

**Guinea-Bissau: Use of Fund Resources—Request for Emergency Post-Conflict Assistance—Staff Report; Press Release; and Statement by the Executive Director for Guinea-Bissau**

In the context of the Use of Fund Resources—Request for Emergency Post-Conflict Assistance by Guinea-Bissau, the following documents have been released and are included in this package:

- The staff report for the Use of Fund Resources—Request for Emergency Post-Conflict Assistance, prepared by a staff team of the IMF, following discussions that ended on November 19, 2007, 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 January 9, 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 January 28, 2008 discussion of the staff report that concluded the request.
- 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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INTERNATIONAL MONETARY FUND

GUINEA-BISSAU

**Use of Fund Resources—Request for Emergency Post-Conflict Assistance**

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

Approved by David Andrews and Michael T. Hadjimichael

January 9, 2008

**Discussions on a program that could be supported by Emergency Post-Conflict Assistance (EPCA) were held in Bissau November 6–19, 2007.** The team consisted of C. McAuliffe (head), L. Ocampos, C. Fernandez, and L. Leony (all AFR). World Bank staff joined the mission.

**The program for January–December 2008 is designed to address the immediate post-conflict challenges of restoring fiscal stability, building capacity for implementing policy, and regularizing relations with donors.**

**The authorities have met the prior actions:** (i) submission to Parliament of the 2008 budget in line with the macroeconomic framework agreed for EPCA; and (ii) assurances from donors that the 2008 fiscal financing requirements will be filled.

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## EXECUTIVE SUMMARY

- **After nearly a decade of conflict and political instability, Guinea-Bissau remains very fragile.** Real GDP growth, which was below 2 percent in 2006, is estimated to have increased by 2.7 percent in 2007. Recent high food prices could push average inflation above 3 percent for 2007.
- **After a sharp deterioration in early 2007, fiscal performance has improved markedly since the new government implemented its emergency fiscal plan in April.** Since June tax revenues have surged, expenditures have been kept within budget, and donor disbursements have resumed. However, the fiscal deficit is still expected to widen for 2007 as a whole.
- **The authorities' program for 2008 builds on the gains achieved in the emergency fiscal program and aims to stabilize public finances by improving fiscal management.** The program envisages an increase in real GDP growth to over 3 percent in 2008 and a moderation in inflation to about 3 percent, consistent with the regional trend.
- **The key fiscal objective for 2008 and beyond is to avoid new domestic arrears.** This will be achieved through a nominal freeze of current expenditures, including the wage bill, and strict control of nonwage discretionary outlays. Tax revenues as a share of GDP are projected to remain roughly constant.
- **The 2008 program includes structural measures to strengthen revenue administration and improve expenditure management and transparency.** The authorities agreed that achieving fiscal sustainability over the medium term depends critically on reining in nonpriority current spending, intensifying revenue mobilization, and regularizing relations with external creditors.
- **The authorities have already secured a significant amount of donor financial and technical assistance for 2008.** Satisfactory performance with Emergency Post-Conflict Assistance (EPCA) could pave the way for a PRGF arrangement and eventual debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).
- **The proposed initial EPCA purchase is for SDR 1.775 million (12.5 percent of quota).** Another purchase of SDR 1.775 million is envisaged for July 2008, assuming continued good performance. The purchases would support the authorities' stabilization and reform efforts; good performance could also help catalyze additional international support. High among the risks to the program are delays in donor support.

## I. BACKGROUND

1. **Nearly a decade of conflict and political instability has left Guinea-Bissau very fragile (Table 1).** Though the 1998 civil war and the coup in mid-2003 have ended, they left a legacy of deteriorated physical infrastructure, weakened administrative and policy implementation capacity, unsustainable fiscal deficits, and heavy reliance on donor support. As discussed in the 2007 Article IV consultation,<sup>1</sup> economic and social conditions have worsened since the conflict, with per capita incomes declining in most years (Text Table 1). Since parliamentary elections in 2004 and presidential elections in 2005 the government has attempted to rebuild the administration and address the country's economic problems. However, political tensions have caused delays in policy implementation and persistent postponement of donor support. In April 2007 a new Prime Minister and cabinet of ministers were appointed under considerable pressure from a new coalition of political parties within Parliament. To stabilize a deteriorating fiscal position, the new government moved forward quickly with an emergency fiscal program that has received widespread support from Parliament, donors, development partners, and the public. However, the political situation is still marked by frequent strikes triggered by arrears on government wages. Legislative elections are scheduled for October 2008, followed by Presidential elections in 2009.

Text Table 1. Guinea-Bissau: Macroeconomic Indicators, 2001-07

	2001	2002	2003	2004	2005	2006	2007 Est.
	(Annual percent change, unless otherwise specified)						
Real GDP growth	0.2	-7.1	-0.6	2.2	3.5	1.8	2.7
GDP per capita <sup>1</sup>	-2.6	-9.8	-3.4	-0.7	0.3	-1.1	-0.4
Inflation (annual average)	3.3	3.3	1.6	0.8	3.4	2.0	3.8
Export value (CFAF basis)	3.8	-0.5	7.4	12.1	0.2	-17.7	49.3
Import value (CFAF basis)	10.0	-14.3	-12.9	1.0	16.1	7.4	4.3
Broad money	9.5	24.2	-65.3	44.0	20.6	5.3	16.0
	(Percent of GDP)						
Overall Fiscal balance, commitment basis, including grants	-9.8	-10.1	-12.9	-15.0	-11.9	-9.7	-9.7
External current account balance	-35.1	-16.9	-9.7	-9.4	-9.7	-24.7	-11.4

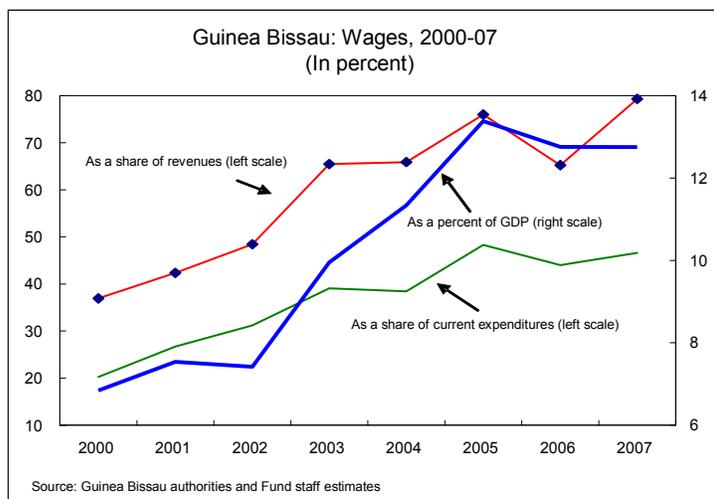
Source: Guinea-Bissau authorities, and IMF staff estimates and projections.

<sup>1</sup> Based on updated staff projections for 2006.

<sup>1</sup> IMF Country Report No. 07/370.

## 2. Contributing to Guinea-Bissau's economic emergency are unsustainably large fiscal imbalances.

The public wage bill has increased fivefold since the civil war, reflecting the rise in military personnel and a series of politically motivated civil and military salary increases since 2004. While government revenues have been about 16 percent of GDP since 2000, current expenditures rose from about 20 percent of GDP in 2000 to 29 percent in 2006, with the share of the wage bill rising.



It now accounts for almost half of current expenditures, soaking up about 80 percent of government revenues. Meanwhile, as the erosion of donor support led to large financing shortfalls, the authorities resorted to short-term commercial borrowing and accumulated large amounts of external and domestic arrears, including government wages. The situation is clearly unsustainable.

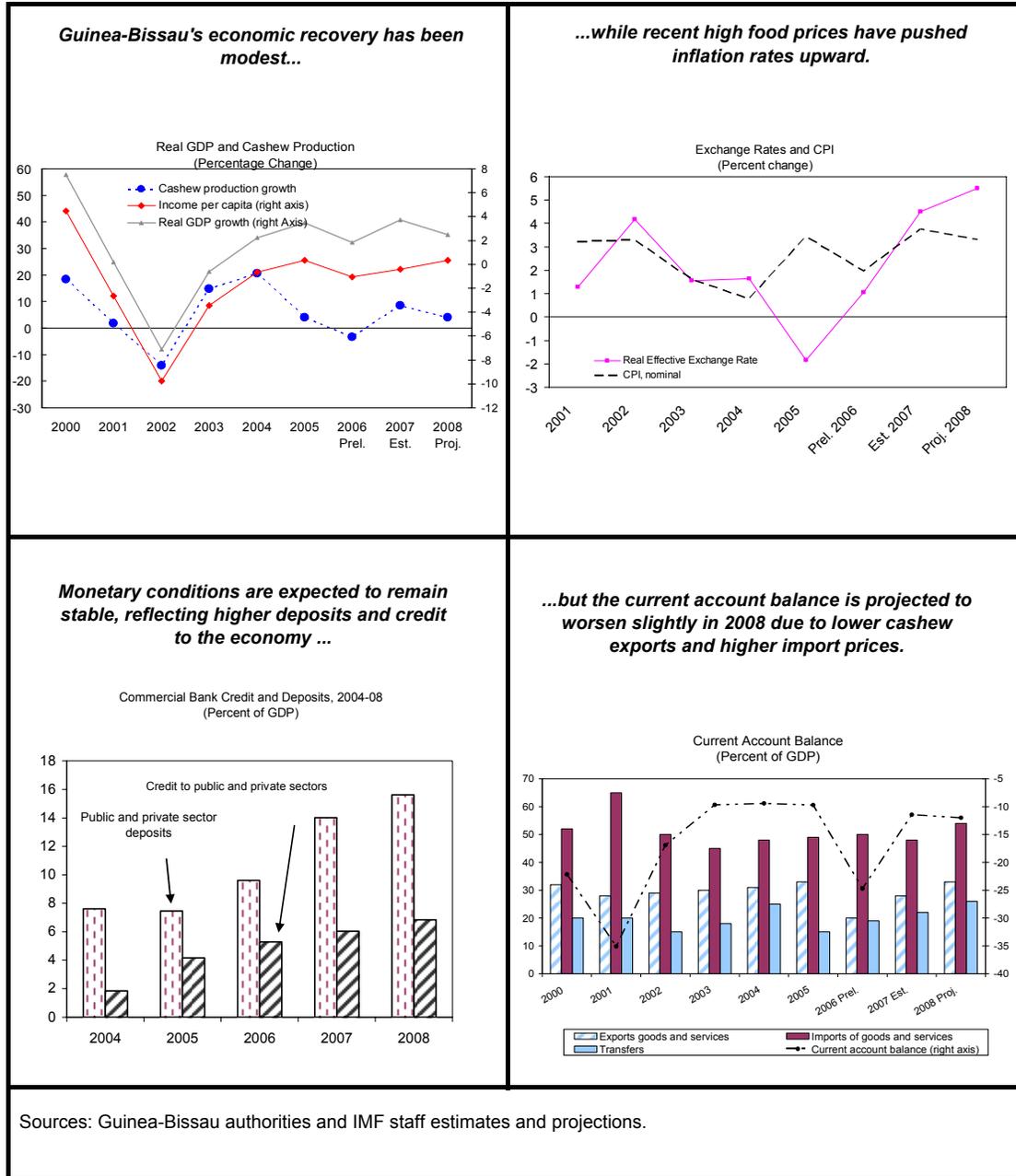
3. **The government appointed in April 2007 has made major progress in the essential task of restoring fiscal control.** It moved quickly to adopt an Emergency Action Plan that included forceful measures to collect additional revenue, especially tax arrears; control expenditures; and address weaknesses in revenue administration, expenditure management, and fiscal transparency (MEFP ¶ 6). The improvements in fiscal performance in the second half of 2007 have been encouraging, and the international community has responded positively by disbursing earlier pledges. The challenge for the government now is to build on these gains to reduce fiscal imbalances and the burden of expensive commercial debt, put public finances on a more sustainable path, and implement much-needed structural reforms, especially in the civil and military services.

## II. RECENT ECONOMIC DEVELOPMENTS

4. **Economic activity in 2007 was weaker than expected; real GDP growth is only an estimated 2.7 percent (Figure 1) against a projected 3.3 percent.** It appears from provisional data that production of cashews in 2007 fell slightly below projections even though cashew marketing arrangements were normalized, and rice and other cereals were severely affected by late and inadequate rains. As elsewhere in the WAEMU area, inflation in Guinea-Bissau has been subdued, although food prices could push year-end inflation above the 3 percent target (Table 2). The external current account deficit (excluding official current transfers) is expected to narrow to 11 percent of GDP in 2007, from 25 percent in 2006, reflecting higher exports of cashews, some from last year's stock (Table 3). Monetary

developments were stable in 2007; broad money grew at moderate rates. This reflects a pick-up in credit to the economy as commercial banks took over a large part of cashew financing, and a rise in net credit to the government (Table 4).

