wage discretionary outlays by enforcing procedures that allow expenditures only through the Treasury account at the BCEAO national office, and to maintain domestic expenditures within available resources, both domestic and external, as well as in line with program projections.

7. On the revenue side, the government will strive to sustain the strong performance achieved during the first quarter of 2008, including in efforts to offset revenue shortfall from tax exemptions on rice imports and ensure that the budget is fully financed. My authorities have already secured financial resources from donors and stand ready for additional measures to fully cover the financing gap and avoid accumulation of domestic arrears for 2008 as a whole. Nonetheless, they continue to mobilize the donor community for increasing support to their overall reform agenda, especially the reforms of the security and civil service as well as well targeted programs to expand and diversify agriculture production. My authorities intend to hold a Donors' Round Table toward the end of 2008 to follow up on the donors' meeting held in November 2006.

8. Furthermore, in line with their strong resolution to address the remaining structural weaknesses in revenue collection and public expenditure management and move the country forward, my authorities' reform agenda includes additional measures that go beyond the set of measures currently being pursued under the EPCA-supported program. In addition to ceasing payment of previous arrears and tightening expenditure control, my authorities are also moving to open up the flow of information on the treasury operations, clean up the payroll database, and identify possible sources of tax revenues. In the same order, they are

taking steps to upgrade the automated customs systems, and will subcontract an inspection agency to assist carrying out pre-shipment inspections.

9. My Bissau-Guinean authorities will continue to adhere to the prudent **monetary policy** conducted by the regional central bank BCEAO. In addition, coordination between fiscal and monetary policies will be strengthened to ensure timely action of sterilizing liquidity stemming from use of donor funds. The decision to revitalize the PNG Committee to ensure weekly reconciliation of Treasury operations with BCEAO and domestic banks is a step in this direction.

10. In view of the capacity constraints facing the country, my authorities are thankful for the **technical assistance** they continue to receive from the international community, especially from the Fund's West AFRITAC, AFRISTAT, the World Bank and the EU. They look forward to working with their development partners so as to continue strengthening the country's institutional and human capacity for development policy design and implementation.

III. Conclusion

11. With the commendable achievements so far, my Bissau-Guinean authorities have demonstrated their commitment to the policies and reforms laid out under the ongoing EPCA-supported program. Despite the daunting challenges facing the country, namely sustaining the newly stabilized socio-political environment, reviving economic growth and reducing poverty, my authorities are dedicated to resolutely move forward with their stabilization agenda, and quicken the pace of the process toward a PRGF-supported program and debt relief, which will help lay the ground to the long-term development and poverty reduction agenda. The additional macroeconomic stabilization measures which they are taking over and above the measures set under EPCA demonstrates my authorities' ownership of the program and their readiness to advance to a PRGF-supported program.

12. In view of the above, I will appreciate the Board's support for the completion of this first review, and the approval of the authorities' request of the second purchase under the EPCA. My authorities also look forward to negotiating the PRGF program before the end of this year.