Figure 1. Guinea-Bissau: Main Economic Trends, 2000-08

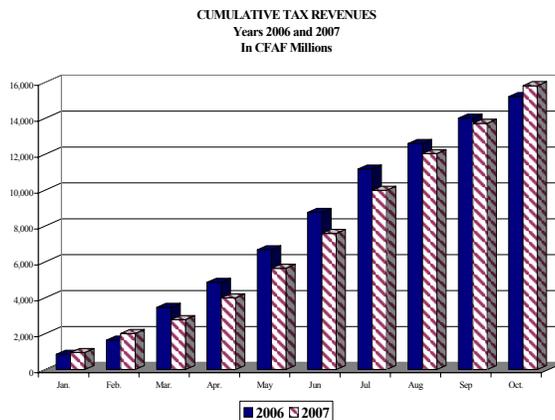


5. **After a sharp deterioration in early 2007, fiscal performance has improved markedly since the new government implemented its emergency plan.** Tax revenues in particular surged in the second half of 2007 (Box 1). As a share of GDP, second-half tax revenues were nearly double the intake from the first half (Text Table 2), when revenue administration withered under the former government and imports fell due to political

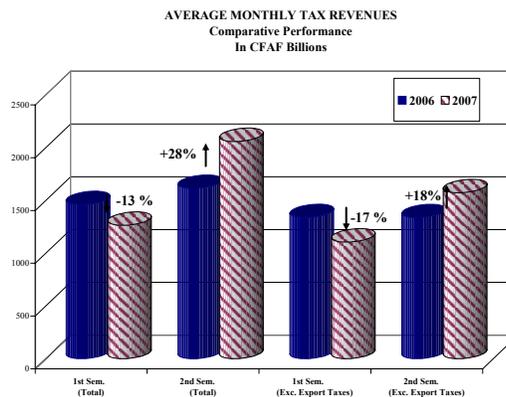
uncertainties. The pickup in budget support in the second half allowed for increased expenditures, including full payment of government wages and more domestically financed capital expenditures. Importantly, expenditure control improved in the second half of the year, and wages and other discretionary expenditures were held within budget. The increase in budget support also allowed for some repayment of domestic arrears, including wages, that had accumulated in the first half of 2007.

### Box 1. Guinea-Bissau: 2007 Tax Performance

**Tax revenue has risen markedly since the government implemented its emergency fiscal plan.** While for most of the year cumulative tax revenues were lower than in 2006, the margin has been narrowing since July. By October, cumulative tax revenues of CFAF 15.8 billion were 4 percent higher than in the same period last year. In contrast, through June, tax revenues were about 13 percent lower than in 2006.



**The improvement is significant even excluding export taxes, which are seasonally higher in the second half of the year.** Monthly tax revenues (excluding export taxes) starting in July have been averaging about 18 percent higher than in the same period last year; earlier in the year they were 17 percent lower on average than in 2006.



Text Table 2. Guinea-Bissau: 2007 Fiscal Performance - Selected Cash Flow Items  
(In millions of CFA francs and percent of GDP)

	Total 2007 Est.	Jan-Jun in millions of CFA francs	Jul-Dec	Jan-Jun in percent of GDP	Jul-Dec
Revenue and grants	44,269	15,017	29,252	8.9	17.3
Revenue	27,613	11,517	16,096	6.8	9.5
Taxes	19,721	7,582	12,139	4.5	7.2
Nontax revenue	7,892	3,935	3,957	2.3	2.3
Expected budget support	16,656	3,501	13,155	2.1	7.8
Expenditure	44,957	18,953	26,004	11.2	15.4
Current expenditure	42,706	18,060	24,646	10.7	14.6
<i>of which:</i> Wages and salaries	21,833	9,872	11,961	5.8	7.1
Capital expenditure (domestically financed)	2,251	893	1,358	0.5	0.8
Extrabudgetary expenditures	132	0	132	0.0	0.1
Cash flow balance A-(B+C)	-820	-3,935	3,115	-2.3	1.8
Net change in domestic arrears	2,931	7,892	-4,961	4.7	-2.9
Financing	-2,111	-3,957	1,846	-2.3	1.1

6. **However, the fiscal deficit (excluding grants) is still expected to widen from 22 percent of GDP in 2006 to about 25 percent (Text Table 3 and Table 5).** Total revenues are currently projected to decline to 16 percent of GDP, down about 3.5 percent of GDP from 2006 because sizable annual fishing compensation from the E.U. was postponed until early 2007.<sup>2</sup> On the other hand, current expenditures are expected to be lower, down to 27 percent of GDP from 29 percent in 2006, reflecting better control of nonwage discretionary spending, especially travel and representation costs.

<sup>2</sup> Owing to delays in concluding a new fishing agreement in 2007, the E.U. will not disburse annual compensation (US\$9 million), previously expected in 2007, until early 2008.

Text Table 3. Guinea-Bissau: Central Government Operations, 2005–08  
(Percent of GDP)

	2005	2006	2007 Est.	2008 Program
Revenue and grants	30.4	31.5	31.7	42.3
Revenue	17.6	19.6	16.1	20.7
Tax revenue	11.5	11.5	11.5	11.4
Nontax revenue	6.1	8.1	4.6	9.3
Grants	12.7	11.9	15.6	21.6
<i>Of which:</i> Budget support	3.2	6.4	9.7	13.7
Expenditure	42.2	41.2	41.4	41.6
Current expenditure	27.7	29.0	27.4	26.3
<i>Of which:</i> wages and salaries	13.4	12.8	12.8	11.8
Capital expenditure and net lending	14.5	12.2	14.0	15.3
Overall balance, including grants (commitment basis)	-11.9	-9.7	-9.6	0.7
Overall balance, excluding grants (commitment basis)	-24.6	-21.6	-25.3	-20.9
Net Domestic Arrears	-0.1	3.4	1.7	-2.0
Overall balance, including grants (cash basis)	-10.2	-4.7	-6.3	0.0
Financing	10.2	4.7	6.3	0.0
Domestic financing	5.9	-1.1	0.1	-9.6
Foreign financing (net)	4.3	5.8	6.2	3.6
<i>Of which:</i> external arrears	8.4	5.4	4.6	4.0
debt relief	3.3	3.3	2.2	0.4
project and program loans	3.9	5.4	6.8	6.3
Financing gap (+ = financing needs)	0.0	0.0	0.0	6.0
Additional financing		0.0	0.0	5.9
Residual financing gap		0.0	0.0	0.0
Domestic primary balance	-6.9	-7.5	-9.6	-4.1
Revenue	17.6	19.6	16.1	20.7
Primary expenditure	24.5	27.1	25.7	24.9
Current	23.5	25.9	24.4	23.7
Capital	1.1	1.2	1.3	1.2

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

7. **Donor disbursements resumed in 2007.** External budget support for 2007 amounted to US\$34 million from the E.U.; regional partners (WAEMU and ECOWAS); bilateral partners (France, Portugal, Spain, and China); and nontraditional partners such as Angola (Text Table 4). Expected budget support of US\$10 million from the World Bank was delayed until early 2008. Budget support of US\$1.7 million expected from the African Development Bank in 2007 was also delayed until early 2008.<sup>3</sup>

<sup>3</sup> The delays in disbursement of World Bank and AfDB budget support reflected in part the delay in concluding a program for EPCA in 2007.

Text Table 4. Guinea-Bissau: 2007 Sources of Financing

	CFAF billions	US\$ millions
<b>Fiscal financing needs (Art. IV report -September 2007)</b>	46.5	93.4
<b>Sources of financing</b> (net changes)	39.9	80.1
<b>Budget support</b>	16.7	33.5
European Union	3.6	7.2
Regional institutions: ECOWAS and WAEMU	5.5	11.1
Angola support	6.5	13.0
Other bilaterals 1/	1.1	2.2
<b>External debt arrears</b>	10.7	21.5
<b>Domestic financing (rescheduling)</b>	11.1	22.3
Domestic and regional commercial banks	2.9	5.8
T-bills	6.7	13.5
BCEAO	1.5	3.0
<b>Other net changes</b> 2/	1.4	2.8
<b>Accumulation of domestic arrears</b>	6.6	13.3

Source: IMF staff estimates

1/ France, Portugal, Spain, and China.

2/ Including revenue, expenditure, and other domestic financing items.

8. **Despite the recovery in external assistance, to avoid substantial accumulation of domestic arrears the government had to reschedule most of its commercial debt that was due in 2007 (about US\$ 22 million or 6 percent of GDP).** Nevertheless, some domestic arrears accumulation (about CFAF 6.6 billion, 3.8 percent of GDP) was unavoidable. A portion of these (about CFAF 3.6 billion related to medical and education supplies) will be paid in early 2008 with the delayed World Bank disbursement; a considerable amount will be included in an E.U.-financed audit of domestic arrears and repaid over time as financing becomes available (see below).

### III. THE PROGRAM FOR 2008

#### A. Overview

9. **In their program for January–December 2008 (Memorandum on Economic and Financial Policies (MEFP), Appendix II) the authorities address Guinea-Bissau’s main post-conflict challenges of rebuilding physical infrastructure, reinforcing administrative and policy implementation capacity, and reducing fiscal imbalances.** Their objectives are to (i) strengthen revenue collection; (ii) restore effective expenditure control; and (iii) rein in the expansion in the wage bill. With the 2008 program, the country will start gradually moving toward fiscal sustainability and more regular relations with external creditors. However, achieving fiscal sustainability will take time, given the large external debt burden,

and will require continued and increased access to grants and concessional aid inflows over the medium term.<sup>4</sup> The authorities, who have already secured a significant amount of donor financial and technical assistance for 2008, are requesting an Emergency Post-Conflict Assistance (EPCA) purchase to support their 2008 program.

10. **Guinea-Bissau meets the Fund’s conditions for EPCA support.** First, its institutional and administrative capacity have been severely undermined by the protracted conflict, and the country is clearly not yet able to implement a comprehensive program that could be supported by a PRGF or other Fund arrangement. Second, despite the weaknesses, there are signs that the country has enough capacity for policy planning and implementation, as demonstrated by the new government’s commitment to restore fiscal stability. Third, there is urgent need to meet essential external payments, including payments to multilaterals. Finally, concerted international support for Guinea-Bissau has re-emerged.

11. **The authorities see their program as essential for restabilizing the economy and preparing for higher and sustained economic growth.** A Fund-supported program would help restore confidence in their economic management and help them implement their policy priorities. The authorities are confident that good performance on the EPCA program could catalyze additional donor support for critical structural reforms, especially security and civil service reforms, and allow them to spend more to address pressing needs for poverty reduction, infrastructure rehabilitation, and other priorities. More external assistance would also help reduce the heavy burden of domestic arrears.

12. **The authorities hope that the EPCA-supported program could pave the way to a PRGF arrangement, the completion point for the Highly-Indebted Poor Countries (HIPC) initiative, and Multilateral Debt Relief Initiative (MDRI) relief.** However, while the 2008 EPCA-supported program would be an important step in that direction, much more needs to be done to improve policy implementation and administrative capacity before the country can move to a PRGF arrangement. Such an arrangement is currently anticipated for 2010 after successive EPCA-supported programs establish a performance track record.

## **B. The Macroeconomic Framework**

13. **The macroeconomic framework for the program is based on the medium-term outlook presented in the 2007 Article IV consultation, which envisages a gradual recovery of annual real GDP growth to above 3 percent over the medium term (Text**

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<sup>4</sup> Guinea-Bissau’s total concessional external assistance needs over the medium term are significant. In addition to budget support to cover the domestic primary deficit, Guinea-Bissau also requires significant amounts of project grants and loans to finance minimal capital expenditures, mostly in the Public Investment Program. Guinea-Bissau will also need comprehensive debt relief to reduce the burden of annual scheduled debt service. For more on Guinea-Bissau’s external assistance requirements, see IMF Country Report No. 07/370.

**Table 5).**<sup>5</sup> This is based on (i) the government's continued commitment to policy reform, which would enable it to implement more forceful Fund-supported reforms and achieve sustained levels of donor support; (ii) steady rebuilding of infrastructure and institutional capacity; and (iii) a return of investor confidence.

- **Real GDP growth is projected to increase to 3.3 percent in 2008**, slightly above the average for the past four years. The projections assume (i) more normal rains and an increase in cereal production to previous levels; (ii) an increase in cashew production as the crop matures; and (iii) public investment of about 13 percent of GDP—above the average for the past five years—as the government continues to garner donor support. Real per capita income would rise slightly, reversing the trend of recent years.
- **Average inflation is projected at about 3.3 percent**, in line with the WAEMU convergence criteria.
- **The external current account deficit (excluding official current transfers) is expected to widen slightly to 12 percent of GDP in 2008**, as fewer cashews are exported than in 2007 and prices for rice and oil imports rise.
- **Monetary conditions are expected to hold steady in 2008**. Broad money is expected to increase by 8 percent, reflecting an increase in private sector deposits in commercial banks as the banking system expands.

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<sup>5</sup> See IMF Country Report No. 07/370.

Text Table 5. Guinea-Bissau: Medium Term Scenario

	2005	2006	2007	2008	2009	2010
		Prel.	Est.	Proj.	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	3.2	3.4
Real GDP per capita	0.3	-1.1	-0.4	0.3	0.2	0.4
Consumer price index (end of period)	1.0	3.2	4.3	2.4	2.5	2.5
(Percent of GDP, unless otherwise indicated)						
Investments and savings						
Gross investment	14.6	12.2	14.1	15.8	14.7	15.0
<i>Of which:</i> government investment	14.1	10.8	13.4	13.9	13.3	13.3
Gross national savings	9.5	0.9	12.4	22.7	17.5	17.7
Government finances						
Budgetary revenue	17.6	19.6	16.1	20.7	18.0	18.0
Total domestic primary expenditure	24.5	27.1	25.7	24.9	21.9	21.2
Domestic primary balance	-6.9	-7.5	-9.6	-4.1	-3.9	-3.2
Overall balance (commitment basis)						
Including grants	-11.9	-9.7	-9.7	0.7	-4.9	-4.6
Excluding grants	-24.6	-21.6	-25.3	-20.9	-20.1	-19.3
Overall balance, including grants (cash basis)	-10.2	-4.7	-6.3	0.0	-3.8	-4.6
Financing	10.2	4.7	6.3	0.0	3.8	4.6
Domestic and Foreign Financing	10.2	4.7	6.3	-6.0	2.5	5.9
Additional Financing	0.0	0.0	0.0	5.9	0.0	0.0
Residual Financing gap ( + = financing needs)	0.0	0.0	0.0	0.0	1.3	-1.3
External current account (including official current transfers)	-5.1	-11.3	-1.7	7.0	2.8	2.7
Excluding official current transfers	-9.7	-24.7	-11.4	-12.0	-7.0	-6.7
Nominal stock of external debt, including arrears	440.6	436.3	403.2	389.2	305.3	197.3

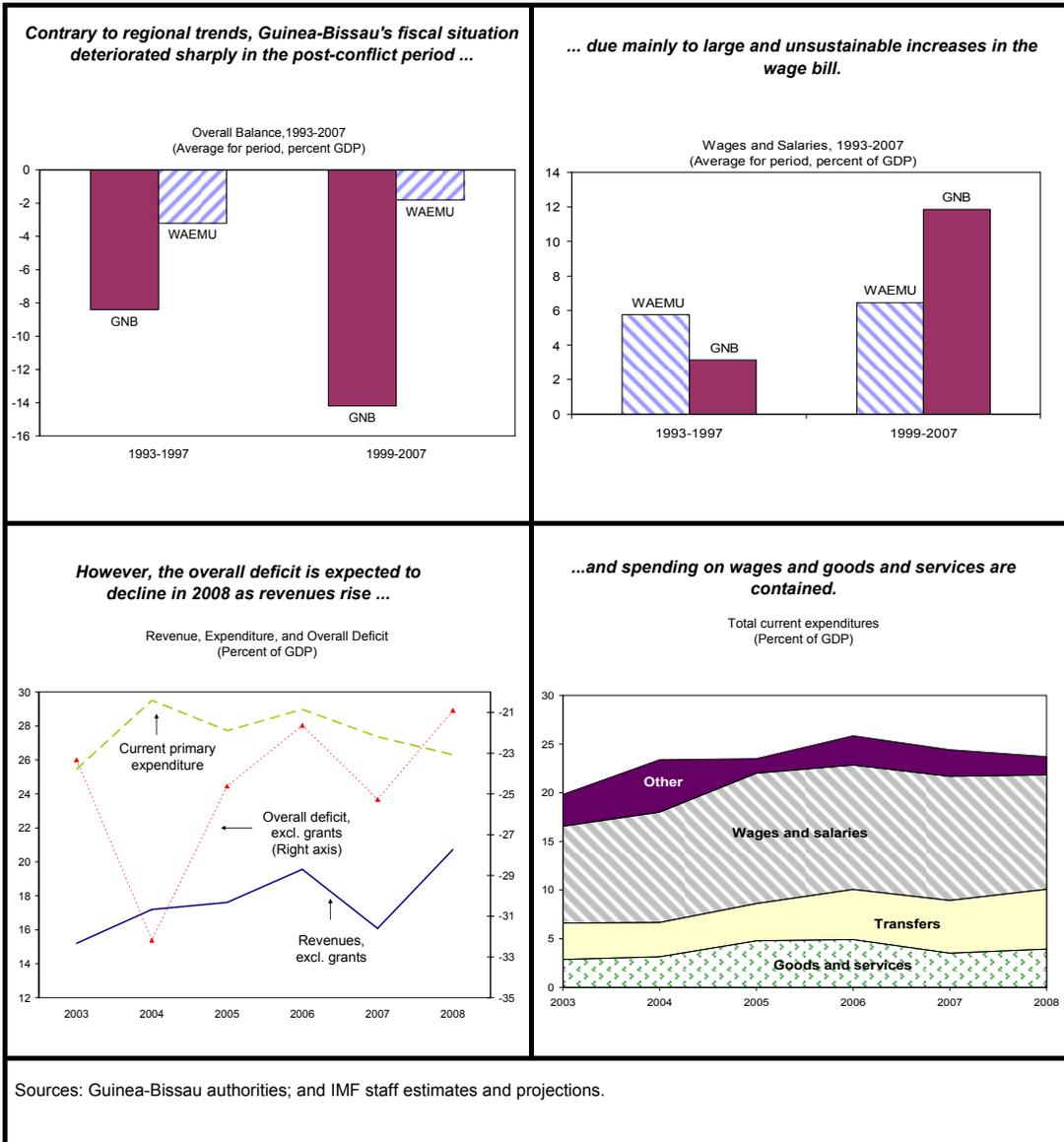
Sources: Guinea-Bissau authorities, and IMF staff estimates and projections.

### C. The Fiscal Framework

14. **The fiscal deficit is expected to narrow in 2008**, in line with the budget drafted after discussions with the staff and approved by Parliament.<sup>6</sup> The 2008 budget targets a deficit on a commitment basis (excluding grants) of 21 percent of GDP, a decline of nearly 5 percent for the year (Figure 2). This target is based on a revenue increase of 5 percent of GDP—nontax revenues are expected to be above normal in 2008 because of two disbursements from the E.U. for fishing compensation (compensation for 2008 and delayed compensation for 2007)—and restrained spending, notably a nominal freeze of current expenditures on wages and strict control of nonwage discretionary outlays, which should enable the authorities to avoid accumulating domestic arrears. Tax revenues are projected to remain roughly constant as a share of GDP, assuming no change in tax rates (which are already in line with rates elsewhere in the WAEMU) and limited administrative capacity to improve tax collection significantly in the short term.

<sup>6</sup> The 2008 budget was approved by the National Assembly on December 7, 2007. This was a prior action for submission of the EPCA request to the Board (MEFP Table 1).

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



15. **The key fiscal objective for 2008 and beyond is to avoid accumulating domestic arrears by strictly controlling expenditures and boosting revenue.** The authorities recognized that the spending plan is tight and reflects only minimum requirements, but they are committed to keeping expenditures within the financing identified. Should donors provide additional budgetary grants, the priority will be to use them to repay audited domestic arrears, fully repay outstanding commercial bank borrowing, and increase spending in social areas beyond what is budgeted, in consultation with the Fund. Staff agreed with the authorities that expenditures related to parliamentary elections scheduled for October 2008 should be limited primarily to those financed by external assistance specific to this purpose.<sup>7</sup>

16. **The 2008 program will include a few measures the structural content of which is considered appropriate for a post-conflict country like Guinea-Bissau.** They deal with building capacity in critical areas of revenue administration, public expenditure, and cash management (MEFP ¶ 16). Progress in these areas is important not only for reducing fiscal imbalances but also for improving fiscal transparency, restoring confidence, and shoring up donor support. The measures begin with strengthening intelligence and audit activities and improving information flows between government agencies and departments for better cash flow management. The reforms are supported by a new Ministry of Finance management information system.<sup>8</sup> The revenue administration measures include updating taxpayer databases to improve compliance of large taxpayers and broaden the tax base. On the expenditure side, steps will be taken to ensure that government transactions are properly accounted for and closely monitored.

17. **A major objective of the authorities is to control the wage bill. In view of the exceptionally difficult fiscal position, the authorities will maintain a nominal freeze on the wage bill for 2008.** They have also set informal targets on global personnel expenditures (including benefits, pensions, and retrenchment) for purposes of cash flow management. Given the size of Guinea-Bissau's wage bill (at some 13 percent of GDP it is more than double the regional average) and its contribution to the large fiscal imbalances post-conflict, the authorities consider the wage bill freeze and target to be critical for economic management. For 2008 the wage freeze is not expected to affect vital hiring in the social sectors; the authorities do not plan additional hiring in health and education in 2008, because they have already budgeted salary increases for 5,000 teachers and 3,000 health care workers whose positions were converted from contractual to regular staff in 2007.

18. **The authorities also recognize that a nominal wage freeze can only be temporary and must ultimately be replaced by civil and military service reforms.** Some efforts will

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<sup>7</sup> The European Union has already committed about US\$1 million for the 2008 parliamentary elections. The budget incorporates CFAF 0.6 billion (US\$1.2 million) in domestically financed election spending.

<sup>8</sup> Installation of the system was supported by technical assistance from FAD and West AFRITAC.

be made in 2008 to clean up the public sector payroll to reduce fraud and duplication of payment of government salaries. As a first step, the authorities will finalize the merger of the separate payroll databases of the ministries of Finance and Public Administration. For 2008, it is expected that some 2,300 civil servants and 1,000 military who were already removed from the government's payroll will continue to be paid by the Ministry of Public Administration, pending full reintegration to the private sector.<sup>9</sup>

19. **Staff expressed concern about nonconcessional domestic commercial borrowing and urged the authorities to rely on grant financing as much as possible.** They agreed on the importance of grant financing but stressed that their recourse to commercial loans from domestic banks reflected urgent priority expenditure needs resulting from shortfalls and delays in external assistance. They intend to repay expensive commercial bank debt as soon as possible and rely on grant assistance in 2008.

20. **The government will make a major effort to resolve its domestic arrears, which are now estimated at about CFAF 48 billion—28 percent of GDP.**<sup>10</sup> The authorities have contracted for an external audit of domestic arrears accumulated in 2000–06 (CFAF 44 billion) and a portion of 2007 arrears (about CFAF 4 billion).<sup>11</sup> After the audit the authorities will seek external assistance beyond existing external assistance expectations (see ¶ 9) to pay off the arrears. They will also seek external assistance to pay down pre-2000 arrears that have already been audited (CFAF 20 billion). Even assuming that about half of the 2000–07 arrears will be eliminated after the audit, paying off the arrears over the medium term (2008–10) could require some 8 percent of GDP annually in additional external assistance.<sup>12</sup> Meanwhile, the government will strive to honor current obligations and avoid accumulating new arrears in 2008.

21. **Beyond 2008 the fiscal position should steadily improve as fiscal controls are restored and nonpriority expenditures are reined in.** Continued commitment to reform will enable the government to implement stronger Fund-supported reform programs and achieve sustained levels of donor support. The overall fiscal balance (excluding grants) is projected to decline to below 20 percent of GDP in 2010, to levels that are more manageable

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<sup>9</sup> The salaries of retrenched civil servants are being paid from a special fund set up at the Ministry of Public Administration pending full reintegration into the private sector. The E.U. is planning to roll out in 2008 the first phase of a US\$ 10 million civil service reform project, which includes some support for reintegration of retrenched civil servants.

<sup>10</sup> Guinea-Bissau also has sizeable external payment arrears to sovereign bilateral creditors and multilateral creditors and further accumulation of external arrears are expected during the EPCA-supported program period. See IMF Country Report No. 07/370.

<sup>11</sup> The audit is to be financed by the European Union and is expected to be conducted in the first half of 2008.

<sup>12</sup> See IMF Country Report No. 07/370.

given domestic resources and external budget support. This will allow the country finally to focus external assistance on meeting critical development needs.

#### **D. Financing the Budget**

22. **The financing needs for 2008 are large (about US\$92 million or 27 percent of GDP) (Text Table 6).** Some arise from the previous rescheduling of domestic debt owed to commercial banks and the BCEAO, as well as the rescheduling of Treasury bills, which are now expected to be repaid in 2008.

23. **The financing needs will be filled mainly by budget support from both traditional and nontraditional donors.** There is limited scope for further fiscal adjustment in 2008; spending is already minimal and capacity to raise revenues in the short term is limited. Additional uncollateralized domestic financing is also limited, given the rescheduling of domestic debt to 2008 and the high cost of commercial borrowing. In these circumstances, the authorities have made securing donor support a priority. The donor community has already made firm pledges of some CFAF 25 billion (US\$50 million) in budget support for 2008.<sup>13</sup> The authorities also expect an extension of interim debt relief from the World Bank to cover about US\$8.5 million (CFAF 4.2 billion) in debt service owed in 2008. They also intend to take measures to collect more back taxes in 2008 (CFAF 0.7 billion). While the authorities intend to repay most of the outstanding domestic debt rescheduled to 2008, they are planning to reschedule about CFAF 3.1 billion (roughly a quarter of all debt owed in 2008) to provide additional financing for 2008. Though they will continue to accumulate arrears on external debt in 2008 (CFAF 9.7 billion or US\$20 million), they are committed to taking whatever measures are necessary to find additional financing.

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<sup>13</sup> Includes EU (US\$7.3 million), World Bank (US\$16 million), WAEMU (US\$3 million), and other traditional donors, as well as nontraditional donors including South Africa (US\$10 million). Most of these pledges are conditional on an EPCA for 2008 and good policy performance.

**Text Table 6. Guinea-Bissau: Financing the 2008 Fiscal Program**

	CFAF billions	US\$ millions
<b>Fiscal financing needs</b>	45.3	91.5
<b>Expected budget support</b>	24.8	50.0
European Union	3.6	7.3
World Bank	7.9	16.0
AfDB	0.8	1.7
WAEMU	1.5	3.0
South Africa	5.0	10.0
Japan	2.0	4.0
Portugal	1.5	3.0
Spain	1.5	3.0
Additional regional support	1.0	2.0
<b>External debt arrears</b>	9.7	19.6
<b>Additional financing</b>	10.8	21.7
EPCA	2.8	5.6
World Bank debt relief	4.2	8.5
Authorities' measures	3.8	7.7
Recovery of tax arrears	0.7	1.4
Partial rescheduling of T-bills	3.1	6.3

Source: IMF staff estimates and projections.

### E. Program Monitoring, Access, and Capacity to Repay

24. **The fiscal framework underlying EPCA covers calendar 2008.** This allows enough time to demonstrate a track record of credible policies to restore fiscal stability and avoid domestic arrears for the full period.

25. **The authorities' MEFP contains quantitative indicators through December 2008 and a few structural indicators that are critical for fiscal sustainability.** Prior actions and structural indicators are listed in Table 3 of the MEFP. The structural indicators relate to priority expenditure management measures that can be implemented in 2008. The authorities, with the help of Fund staff, have formulated a monthly treasury cash-flow plan for 2008 on which quarterly quantitative indicators are based (MEFP Tables 2 and 4). Definitions and adjusters of financial indicators and requirements for transmitting data to staff are described in the Technical Memorandum of Understanding (Appendix II, Attachment II).

26. **Guinea-Bissau has sizable payment arrears to sovereign and multilateral creditors<sup>14</sup> and external arrears are expected to accumulate further during the EPCA-supported program.** The authorities have received assurances that there are no objections to EPCA from Paris Club creditors to whom Guinea-Bissau is currently in arrears. They have also informed non-Paris Club creditors that they will continue to have difficulties servicing their external debt even during the EPCA program period. Given these actions and the financing commitments the authorities have received from other donors, staff considers that financing for the authorities' 2008 program, which includes a continued build up of external arrears, is adequate, and the authorities can therefore request EPCA.

<sup>14</sup> See IMF Country Report No. 07/370.

27. **Staff considers Guinea-Bissau's capacity to repay the Fund to be adequate.** The Government is current on its Fund obligations, and the BCEAO has a good record of honoring debt service to the Fund on behalf of WAEMU members, even though arrears to other creditors are significant.

28. **The proposed initial EPCA purchase is for SDR 1.775 million, equivalent to 12.5 percent of quota.** A second purchase of SDR 1.775 million (12.5 percent of quota), is expected in July 2008, assuming performance is satisfactory, for a maximum purchase of 25 percent of quota in 2008. The authorities would continue to make EPCA purchases (up to an annual limit of 25 percent of quota for a cumulative maximum of 50 percent of quota over three years) until they have capacity to move to a PRGF arrangement. The purchases in 2008 are beyond repayment of PRGF resources during the year. Guinea-Bissau could receive subsidies to lower the annual basic rate of charge on the EPCA purchase to 0.5 percent, if resources are available. It is also subject to burden-sharing adjustments to the basic rate of charge, currently 21 basis points annually, which are not covered by the subsidies. With the proposed first-year purchases, Guinea-Bissau's credit outstanding to the Fund would increase from 23.1 percent of quota in 2007 to 39.3 percent in 2008 (Table 7).

29. **High among the risks to the program is the risk of shortfalls and delays in donor disbursements.** Absence of donor support could lead to more wage arrears, reigniting political instability, and to delays in reforms crucial to fiscal sustainability (e.g., civil service and security reforms). Parliamentary elections, currently scheduled for October 2008, could jeopardize fiscal discipline due to pressures to exceed budgeted outlays. Donors may also take a wait-and-see approach in the period leading up to the elections, which could delay disbursements. The limit on access to EPCA incorporates the risk to Fund resources, and any further purchases would be subject to an updated risk assessment.

30. **To ensure that the fiscal reforms are effective and sustainable, the EPCA program will be supported with technical assistance (MEFP Table 1).** The IMF will continue to provide support, including technical assistance from West AFRITAC and AFRISTAT, to firm up budget management and tax collection and improve economic statistics. The World Bank is also helping with these reforms through its support to low-income countries under stress (LICUS), including financing a long-term resident fiscal advisor. Other donors, including the EU and bilaterals, are also providing technical assistance to government revenue and expenditure departments.

#### IV. STAFF APPRAISAL

31. **Guinea-Bissau faces enormous challenges.** The erosion of its institutional and administrative capacity seriously impedes economic management and recovery. Moreover, the fragile political situation reflects the population's impatience with the country's difficult financial situation.

32. **The new government has demonstrated determined commitment in beginning to address these challenges.** Its emergency fiscal program and the improved fiscal performance in the second half of 2007 are a solid foundation for stability in the period ahead.

33. **The focus of the authorities on stabilizing public finances and improving economic management and transparency reflects a sober and sound view of urgent priorities.** The proposed program aims to support these efforts and catalyze much-needed financial and technical assistance from donors, which will be indispensable for rebuilding capacity and putting the country on the path to sustained economic growth.

34. **Keeping current spending, particularly wages, within available resources is essential to the stability of public finances and—recognizing the past link between salary arrears and political instability—the sustainability of the reforms.** The authorities will need to resist the inevitable pressures to backtrack on the nominal freeze of the wage bill. Structural measures will be crucial to improve payroll management and to ensure that the share of wages in public expenditures gradually decreases. Ensuring that the Treasury remains in sole charge of managing all government accounts and effectively applying the cash flow plan are crucial to restore confidence in management of the economy. It is also critical that the government finds a lasting resolution to its domestic arrears.

35. **Efforts to enhance revenue collection, including improving tax administration, are necessary to boost revenues on a lasting basis and ensure that the state has the resources to meet its core expenditure needs and provide basic public services.** The recent improvements are encouraging and should be built on.

36. **The viability of the 2008 budget depends critically on significant concessional external assistance.** The authorities must be steadfast in their efforts to improve governance, strengthen institutional capacity, and implement credible reforms. Slippage in any of these areas could jeopardize external assistance.

37. **Staff considers that Guinea-Bissau meets the requirements for Fund EPCA.** Help in meeting current external payments is urgently needed, and the country's capacity has been so disrupted that the authorities are not yet able to carry out a comprehensive program that could be supported by a different Fund arrangement. Nonetheless, recent progress demonstrates that the authorities have the capacity to implement the proposed program, which would be part of a concerted international effort. Moreover, the authorities are determined to establish the track record necessary for a PRGF-supported program and for reaching the HIPC Initiative completion point. Policy implementation should therefore improve under the proposed program, especially in the fiscal area. Recognizing the role that the proposed program would play in stabilizing the economy and catalyzing international support, the staff recommends approval of the authorities' request for Emergency Post-Conflict Assistance.

**Table 1. Political Developments, 1998-2007**

June 1998	Power struggle between President Vieira and military escalates quickly into a much broader conflict. Fighting is concentrated in the capital, Bissau. The result is thousands of deaths; widespread damage to housing, infrastructure, and government buildings; virtual annihilation of small industry; and the departure of many better-educated citizens.
January 1999	A national transition government is set up (January 1999–February 2000). Post-conflict strategy supported by the PRGF and interim HIPC Initiative debt relief are negotiated with the IMF.
May 1999	President Vieira is ousted by a military coup, ending the 11-month-long civil war.
November 1999	Presidential and legislative elections are held. The former opposition leader, Koumba Yala, is the new president. A new government is made up of a coalition of two former opposition parties, PRS (President Yala’s party) and RGB, headed by Caetano Intchama.
November 2000	Forces loyal to President Yala kill the leader of the former military junta after an unsuccessful uprising.
December 2000	The PRGF arrangement and the HIPC decision point are approved.
May 2001	The PRGF arrangement goes off track and expires.
April 2002	The PRS/RGB coalition ends. President Yala appoints a new government, headed by Alamara Nhasse (PRS) (April–November, 2002).
November 2002	President Yala dissolves Parliament.
December 2002	A caretaker government headed by Mario Pires is set up (December 2002–October 2003).
September 2003	The military remove President Yala in a bloodless coup.
October 2003	The military appoints a national civilian government (October 2003–April 2004), headed by Artur Sanha (PRS).
March 2004	The civilian government organizes parliamentary elections, which are won by the main opposition party (PAIGC) but without a majority in parliament.
October 2004	Military units stage a rebellion—ostensibly to protest against corruption in the senior ranks of the army and bad living conditions in the barracks. Among others the army chief of staff is killed.
May 2005	A new government is set up, headed by Mr. Carlos Gomes (PAIGC).
July / Aug. 2005	Former President Vieira wins the presidential elections.
October 2005	President Vieira dismisses the government and appoints a coalition government (PAIGC dissidents, PRS and PUSD) headed by Aristides Gomes, PAIGC leader.
March 2007	Parliamentary vote of no confidence against Mr. Gomes. New coalition government headed by Mr. Martinho Kabi is sworn in.

Table 2. Guinea-Bissau: Selected Economic and Financial Indicators, 2003-10

	2003	2004	2005	2006	2007	2008	2009	2010
				Prel.1/	Est.	Proj.	Proj.	Proj.
(Annual percentage change, unless otherwise indicated)								
National accounts and prices								
Real GDP at market prices	-0.6	2.2	3.5	1.8	2.7	3.3	3.2	3.4
Real GDP per capita <sup>2</sup>	-3.4	-0.7	0.3	-1.1	-0.4	0.3	0.2	0.4
GDP deflator	-2.8	2.7	7.7	-0.5	3.6	3.3	2.5	2.5
Consumer price index (annual average) <sup>3</sup>	1.6	0.8	3.4	2.0	3.8	3.3	2.5	2.5
Consumer price index (end of period) <sup>3</sup>	0.7	2.2	1.0	3.2	4.3	2.4	2.5	2.5
External sector								
Exports, f.o.b. (based on US\$ values)	16.1	21.8	18.2	-32.5	53.6	-4.0	8.4	8.5
Imports, f.o.b. (based on US\$ values)	0.2	17.2	27.9	13.9	7.6	5.3	-4.2	8.4
Export volume	7.4	12.1	0.2	-17.7	49.3	-7.3	6.0	6.0
Import volume	-12.9	1.0	16.1	7.4	4.3	4.4	-2.9	9.3
Terms of trade (deterioration -)	-6.1	-6.3	7.1	-22.6	-0.3	3.6	4.5	4.0
Real effective exchange rate (depreciation -)	1.6	1.6	-2.0	...	...	...	...	...
Nominal exchange rate (CFA francs per US\$; average)	580.1	527.6	526.6	522.4	498.4	498.4	496.5	494.5
Government finances								
Domestic revenue (excluding grants) <sup>4</sup>	-4.1	17.7	14.1	12.4	-12.5	36.6	-7.9	6.2
Total expenditure	13.8	33.3	-4.7	-1.3	7.0	6.6	-2.9	4.0
Current expenditure <sup>4,5</sup>	3.5	20.6	4.7	5.8	0.5	1.9	-4.7	2.7
Capital expenditure	41.3	58.1	-18.7	-14.8	21.9	16.1	0.2	6.2
Money and credit <sup>6</sup>								
Credit to government (net)	-2.4	-7.4	1.8	-0.5	3.2	-15.2	-2.9	-2.1
Credit to the rest of the economy	-1.8	-1.3	2.6	5.6	7.2	3.2	1.8	1.9
Broad money <sup>7</sup>	-65.3	44.0	20.6	5.3	16.0	8.3	4.0	5.9
Velocity (GDP/broad money)	4.5	3.3	3.0	2.9	2.7	2.6	2.7	2.7
(Percent of GDP, unless otherwise indicated)								
Investments and savings								
Gross investment	12.6	13.2	14.6	12.2	14.1	15.8	14.7	15.0
Of which: government investment	11.1	11.1	14.1	10.8	13.4	13.9	13.3	13.3
Gross domestic savings	-1.6	-3.0	-2.3	-19.0	-4.4	-4.9	-1.3	-0.6
Of which: government savings	-16.7	-30.1	-16.7	-17.4	-20.4	-12.6	-13.0	-12.2
Gross national savings	9.8	15.5	9.5	0.9	12.4	22.7	17.5	17.7
Government finances								
Budgetary revenue <sup>4</sup>	15.2	17.2	17.6	19.6	16.1	20.7	18.0	18.0
Total domestic primary expenditure <sup>4</sup>	20.2	24.8	24.5	27.1	25.7	24.9	21.9	21.2
Domestic primary balance	-5.0	-7.6	-6.9	-7.5	-9.6	-4.1	-3.9	-3.2
Overall balance (commitment basis)								
Including grants	-12.9	-15.0	-11.9	-9.7	-9.7	0.7	-4.9	-4.6
Excluding grants	-23.3	-32.2	-24.6	-21.6	-25.3	-20.9	-20.1	-19.3
External current account (including official current transfers)								
Excluding official current transfers	-2.8	2.4	-5.1	-11.3	-1.7	7.0	2.8	2.7
Excluding official transfers (other than fishing licenses)	-9.7	-9.4	-9.7	-24.7	-11.4	-12.0	-7.0	-6.7
Excluding official transfers (other than fishing licenses)	-6.2	-6.1	-6.7	-21.8	-11.4	-6.6	-4.6	-4.2
Net present value of external debt/exports of goods and nonfactor services (percent)								
	0.0	0.0	788.5	683.2	481.3	505.4	481.2	220.3
Nominal stock of external debt, including arrears								
	474.5	487.7	440.6	436.3	403.2	389.2	305.3	197.3
Memorandum items (millions US\$ unless otherwise indicated)								
Current account balance (including official current transfers)	-6.6	6.4	-15.3	-34.8	-5.8	25.6	10.8	11.4
Overall balance of payments	-121.0	-10.8	-21.0	-38.8	-15.6	-32.1	-6.7	-5.7
Nominal GDP at market prices (CFAF billions)	137.1	142.6	158.8	160.8	171.1	182.5	192.9	204.4
Nominal stock of external debt (end of period; excluding arrears)	915.2	1024.0	1002.1	993.3	1012.7	1038.3	1077.1	820.2
Nominal stock of external arrears, end of period	206.4	293.8	327.0	349.8	371.0	392.0	113.8	0.0

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

<sup>1</sup> Based on updated staff projections for 2006.

<sup>2</sup> Projections based on population growth of 2.5 percent per year.

<sup>3</sup> There is a break in the series in July 2002, when Guinea-Bissau adopted a new harmonized CPI index.

<sup>4</sup> In 2004 domestic revenue includes CFAF 2,342 million in payments to Guinea-Bissau soldiers participating in the UN Liberia peacekeeping mission.

The same amount is recorded in current expenditure under salaries.

<sup>5</sup> In 2004 and 2005, includes CFAF 3.4 billion for legislative elections and CFAF 1.6 billion for presidential elections.

<sup>6</sup> Change in percent of beginning-of-period stock of broad money.

<sup>7</sup> In 2003 the BCEAO corrected its estimate of currency in circulation, resulting in a large drop of base money.

Table 3. Guinea-Bissau: Balance of Payments, 2003–10

	2003	2004	2005	2006	2007 Est.	2008 Proj. <sup>1</sup>	2009 Proj.	2010 Proj.
( CFAF billions)								
Goods and services	-19.4	-23.1	-26.8	-50.1	-31.6	-37.7	-30.8	-31.9
Goods	-5.0	-3.8	-8.7	-31.5	-18.5	-23.7	-17.1	-18.4
Exports, f.o.b	36.1	40.0	47.2	31.6	46.3	44.3	47.8	51.6
Of which : cashew nuts	32.3	38.4	44.7	29.0	42.5	40.2	43.5	47.0
Imports, f.o.b	-41.1	-43.8	-55.9	-63.2	-64.8	-68.0	-64.9	-70.0
Services (net)	-14.4	-19.3	-18.1	-18.6	-13.1	-14.0	-13.8	-13.5
Credit	5.0	4.3	2.6	6.7	6.4	6.6	6.7	6.8
Debit	-19.4	-23.6	-20.7	-25.3	-19.5	-20.5	-20.5	-20.3
Income (interest scheduled)	-7.3	-6.0	-6.3	-4.9	-4.4	-4.0	-3.7	-3.8
Current transfers (net)	22.8	32.5	25.0	36.8	33.1	54.5	39.9	41.3
Official <sup>2,3,4</sup>	9.4	16.8	12.1	21.6	16.7	34.6	18.9	19.2
Of which: balance of payments support grants	4.8	12.0	5.1	10.2	16.7	24.8	14.2	14.2
Of which: EU fishing compensation	4.8	4.8	4.8	4.8	0.0	9.8	4.8	5.1
Private	13.4	15.7	12.9	15.3	16.4	19.9	21.0	22.1
Of which: fishing license fees	3.2	4.2	2.8	2.4	1.8	3.4	3.6	3.8
Current account								
Including official transfers	-3.8	3.4	-8.0	-18.2	-2.9	12.7	5.3	5.6
Excluding official transfers	-8.5	-8.6	-15.4	-35.0	-19.5	-12.0	-8.8	-8.6
Excluding official transfers and interest payments	-1.2	-2.6	-9.1	-30.1	-15.2	-8.0	-5.1	-4.7
Capital and financial balance	-66.4	-9.0	-3.0	-2.1	-4.9	-28.7	-9.2	-8.3
Capital account <sup>5</sup>	9.4	15.4	23.7	17.6	12.3	16.6	17.5	18.6
Financial account	-75.8	-24.5	-26.7	-19.6	-17.2	-45.3	-26.7	-26.9
Official medium- and long-term disbursements	8.0	13.8	6.2	8.8	11.6	11.4	12.0	12.8
Balance of payments support	2.3	7.6	0.0	0.0	0.0	0.0	0.0	0.0
Projects	5.7	6.2	6.2	8.8	11.6	11.4	12.0	12.8
Scheduled amortization	-19.0	-18.9	-18.0	-13.4	-12.7	-12.8	-11.9	-11.0
Treasury bills and regional financing	0.0	0.0	10.0	-1.1	-1.3	-8.5	0.0	0.0
Commercial bank net foreign assets	-9.8	0.1	5.9	-10.0	1.5	-2.4	3.3	0.5
Private net foreign assets and errors and omissions <sup>5</sup>	-55.0	-19.4	-30.7	-3.9	-16.4	-32.9	-30.2	-29.2
Overall balance	-70.2	-5.7	-11.1	-20.3	-7.8	-15.9	-3.9	-2.7
Financing	70.2	5.7	11.1	20.3	7.8	15.9	3.9	2.7
Net foreign assets (increase -) <sup>6</sup>	43.5	-18.9	-10.3	3.0	-6.7	-5.3	-8.2	-5.0
Of which: net IMF credits <sup>7</sup>	-2.8	-2.8	-1.1	-2.2	-1.9	-0.9	-0.8	1.5
Purchases and loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.3
Repurchases and repayments	-2.8	-2.8	-1.1	-2.2	-1.9	-0.9	-0.8	-0.8
Debt relief	5.1	4.5	5.3	5.4	3.8	0.7	0.7	11.1
Change in debt-service arrears (decrease -)	21.6	20.0	17.2	11.9	10.6	9.7	8.0	0.0
<i>Memorandum items</i>								
Export volume growth (percent)	7.4	12.1	0.2	-17.7	49.3	-7.3	6.0	6.0
Import volume growth (percent)	-12.9	1.0	16.1	7.4	4.3	4.4	-2.9	9.3
Scheduled debt service								
Percent of exports and service credits	64.0	56.4	48.9	47.8	32.3	33.2	28.7	25.4
Percent of total government revenue	126.1	101.8	87.1	58.2	61.8	44.9	45.1	40.3
Current account balance (percent of GDP)								
Including official transfers	-2.8	2.4	-5.1	-11.3	-1.7	7.0	2.8	2.7
Excluding official transfers	-9.7	-9.4	-9.7	-24.7	-11.4	-12.0	-7.0	-6.7
Stock of external arrears, end of period	119.9	140.0	157.2	169.1	179.7	189.4	197.4	197.4
Overall balance (percent of GDP)	-51.2	-4.0	-7.0	-12.6	-4.6	-8.7	-2.0	-1.3
Financing gap (percent of GDP)	0.0	0.0	0.0	0.0	0.0	5.9	1.8	-1.6

Sources: BCEAO and IMF staff estimates and projections.

<sup>1</sup>Based on updated staff projections for 2007.

<sup>2</sup>Including food aid and technical assistance to projects.

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

<sup>4</sup>Official transfers excludes Angola.

<sup>5</sup>Excludes proposed 2008 EPCA drawings.

<sup>6</sup>Excludes the financing gap, BCEAO includes the financing gap in the capital account.

<sup>7</sup>A drop in the level of net foreign assets in 2003 reflects a change in the methodology for the calculation of this series by BCEAO applied for 2003 and afterward. The counterpart of this break in the net foreign assets series in 2003 is included under errors and omissions.

Table 4. Guinea-Bissau: Monetary Survey, 2004–10

	2004	2005	2006	2007 Est.	2008 Proj.	2009 Proj.	2010 Proj.
(CFAF billions)							
Total assets	43.4	52.4	55.2	64.0	69.3	71.5	76.4
Net foreign assets	32.5	36.7	43.2	48.4	56.1	61.0	65.4
Central bank	26.6	36.9	33.9	40.6	45.9	54.1	59.1
Deposit money banks	5.9	-0.2	9.3	7.8	10.2	6.9	6.4
Net domestic assets	10.9	15.7	12.0	15.6	13.2	10.6	11.0
Net domestic credit	12.0	15.9	18.6	23.8	17.3	16.6	17.0
Net claims on government	9.7	12.5	12.3	13.5	4.9	2.9	2.0
Net claims on central government	9.7	12.5	12.3	13.5	4.9	2.9	2.0
Central bank	10.5	13.2	12.4	10.4	7.6	6.9	6.2
Claims	15.1	13.9	13.0	10.8	7.6	6.9	6.2
Advances to the treasury	9.5	8.4	7.6	5.6	2.8	2.2	1.7
Statutory limit	2.1	1.9	1.6	1.4	1.1	1.2	1.2
Use of Fund credit	7.4	6.3	4.1	2.2	1.2	0.4	0.0
Other advances	0.0	0.2	2.0	2.0	0.5	0.5	0.5
Consolidated loans	5.6	5.5	5.4	5.3	4.9	4.7	4.5
Deposits	-4.6	-0.7	-0.6	-0.4	0.0	0.0	0.0
Deposit money banks	-0.7	-0.7	-0.1	3.1	-2.7	-4.0	-4.2
Claims	1.0	3.0	3.6	7.6	1.1	0.0	0.0
Deposits	-1.7	-3.7	-3.7	-4.5	-3.8	-4.0	-4.2
Credit to the economy	2.3	3.4	6.3	10.3	12.4	13.6	15.0
Other items (net)	-1.1	-0.2	-6.7	-8.2	-4.2	-6.0	-6.0
Liabilities	43.4	52.4	55.0	64.0	69.3	71.5	75.9
Broad money	43.4	52.4	55.0	64.0	69.3	71.5	75.9
Local currency	43.4	52.4	55.0	64.0	69.3	71.5	75.9
Currency in circulation	32.6	40.5	39.7	40.0	41.0	42.8	44.2
Demand deposits and quasi money	10.9	11.8	15.3	24.0	28.3	28.8	31.6
Demand deposits	10.3	11.0	13.5	20.9	25.3	26.7	29.4
Quasi money	0.6	0.8	1.9	3.1	3.0	2.0	2.2
(Annual change as percent of beginning-of-period money stock, unless otherwise indicated)							
Net foreign assets	62.4	9.5	12.4	9.4	12.1	7.0	6.3
Net domestic assets	-18.4	11.1	-7.1	6.6	-3.8	-3.8	-0.2
Domestic credit	-19.3	8.9	5.3	9.3	-10.1	-1.1	-0.2
Credit to the government	-7.4	1.8	-0.5	3.2	-15.2	-2.9	-2.1
Credit to the economy (percent)	-1.3	2.6	5.6	7.2	3.2	1.8	1.9
Other items (net)	0.9	2.1	-12.4	-2.7	6.3	-2.7	0.0
Broad money	44.0	20.6	5.3	16.0	8.3	3.2	6.1
Velocity (GDP/M2)	3.3	3.0	2.9	2.7	2.6	2.7	2.7

Sources: BCEAO, and IMF staff estimates and projections.

Table 5. Guinea-Bissau: Central Government Operations, 2003–10

(CFAF billions)

	2003	2004	2005	2006	2007 Est.	2008 Program	2009 Proj.	2010 Proj.
Revenue and grants	35.1	49.1	48.2	50.6	54.3	76.7	63.9	67.0
Revenue	20.8	24.5	28.0	31.5	27.5	37.6	34.7	36.8
Tax revenue	11.9	11.8	18.3	18.5	19.7	20.8	22.6	24.0
Nontax revenue	8.9	12.7	9.6	13.0	7.8	16.9	12.1	12.8
Grants	14.3	24.5	20.2	19.1	26.8	39.1	29.3	30.2
<i>Of which:</i> expected budget support	4.8	12.0	5.1	10.2	16.7	24.8	14.2	14.2
Total expenditure	52.8	70.4	67.1	66.2	70.8	75.5	73.4	76.3
Current expenditure	34.9	42.1	44.0	46.6	46.8	47.7	45.5	46.7
Wages and salaries	13.6	16.2	21.3	20.5	21.8	21.3	20.7	20.7
Goods and services	3.9	4.5	7.6	7.9	6.0	7.1	7.0	7.4
Transfers	5.1	5.0	6.1	8.3	9.3	11.2	9.3	9.8
Other current expenditures	4.5	7.7	2.4	4.9	4.7	3.3	4.5	4.6
Scheduled interest	7.7	8.7	6.7	5.0	5.1	4.7	4.1	4.2
Capital expenditure and net lending	17.9	28.3	23.1	19.7	23.9	27.8	27.9	29.6
Public investment program	15.3	15.8	22.4	17.4	23.0	24.7	25.7	27.3
Other capital expenditure	2.7	12.5	0.6	2.3	1.0	3.1	2.2	2.3
Overall balance, including grants (commitment)	-17.7	-21.4	-18.9	-15.6	-16.5	1.2	-9.4	-9.3
Overall balance, excluding grants (commitment)	-32.0	-45.9	-39.1	-34.8	-43.3	-37.9	-38.7	-39.5
Net domestic arrears	14.8	1.5	-0.1	5.5	3.0	-3.6	0.0	0.0
Accumulation current year	17.7	3.9	4.2	7.9	6.6	0.0	0.0	0.0
Payments previous years	-2.9	-2.4	-4.3	-2.3	-3.6	-3.6	0.0	0.0
External interest arrears current year	5.8	4.5	3.8	3.2	2.8	2.4	2.1	0.0
Float and statistical discrepancies	-6.9	2.0	-1.0	-0.6	0.0	0.0	0.0	0.0
Overall balance, including grants (cash)	-4.0	-13.3	-16.2	-7.5	-10.7	0.0	-7.3	-9.3
Financing	4.0	13.3	16.2	7.5	10.7	0.0	7.3	9.3
Domestic financing	-5.4	-1.6	9.3	-1.8	0.1	-17.3	-1.8	-0.8
Bank financing	-4.5	-1.2	9.2	-0.5	1.2	-17.3	-1.8	-0.8
<i>Of which:</i> domestic banks	0.2	0.6	-0.3	1.6	4.9	-7.2	0.0	0.0
regional financing (including T-bills)	0.0	0.0	10.0	-1.1	-1.3	-8.5	0.0	0.0
BCEAO	-4.7	-1.7	-0.5	-1.1	-2.4	-1.7	-1.8	-0.8
Foreign financing (net)	9.4	14.9	6.9	9.3	10.7	6.5	6.6	12.8
Disbursements	8.0	13.8	6.2	8.8	11.6	11.4	12.0	12.8
Amortization (scheduled)	-19.0	-18.9	-18.0	-13.4	-12.7	-12.8	-11.9	-11.0
External arrears	15.8	15.5	13.4	8.7	7.9	7.3	5.8	0.0
Debt relief	4.7	4.5	5.3	5.4	3.8	0.7	0.7	11.1
Gross financing gap (+ = financing needs)	0.0	0.0	0.0	0.0	0.0	10.8	2.5	-2.7
Additional financing <sup>1/</sup>				0.0	0.0	10.8	0.0	0.0
Residual financing gap				0.0	0.0	0.0	2.5	-2.7
Domestic primary balance	-6.8	-10.8	-11.0	-12.1	-16.4	-7.5	-7.5	-6.6
Revenue	20.8	24.5	28.0	31.5	27.5	37.6	34.7	36.8
Primary expenditure	27.7	35.3	39.0	43.5	44.0	45.1	42.2	43.4
Current	27.2	33.3	37.3	41.6	41.8	43.0	41.4	42.6
Capital	0.5	2.0	1.7	2.0	2.2	2.1	0.7	0.8
<i>Memo item:</i> Effective plus identified budget support	4.8	12.0	5.1	10.2	16.7	35.5	14.2	14.2

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

<sup>1/</sup> In 2008 includes World Bank debt relief, EPCA, and authorities' measures to fill the financing gap.

Table 5. Guinea-Bissau: Central Government Operations, 2003–10 (concluded)

(Percent of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010
					Est.	Program	Proj.	Proj.
Revenue and grants	25.6	34.4	30.4	31.5	31.7	42.3	33.2	32.8
Revenue	15.2	17.2	17.6	19.6	16.1	20.7	18.0	18.0
Tax revenue	8.7	8.3	11.5	11.5	11.5	11.4	11.7	11.7
Nontax revenue	6.5	8.9	6.1	8.1	4.6	9.3	6.3	6.3
Grants	10.4	17.2	12.7	11.9	15.6	21.6	15.2	14.8
Budget support	3.5	8.4	3.2	6.4	9.7	13.7	7.4	6.9
Projects	6.9	8.8	9.6	5.6	5.9	7.9	7.8	7.8
Expenditure	38.5	49.4	42.2	41.2	41.4	41.6	38.1	37.4
Current expenditure	25.5	29.5	27.7	29.0	27.4	26.3	23.6	22.9
<i>Of which:</i> wages and salaries	10.0	11.3	13.4	12.8	12.8	11.8	10.8	10.2
interest	5.6	6.1	4.2	3.1	3.0	2.6	2.1	2.0
Capital expenditure and net lending	13.1	19.9	14.5	12.2	14.0	15.3	14.5	14.5
Public investment program	11.1	11.1	14.1	10.8	13.4	13.6	13.4	13.4
Other capital expenditure	1.9	8.8	0.4	1.4	0.6	1.7	1.1	1.1
Overall balance, including grants (commitment)	-12.9	-15.0	-11.9	-9.7	-9.6	0.7	-4.9	-4.6
Overall balance, excluding grants (commitment)	-23.3	-32.2	-24.6	-21.6	-25.3	-20.9	-20.1	-19.3
Overall balance, including grants (cash)	-2.9	-9.3	-10.2	-4.7	-6.3	0.0	-3.8	-4.6
Financing	2.9	9.3	10.2	4.7	6.3	0.0	3.8	4.6
Domestic financing	-4.0	-1.1	5.9	-1.1	0.1	-9.6	-1.0	-0.4
Foreign financing (net)	6.9	10.5	4.3	5.8	6.2	3.6	3.5	6.3
<i>Of which:</i> external arrears	11.5	10.9	8.4	5.4	4.6	4.0	3.0	0.0
debt relief	3.4	3.2	3.3	3.3	2.2	0.4	0.4	5.4
project and program loans	5.8	9.7	3.9	5.4	6.8	6.3	6.3	6.3
Financing gap (+ = financing needs)	0.0	0.0	0.0	0.0	0.0	6.0	1.3	-1.3
Additional financing				0.0	0.0	5.9	0.0	0.0
Residual financing gap				0.0	0.0	0.0	1.3	-1.3
Domestic primary balance	-5.0	-7.6	-6.9	-7.5	-9.6	-4.1	-3.9	-3.2
Revenue	15.2	17.2	17.6	19.6	16.1	20.7	18.0	18.0
Primary expenditure	20.2	24.8	24.5	27.1	25.7	24.9	21.9	21.2
Current	19.8	23.4	23.5	25.9	24.4	23.7	21.5	20.8
Capital	0.3	1.4	1.1	1.2	1.3	1.2	0.4	0.4
Effective plus identified budget support	3.5	8.4	3.2	6.4	9.7	19.6	7.4	6.9

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

Table 6. Guinea-Bissau: Indicators of Capacity to Repay the Fund, 2007–12

	2007 Actual	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
<b>Fund credit outstanding <sup>1</sup></b>						
SDR millions	3.28	3.81	2.79	1.78	1.11	0.22
CFAF billions	2.48	2.87	2.10	1.34	0.84	0.17
Percent of quota	23.13	26.83	19.65	12.54	7.82	1.55
Percent of exports of goods and services	5.34	6.48	4.39	2.59	1.50	0.28
Percent of fiscal revenue	8.99	7.63	6.06	3.63	2.13	0.40
Percent of gross official reserves	4.28	4.61	2.73	1.68	1.03	0.20
Percent of GDP	1.45	1.57	1.09	0.65	0.38	0.07
<b>Fund obligations (SDR millions) <sup>1</sup></b>						
Total charges and interest (before subsidies)	0.07	0.13	0.13	0.13	0.12	0.08
Existing drawings	0.07	0.06	0.05	0.04	0.04	0.04
Prospective drawings	-	0.13	0.13	0.13	0.12	0.08
Total repayments/repurchases	2.17	1.25	1.02	1.02	0.67	0.89
Existing drawings	2.17	1.25	1.02	1.02	-	-
Prospective drawings	-	1.25	1.02	1.02	0.67	0.89
<b>Fund obligations (CFAF billions) <sup>1</sup></b>						
Total charges and interest (before subsidies)	0.05	0.10	0.10	0.10	0.09	0.06
Total repayments/repurchases	1.64	0.94	0.77	0.77	0.50	0.67
Percent of quota	15.78	9.72	8.10	8.10	5.56	6.83
Percent of exports of goods and services	3.65	2.35	1.81	1.67	1.07	1.22
Percent of fiscal revenue	6.14	2.76	2.50	2.35	1.52	1.75
Percent of gross official reserves	2.92	1.67	1.12	1.09	0.73	0.89
Percent of GDP	0.99	0.57	0.45	0.42	0.27	0.31
<b>Memorandum items:</b>						
Total charges and interest (after subsidies) <sup>2</sup>	-	0.07	0.06	0.06	0.05	0.05
Exports (CFAF billions) <sup>3</sup>	46.33	44.30	47.84	51.59	55.57	59.86
Government fiscal revenue (CFAF billions)	27.53	37.61	34.65	36.80	39.13	41.65
Quota (SDR millions)	14.20	14.20	14.20	14.20	14.20	14.20
Quota (CFAF billions)	10.70	10.70	10.69	10.66	10.69	10.66
Gross official reserves (CFAF billions)	57.87	62.31	77.00	79.45	81.49	81.99
Exchange rate (CFAF/SDR; period average)	753.86	753.28	752.50	750.75	752.50	750.70
GDP (CFAF billions)	171.07	182.48	192.92	204.39	217.45	231.59

Sources: Data provided by the authorities; IMF staff estimates and projections.

<sup>1</sup>Includes EPCA purchase of SDR 1.775 millions (12.5 percent of quota) in January 2008.

<sup>2</sup> 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 resources.

<sup>3</sup> Exports of goods and nonfactor services.

**APPENDIX I**

Bissau, January 9, 2008

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

Dear Mr. Strauss-Kahn:

1. Guinea-Bissau is slowly recovering from a decade of conflict and political instability. Economic and social conditions have worsened in the post-conflict period; the country's physical infrastructure was destroyed, and its administrative capacity was severely weakened. The fiscal situation has become unsustainable and relations with the international community have suffered. A new government appointed in April 2007 has taken early measures to adopt an emergency program to restore fiscal stability and improve economic management. This government has taken firm action to control expenditures, increase revenue collection, and improve fiscal management, transparency, and governance. There are already encouraging signs of an improvement in fiscal performance in the second half of 2007, and donor support has resumed.
2. In order to build on these recent gains, the government has agreed on a program of economic and financial policies for 2008 that addresses the immediate post-conflict challenges of stabilizing the fiscal position, building capacity for policy implementation, and regularizing relations with the donor community. The program also includes structural measures that lay the ground work for meeting the country's medium-term objectives of reviving growth, reducing poverty, and achieving fiscal and external sustainability. The donor community has already indicated it will provide significant financial and technical support for the 2008 program. To help achieve its objectives and restore confidence in economic management, the government is requesting a first purchase of SDR 1.775 million (12.5 percent of quota) under the Fund's Emergency Post-Conflict Assistance (EPCA) program. A second request for an EPCA purchase will be made later in 2008..
3. The details of the program for 2008 are included in the attached Memorandum on Economic and Financial Policies (MEFP). The government believes that the policies and measures set forth in the MEFP are adequate for achieving the objectives of the program, but we will take any further measures that may become appropriate for that purpose. In such cases, as well as before implementing policies that could adversely affect the program, we will consult the Fund.

4. To assist the Fund in assessing progress on the program, we will provide information on a regular basis as detailed in the attached Technical Memorandum. Moreover, we invite the staff of the Fund to review performance under the program quarterly, on the basis of quantitative and structural indicators (Tables 2 and 3 of the MEFP) as well as on 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 ON ECONOMIC AND FINANCIAL POLICIES FOR EMERGENCY  
POST-CONFLICT ASSISTANCE FOR 2008

Bissau, January 9, 2008

## I. INTRODUCTION

1. **Guinea-Bissau remains a fragile post-conflict country.** The conflicts and prolonged political instability have taken a toll on the country's physical infrastructure, weakened administrative and technical capacity, and left unsustainable fiscal balances. The country is heavily dependent on external assistance, but relations with the donor community have suffered. The government of Guinea-Bissau is determined to take the necessary actions to address the immediate post-conflict challenges of stabilizing the fiscal position, building capacity for policy implementation, improving economic confidence, and regularizing relations with donors. A new government appointed in April 2007 has already made progress on an emergency program<sup>1</sup> to restore fiscal stability and improve economic management. The new government has taken strong measures to control expenditures, increase revenue collection, and improve fiscal management, transparency, and governance. We have also vigorously pursued efforts to secure much-needed financing, including reaching out to new donors. There have been encouraging signs of improved fiscal performance in the second half of 2007, and donors have resumed disbursements on pledges from the 2006 donors conference.

2. **To build on these recent gains, the government has agreed on a program of economic and financial policies for 2008 that aims to achieve fiscal stability in the near term and lay the groundwork for meeting the country's medium-term objectives of reviving growth, reducing poverty and achieving fiscal and external sustainability.** The government is requesting a purchase from the Fund's Emergency Post-Conflict Assistance (EPCA) to achieve its objectives and restore confidence in its economic management.

3. **This memorandum describes economic developments in 2007 and outlines policies and measures planned for 2008.**

## II. RECENT ECONOMIC DEVELOPMENTS

4. **Preliminary projections for 2007 point to real GDP growth of 2.7 percent,** slightly higher than in 2006. Despite a normalization in cashew marketing arrangements in 2007, when the government avoided intervention in the cashew market—the 2007 domestic

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<sup>1</sup> *Minimum Program for Restoration of Fiscal Stability*, May 2007.

reference price of CFA 200/kilo for cashews was agreed by all major stakeholders—provisional data indicate that production and exports of cashews was slightly lower than expected. In addition, the production of rice and other cereals has been severely affected by late and inadequate rains. Inflation has remained subdued, as it has been elsewhere in the WAEMU area, although recent high food prices could push the inflation rate for the year to slightly above the 3 percent target. The current account deficit (excluding grants) is expected to narrow to 11 percent of GDP in 2007, from 25 percent in 2006, reflecting higher exports of cashews, including from last year's harvest.

5. **The fiscal stance deteriorated sharply in early 2007, reflecting a severe breakdown in controls since late 2006.** Tax revenues declined 13 percent in the first half of 2007 compared to the same period in 2006, as revenue administration weakened and imports fell in the wake of political uncertainties. Although resources were scarce, the former government repaid large stocks of (unaudited) domestic arrears of previous years and there were other unprogrammed and extra-budgetary expenditures; substantial arrears, among them four months of civil service salaries, accumulated.

6. **Faced with the extremely difficult fiscal situation and a large financing gap estimated for 2007, in April the new government undertook an emergency program to restore fiscal stability.** The government plan received widespread support from Parliament, donors, development partners, and the public. Strong measures were taken to increase revenues, restrain expenditures, improve financial management, enhance supervision and monitoring, and address financing weaknesses.

#### **Revenue Measures:**

- (i) Limited the granting of exemptions to only those situations foreseen in the law (NGOs, embassies, ex-combatants, projects).
- (ii) Abolished the tax compensation system for customs (DGA) and corporate tax payers (DGCI), and allowed only the Treasury to grant tax compensations.
- (iii) Returned tax rates to previous levels on 14 of 18 products on which rates were lowered in May 2006.
- (iv) Enforced collection of stamp tax (cigarettes, bank checks, credit cards, airline tickets, insurance companies).
- (v) Contracted with commercial banks to manage tax collection for the DGA and DGCI departments.
- (vi) Pursued collection of tax arrears.

#### **Expenditure Measures:**

- (i) Closed accounts of all ministries and public entities at the BCEAO and opened accounts at the Treasury. The Treasury now holds only one account, the Treasury Current Account, at the BCEAO (rather than having financial directorates of ministries and public

entities managing government accounts as before).<sup>2</sup> The Treasury is now in sole charge of managing all government revenue and expenditure accounts.

- (ii) Process all payment orders through the Budget Directorate (DGO).
- (iii) Restrict extrabudgetary expenditures (DNT) only to emergency situations and regularize them within 48 hours.<sup>3</sup>
- (iv) Standardize budget execution procedures
- (v) Require pre-approval by the Ministry of Finance's Financial Control Department for any purchase of goods and services.
- (vi) Cease Treasury issuance of checks in the names of finance managers of ministries to directly pay for goods and services.
- (vii) Computerize payment system at the Treasury.
- (viii) Placed a ceiling of CFAF 300,000 on expenditures that can be paid by cash.

### **Transparency and Financial Management**

- (i) Improved the transparency of and public confidence in the Treasury Committee, which is in charge of implementing the Treasury's cash flow plan, by inviting members from civil society, the armed forces, the Ministry of Interior, and ex-combatants, in addition to donor representatives, to participate as observers.
- (ii) Dismantled internal nontariff barriers on transporting cashews within the country.
- (iii) Introduced a requirement that all government suppliers have taxpayer identification numbers and bank accounts for payment, and that payments are to be made only after goods or services have been verified.

7. **Fiscal performance has improved markedly in the period since the new government began implementing its emergency fiscal plan.** In July–October, tax revenues were some 28 percent higher than during the same period last year, an important reversal of the trend observed in the first half of the year. There have also been positive developments with respect to expenditure control: The new government has ceased to pay domestic arrears from previous years, the amount of extrabudgetary expenditures (DNT) was reduced, and wages and other discretionary expenditures have been kept within budget.

8. **Despite these improvements in fiscal management, the fiscal stance is expected to deteriorate in 2007; the overall balance (excluding grants) is expected to widen to about 25 percent of GDP, from 22 percent in 2006.** Despite the improvement in revenue, it will not be possible to make up for the delay in disbursement of sizable annual fishing

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<sup>2</sup> A special account used to honor outstanding debt service is also held at the BCEAO.

<sup>3</sup> Such expenditures were at the heart of the fiscal deterioration observed at the end of 2006 and the beginning of 2007.

compensation from the E.U., which is now planned for early 2008.<sup>4</sup> Total revenues are currently projected to decline to 16 percent of GDP, some 3.5 percent of GDP lower than in 2006. On the other hand, current expenditures are expected to be lower in 2007, down to 27 percent of GDP from 29 percent in 2006, reflecting improved expenditure control.

9. **Donor disbursements resumed in 2007, among them outstanding pledges from the November 2006 donor meeting.** External budget support for 2007 amounted to CFAF 17 billion (US\$34 million) from the European Union, regional partners (WAEMU and ECOWAS), bilateral partners (Spain, Portugal, France and China), and such nontraditional partners as Angola. Expected budget support of US\$10 million for 2007 from the World Bank was delayed and will be disbursed in early 2008. Budget support expected from the African Development Bank in 2007 (US\$1.7 million) has also been delayed until early 2008.

10. **On the financing side, the government rescheduled the domestic commercial debt it owed in 2007, in order to avoid substantial accumulation of domestic arrears:**

- (i) CFAF 3 billion (US\$5.7 million) in debt service owed in 2007 on commercial bank loans, as well as CFAF 1.5 billion (US\$3 million) in debt payments owed to the BCEAO, and
- (ii) CFAF 6.7 billion (US\$13.5 million) in Treasury bills that were due in February 2007

11. **Despite the government's efforts, some accumulation of domestic arrears (about CFAF 6.6 billion, 3.8 percent of GDP) was unavoidable in 2007, largely because of the delayed budget support in 2007.** A portion of the domestic arrears (about CFAF 3.6 billion related to medical and education supplies) will be paid with the World Bank disbursement expected in early 2008, and the remaining 2007 arrears will be included in an E.U.-financed audit of domestic arrears and repaid over time as financing becomes available (see below).

### III. OUTLOOK, OBJECTIVES, AND POLICIES FOR 2008 AND THE MEDIUM TERM

12. **Real GDP growth is projected to increase to 3.3 percent in 2008, slightly higher than the average for the past four years.** The projections assume (i) an increase in cereal production to levels observed in previous years; (ii) an increase in cashew production from crop maturing; (iii) a slight pickup in public investment as the government continues to gather external donor support. Inflation is expected to converge to moderate levels below 3 percent, in line with WAEMU convergence criteria. The current account deficit (excluding grants) is expected to widen slightly to 12 percent of GDP in 2008, reflecting a lower export volume of cashews compared to 2007 (which included stocks from the previous year) and higher expected prices for rice and oil imports.

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<sup>4</sup> Owing to delays in concluding a new fishing agreement, the E.U. will not disburse the annual compensation (amounting to CFAF 4.5 billion or US\$9 million) expected in 2007 until early 2008.

13. **The fiscal stance is expected to improve in 2008 as the government continues to implement its fiscal adjustment plan.** For the year as a whole government revenues are projected to increase by some 5 percent of GDP to about 21 percent of GDP. Nontax revenues are expected to be above normal in 2008 because of two disbursements from the E.U. for fishing compensation (corresponding to the 2008 annual compensation and the delayed 2007 compensation). Tax revenues are projected to remain roughly constant as a share of GDP, but efforts will be made to bring in more revenues by year-end. Current expenditures are expected to decline by about 1 percent of GDP in 2008, reflecting a nominal freeze of current expenditures, including the wage bill, and strict control of nonwage discretionary outlays. While it is recognized that the expenditure framework is tight and encompasses only minimum spending requirements, the government is committed to maintaining domestic expenditures within available resources, both domestic and external. The overall balance (excluding grants) is expected to decline to about 21 percent of GDP, lower than in previous years.

14. **Financing needs will continue to be large in 2008,** amounting to CFAF 45 billion (US\$92 million or 27 percent of GDP). The 2008 financing needs include the rescheduling of Treasury bills and domestic debt owed to commercial banks and the BCEAO that are now expected to be repaid in 2008, as well as repayment in 2008 of domestic arrears that arose in 2007. The authorities have already secured the following sources of financing for 2008:

- (i) budget support from traditional and nontraditional donors (CFAF 24.8 billion or US\$50 million)<sup>5</sup>
- (ii) an extension of interim debt relief from the World Bank to cover US\$8.5 million (CFAF 4.2 billion) in 2008 external debt service obligations
- (iii) additional recovery of tax arrears (CFAF 0.7 billion)
- (iv) partial rescheduling (about CFAF 3.6 billion or US\$6 million) of domestic commercial debt owed in 2008
- (v) further accumulation of arrears on external debt (CFAF 9.7 billion or US\$20 million).

15. **These measures, along with two EPCA purchases (US\$5.6 million or CFAF 2.8 billion), should fully cover the financing gap and avoid accumulation of 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 its domestic debts, to the extent possible. In 2008 the government also intends to hold a meeting following up on the November 2006 Round Table Conference to present its

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<sup>5</sup> Including World Bank (US\$16 million), European Union (US\$7 million), WAEMU (US\$3 million), and the African Development Bank (US\$1.7 million). The World Bank figure includes US\$6 million delayed from 2007, as is the African Development Bank disbursement. The total also includes South Africa (US\$10 million), Japan (US\$4 million), Portugal (US\$3 million), and Spain (US\$3 million).

2008 program and 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 outstanding commercial debts and audited domestic arrears, and increase priority spending in social sectors above budgeted levels, in consultation with the Fund.

**16. The government in 2008 will also implement policy measures to address remaining structural weaknesses in revenue collection and expenditure management.**

These will:

- (i) Improve accounting and information flows of all Treasury transactions, including nonregularized expenditures and bank financing.
- (ii) Conduct a comprehensive audit of outstanding domestic arrears for 2000–06 and a portion of new 2007 arrears.<sup>6</sup>
- (iii) Avoid payment of audited arrears until the audit is completed and specific external financing for their clearance is obtained.
- (iv) As a first priority, avoid the accumulation of new domestic arrears in 2008.
- (v) Implement an integrated management information system, linking data flows between the customs (DGA) and tax department (DGCI), the budget office (DGO), and the Treasury.
- (vi) Strengthen the inspection capabilities of the General Audit Department of the Ministry of Finance and the Financial Control Unit of the Budget Office (DGO) through human and technological capacity building.
- (vii) Approve and have the Council of Ministers adopt a new state budget classification system in line with WAEMU regulations and implement it for the 2009 budget process.
- (viii) Finalize the merger of the payroll databases of the Ministry of Finance and the Ministry of Public Administration.

**17. Beyond 2008 the fiscal position should steadily improve as controls are restored and nonpriority expenditures are reined in.** Continued commitment to policy reform will enable the government to implement stronger Fund-supported reform programs and achieve sustained donor support. The government will in particular pursue efforts to contain the wage bill through civil and security sector reform. The overall fiscal balance (excluding grants) is projected to decline to below 20 percent of GDP in 2010, to levels that are more manageable given domestic resources and sustainable levels of external budget support.

**18. The authorities intend to avoid introducing or intensifying exchange and trade restrictions** in 2008 and beyond.

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<sup>6</sup> This audit will be conducted by a reputable international firm and financed by the E.U. The audit is expected to be launched before May 2008 and completed later in 2008.

#### IV. CAPACITY-BUILDING AND TECHNICAL ASSISTANCE

19. **Capacity-building is a key complement to fiscal reform in order to ensure that reform is effective and sustainable.** The recent missions from the World Bank and the IMF—including its regional technical assistance center West AFRITAC—identified technical assistance needs in all areas of public financial management as well as macroeconomic statistics (Table 1). The highest priority is 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 the statistics. The World Bank is also assisting with these reforms through its support to low-income countries under stress (LICUS), including financing a long-term resident fiscal advisor.

#### V. PROGRAM MONITORING

20. **The monitoring of progress on the program outlined will be based on the quantitative and structural indicators provided in Tables 2 and 3.** 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; and (v) a ceiling on payment of previous arrears; and (vi) no short- or long-term nonconcessional external borrowing. The quantitative indicators are based on the monthly treasury cash flow plan for 2008 (Table 4).<sup>7</sup> 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 technical memorandum of understanding. A second EPCA purchase will take place in July 2008.

21. **To ensure the success of the program, and as prior actions, the government has** (i) submitted to parliament its 2008 government budget consistent with the agreement in this Memorandum; and (ii) sought firm assurances from donors to fully cover the 2008 fiscal financing requirements. The authorities have received assurances that there are no objections to EPCA from official Paris Club creditors to whom Guinea-Bissau is currently in arrears. They have also informed non-Paris Club creditors that they will continue to have difficulties servicing their external debt service obligations, including during the EPCA program period.

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<sup>7</sup> The monthly cash flow also serves as an informal indicative monthly framework for regular assessments of performance under the EPCA.

Table 1. Technical Assistance Needs of the Ministry of Finance

Department	Area	Long term	Short term	(Possible) provider
Minister's Cabinet	Macrofiscal advisor	X <sup>1</sup>		(WB LICUS/IMF) <sup>2</sup>
Budget	Expert public finance	X		(E.U.)
	Expert computer systems	X		(E.U.)
	Computerization expenditure accounts	X <sup>2</sup>		E.U.
	Public financial management		X	IMF/FAD
Treasury	Advisor to the Treasurer	X		WB LICUS <sup>2</sup>
	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 <sup>2</sup>
	Customs advisor	X		
	Advisor implementing ASYCUDA ++			AfDB
External debt	Debt management		X <sup>3</sup>	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

<sup>1</sup> TA requested and under consideration.

<sup>2</sup> TA in place.

<sup>3</sup> First mission conducted in January 2005.

Table 2: Guinea-Bissau: Quantitative Indicators under the Emergency Post-Conflict Assistance for 2008  
 Quarterly Targets 1/  
 (Cumulative, in millions of CFAF)

	2008			
	End-Mar. Prog	End-Jun. Prog	End-Sep. Prog	End-Dec. Prog
<b>1. Government Revenues 2/</b>	4,226.6	10,413.9	17,824.3	23,130.4
<b>2. Domestic primary deficit (commitment basis) 3/</b>	-5,050.0	-4,861.7	-3,522.1	-7,463.7
<b>3. Domestic financing of the budget 4/</b>	-238.7	-7445.7	-7684.3	-17331.6
<b>4. New domestic arrears 5/</b>	0.0	0.0	0.0	0.0
<b>5. Payment of previous years arrears 6/</b>	1772.0	3600.0	3600.0	3600.0
<b>6. External non-concessional public borrowing, maturity &gt; 1 year</b>	0.0	0.0	0.0	0.0

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. From TOFE. 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. From TOFE. 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 3. Guinea-Bissau: Prior Actions and Structural Indicators Under the  
Emergency Post-Conflict Assistance  
January 1, 2008—December 31, 2008

<b>Prior Actions</b>	<b>Target date</b>	<b>Status</b>
Submission to Parliament of 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
<b>Structural Indicators</b>		
Approve and adopt by Council of Ministers legal framework for new state budget classification system in line with WAEMU regulations.	End-March 2008	
Create Information Technology (IT) Department in Ministry of Finance and start training staff	End-March 2008	
Launch financial audit, by a reputable international audit firm, of outstanding domestic arrears for 2000-2007. <sup>8</sup>	End-April 2008	
Finalize merger of two payroll databases of Ministry of Finance and Ministry of Public Administration	End-June 2008	
Improve proper accounting and information flows of all Treasury transactions, including nonregularized expenditures and bank financing	End-June 2008	

<sup>8</sup> Audit financed by E.U..

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

	Jan. Proj.	Feb. Proj.	Mar. Proj.	Apr. Proj.	May Proj.	Jun. Proj.	Jul. Proj.	Aug. Proj.	Sep. Proj.	Oct. Proj.	Nov. Proj.	Dec. Proj.	Jan-Dec Proj.	In percent of GDP
<b>A. Revenue and grants</b>	4,896	2,903	2,010	8,229	3,538	3,000	7,950	2,567	7,159	4,006	2,296	2,947	51,501	28.4
Revenue	1,926	2,061	2,010	6,425	2,038	3,000	3,000	2,567	7,159	2,202	2,296	2,947	37,631	20.8
Taxes	1,100	1,235	1,300	1,420	1,886	2,289	2,807	2,475	1,536	1,376	1,469	1,869	20,764	11.5
Nontax revenue	826	826	710	5,005	151	710	192	92	5,623	826	826	1,077	16,867	9.3
Expected budget support	2,970	842	0	1,804	1,500	0	4,950	0	0	1,804	0	0	13,869	7.7
<b>B. Expenditure</b>	4,022	3,824	3,748	3,879	3,936	4,105	3,988	3,936	3,861	3,990	3,935	4,106	47,331	26.1
Current expenditure	3,923	3,725	3,649	3,780	3,725	3,893	3,777	3,724	3,649	3,778	3,723	3,895	45,242	25.0
Wages and salaries	1,777	1,777	1,777	1,777	1,777	1,777	1,777	1,777	1,777	1,777	1,777	1,777	21,322	11.8
Goods and services	595	595	595	595	595	595	595	595	595	595	595	595	7,134	3.9
Transfers	935	935	935	935	935	935	935	935	935	935	935	935	11,224	6.2
Other current expenditure	277	277	277	277	277	277	277	277	277	277	277	277	3,327	1.8
<i>Of which: Restitutions + Incentives + Others</i>	203	203	203	203	203	203	203	203	203	203	203	203	2,432	
Interest on domestic and foreign debt	339	141	66	196	141	310	193	140	66	195	140	311	2,236	1.2
<i>Of which: World Bank</i>	29	84	8	104	83	252	28	83	8	102	82	253	1,116	0.6
Capital expenditure (domestically financed)	99	99	99	99	212	212	212	212	212	212	212	212	2,089	1.2
<b>C. Extrabudgetary expenditures (DNT + tax compensations)</b>													0	
<b>D. Overall domestic balance: A - (B+C)</b>	875	-921	-1,738	4,350	-399	-1,105	3,961	-1,369	3,298	16	-1,639	-1,159	4,170	2.3
<b>E. Payment of domestic arrears and complimentary period</b>	1,564	208	0	1,828	0	0	0	0	0	0	0	0	3,600	2.0
<b>F. Overall domestic balance (cash basis) D-E</b>	-689	-1,129	-1,738	2,522	-399	-1,105	3,961	-1,369	3,298	16	-1,639	-1,159	570	0.3
<b>Financing</b>	689	1,129	1,738	-2,522	399	1,105	-3,961	1,369	-3,298	-16	1,639	1,159	-570	-0.3
Domestic financing	0	0	-239	-5,244	0	-239	0	0	-239	-1,917	0	-990	-8,868	-4.9
Bank financing	0	0	-239	-5,244	0	-239	0	0	-239	-1,917	0	-990	-8,868	-4.9
BCEAO	0	0	-239	0	0	-239	0	0	-239	0	0	-990	-1,706	-0.9
Commercial banks	0	0	0	-5,244	0	0	0	0	0	-1,917	0	0	-7,161	-4.0
Nonbank financing (incl. privatization)	0	0	0	0	0	0	0	0	0	0	0	0	0	0.0
T-bills and regional commercial banks (net)	0	0	0	-1,724	0	0	0	0	0	-6,740	0	0	-8,464	-4.7
Amortization of external debt	-849	-135	-36	-533	-335	-763	-218	-135	-36	-548	-335	-999	-4,920	-2.7
<b>Financing requirements (+ = financing needs flow)</b>	1,538	1,264	2,013	4,979	733	2,107	-3,744	1,503	-3,024	9,188	1,974	3,149	21,682	12.0
Additional identified budget support		1,485	1,485	4,950	1,000	283	283	283	283	283	283	283	10,900	6.0
EPCA	1,386						1,386						2,772	
World Bank debt relief	94	150	40	591	372	847	94	150	40	591	372	847	4,188	
Authorities' measures	58	58	58	58	58	58	58	58	58	3,213	58	58	3,854	
Recovery of tax arrears (CFA 700 mill.)	58	58	58	58	58	58	58	58	58	58	58	58	700	
T-bills rescheduling	0	0	0	0	0	0	0	0	0	3,154	0	0	3,154	
<b>Financing gap (flow) (+ = financing needs)</b>	0	-429	429	-621	-697	919	-5,565	1,013	-3,405	5,102	1,261	1,993	0	0.0
<b>Financing gap (accumulated stock) (+ = financing needs)</b>	0	-430	0	-621	-1,318	-399	-5,964	-4,952	-8,356	-3,254	-1,993	0		

Source: Guinea-Bissau authorities, and IMF staff estimates and projections based on 2008 Budget.

**ATTACHMENT II**  
**TECHNICAL MEMORANDUM OF UNDERSTANDING FOR PROGRAM FOR 2008 TO BE**  
**SUPPORTED UNDER EMERGENCY POST-CONFLICT ASSISTANCE**

Bissau, January 9, 2008

1. This memorandum describes the definitions of the quantitative indicators for the Program for 2008 to be supported under 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.

Quantitative indicators have been set for end-March, 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 the purposes of the EPCA, the government is defined as the central government of Guinea-Bissau.** This definition excludes public entities with autonomous legal personality whose own budget is not included in the central government budget.
4. For the targeted ceiling presented in Table 1 below, government revenues include direct taxes, indirect taxes, and fishing licenses. The cash-flow estimates are based on the tax revenues and fishing licenses estimated in the draft budget for 2008.

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

	Mar.	Jun.	Sept.	Outturn Dec
<b>1. Government revenues</b>	4,226.6	10,413.9	17,824.3	23,130.4
Tax revenues (Direct and indirect taxes (01.00.00 and 02.00.00))	3,635.0	9,230.7	16,049.5	20,764.0
Fishing licenses (03.01.01)	591.6	1,183.2	1,774.8	2,366.4

Source: Budget 2008.

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. The 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 below.

Table 2. Estimates of the Quarterly Domestic Primary Balance, New Domestic Arrears, and Payment of previous years' arrears, 2008  
(Cumulative, in millions of CFAF)

	Mar.	Jun.	Sept.	Outturn Dec
<b>1. Total domestic primary deficit</b>	-5,050	-4,862	-3,522	-7,464
Revenue	5,998	17,460	30,187	37,631
Current expenditure excluding interest	10,752	21,503	32,255	43,006
Domestically financed capital exp.	297	819	1,454	2,089
<b>2. New domestic arrears</b>	0.0	0.0	0.0	0.0
Wages and other expenditures on personnel (including pensions)	0.0	0.0	0.0	0.0
Nonpersonnel expenditures	0.0	0.0	0.0	0.0
<b>3. Payment of previous years' domestic arrears</b>	1,772	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 defined as the stock of account payables (rest-a-payer); (ii) At end-December, defined as accounts payables accumulated during 2008 and still outstanding one month after end-December in the case of wages and salaries (including pensions), and three months after end-December in the case of goods and services and transfers. The targets for the program period are presented in Table 2 above.

7. **Previous year's domestic arrears are defined as domestic arrears in wages, transfers, and goods and services** previous to 2008 and outstanding as of January 1, 2008. The targets for the program period are presented in Table 2 above. The program allows a partial payment of expenditure commitments related to 2007, that were not paid during that year and are still outstanding as of January 1, 2008, up to a maximum of CFAF 3.6 billion (see MEFP ¶ 14).

8. **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 the net changes in the balances of the treasury accounts at the BCEAO and at commercial bank(s)—excluding balances in those accounts that are not freely available for budget financing, such as accounts that are held under double signature arrangements with donors—as well as the outstanding amounts of loans, including T-bills, from the BCEAO and the commercial banks (local and regional). Domestic nonbank financing encompasses privatization receipts, as well as any other domestic financial debt held outside the banking sector, other than new domestic arrears as defined above, that may arise. Table 3 below provides the details.

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

	Mar.	Jun.	Sept.	Outturn Dec
<b>Domestic financing</b>	-239	-7,446	-7,684	-17,332
Bank financing	-239	-7,446	-7,684	-17,332
BCEAO	-239	-477	-716	-1,706
Commercial bank(s) (local banks)	0	-5,244	-5,244	-7,161
Regional Commercial banks and Treasury bills	0	-1,724	-1,724	-8,464
Nonbank financing	0	0	0	0

Source: Table 2, MEFP.

9. **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 the purposes of the EPCA, 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, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers’ credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided that the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair, or maintenance of the property. Under the definition of debt set out above, arrears,

penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g. payment on delivery) will not give rise to debt. For the purposes of monitoring the 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 initial date of contraction of the loan, the ratio of the present value of the loan, calculated on the basis of the reference interest rates, to its nominal value is less than 50 percent (that is, a grant element of at least 50 percent). For debts with a maturity exceeding 15 years, the ten-year reference interest rate published by the OECD is used to calculate the grant element. For shorter maturities, the six-month market reference rate is used. Purchases from the IMF are excluded from this limit.

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

## B. Adjusters

11. The following adjusters will be in effect:

**The ceilings on domestic primary fiscal deficit will be adjusted upward (downward) for any shortfall (excess) in E.U. fishing compensation:<sup>1</sup>**

- **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.

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<sup>1</sup> For the purposes of the TMU, the CFAF/US\$ exchange rate is 495 and the CFAF/Euro exchange rate is 656.

**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-March CFAF 6.8 billions; by end-June CFAF 21.2 billions; by end-September CFAF 31.9 billions; and by end December CFAF 34.6 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 budget support, the ceiling in the accumulation of new domestic arrears of nonpersonnel expenditures will be adjusted upward (downward) by that difference.

## **II. PROGRAM MONITORING**

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

- The 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);
- Data on any extra-budgetary expenditure (not included above), including: (i) incentives to tax collectors; (ii) restitutions to collecting agencies; (iii) and 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 (rest-a-payer) 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 following 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);
- The Treasury Committee monthly reports (monthly, within ten 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 the disbursements of budget support (grants and loans), by donors (two weeks after the end of the month);
- Indicators to assess overall economic trends, such as the household consumer price index and exports of cashew nuts (when such information becomes available);
- A table with a description of the status of implementation of the structural indicators in Table 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.

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

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



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International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Executive Board Approves US\$2.8 Million in Emergency Post-Conflict Assistance for Guinea-Bissau**

The Executive Board of the International Monetary Fund (IMF) today approved an amount equivalent to SDR 1.775 million (about US\$2.8 million) in Emergency Post-Conflict Assistance (EPCA) for Guinea-Bissau. The assistance supports the authorities' program for 2008 and is intended to help the country address the immediate post-conflict challenges of restoring fiscal stability, building capacity for implementing policy, and regularizing relations with donors.

Emergency Post-Conflict Assistance 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 is a key part of a concerted international effort to provide financial assistance to Guinea-Bissau.

Following the Executive Board's discussion of Guinea-Bissau, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

“The Guinea-Bissau authorities face enormous post-conflict economic challenges. The new government appointed in April 2007 has been implementing an emergency program to correct large, unsustainable fiscal imbalances. As a result, fiscal performance improved in the second half of 2007 and donor disbursements have resumed.

“The authorities’ economic program for 2008, which is supported under the IMF’s Emergency Post-Conflict Assistance, builds on these recent gains. The program seeks to lay the foundation for achieving medium-term fiscal and debt sustainability and normalizing relations with external creditors by reining in nonpriority current spending and intensifying revenue mobilization. The authorities recognize that the spending plan is tight, but they are committed to keeping expenditures within available financing. Given the large wage bill, the authorities consider wage restraint and reform of the civil and military services to be critical for successful fiscal management.

“The 2008 program includes a few structural measures that focus on building capacity in critical areas of revenue administration and public expenditure management. These measures will help to improve fiscal transparency, restore confidence, and boost donor support.

“Given the large external debt burden, Guinea Bissau will require continued and increased access to grants and concessional aid inflows over the medium term. The authorities have already secured a significant amount of donor financial and technical assistance for 2008. Good performance on the 2008 program could catalyze additional donor support for critical structural reforms and priority spending, which would reduce the reliance on domestic borrowing.

“Satisfactory implementation of the 2008 program could pave the way for a successor program supported under the IMF’s Poverty Reduction and Growth Facility, and for debt relief under the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative,” Mr. Portugal said.

**Statement by Laurean Rutayisire, Executive Director for Guinea-Bissau  
January 28, 2008**

**I. Introduction**

1. At the outset, I would like to express my Bissau-Guinean authorities' gratitude to the international community for its continuing support received over the past years, which has been helpful for the country to prevail over the difficulties of conflict and political instability. I would also like to thank the Fund for having maintained a constructive policy dialogue with my authorities amidst the challenges, and the staff for the constructive discussions, particularly during the 2007 Article IV consultations and their recent visit to Bissau.

2. As in my statement of September 17, 2007, I would like to express my authorities' resolve to overturn the legacy of the past decade, and move the country into a sustainable political and economic situation, albeit significant challenges that still lie ahead. Since April 2007, the new government - appointed with strong support of the main political parties and trade unions - has embarked on an Emergency Program for the Restoration of Fiscal Stability with aim at stemming the economic deterioration, rein in fiscal policy and improve good governance including fight against corruption. The minimum program involved forceful measures to increase collection of revenue, recover tax arrears, control expenditures, and improve fiscal management and transparency. The government has successfully implemented these measures, which translated in improved fiscal situation during the second half of 2007 and resumption of donors' support.

3. Moving forward, my Bissau-Guinean authorities intend to consolidate these gains through further measures to put the country's public finances on a more sustainable path, build capacity for policy implementation, and lay grounds for the implementation of the much-needed structural reforms, especially in the civil and military services. My authorities have reiterated their wish to pursue this reform agenda under a program supported by the Fund's Emergency Post-Conflict Assistance (EPCA). They still believe that an EPCA program would help further restore confidence in their macroeconomic management, improve domestic and external credibility, and build the necessary track record for consideration of a new PRGF-supported program and eventually progress towards the completion point for debt relief under the HIPC and MDR initiatives.

4. Although efforts have been made to gain increased support from the donor community, including non-traditional donors, my Bissau-Guinean authorities are confident that an EPCA-supported program will catalyze additional donors' assistance to cover not only current pressing spending needs but also to finance the country's long-term development agenda. They are grateful to their bilateral and multilateral partners for the significant financial and technical support pledged so far for the 2008 program. They would also like to reassure the international community that they are fully committed to implement all measures set out in their 2008 program, especially regarding revenue mobilization and expenditure execution and control. Moving forward, my authorities expect to continue working in concerted efforts with the international community, in order to create the necessary conditions for the implementation of programs that will continue to promote stability and contribute to higher economic growth and poverty reduction.

## **II. Recent economic development**

5. Years of conflicts and political instability have left Guinea-Bissau in a very fragile situation, with a heavy toll particularly on the country's infrastructure, on the institutional capacity for policy implementation as well as the fiscal situation, thereby wiping out the basis for higher economic growth. The real GDP growth for 2007 is estimated at 2.7 percent, lower than the initially projected 3.7 percent, owing mainly to less than expected production and exports of cashews, and the difficulties in the agricultural area which was affected by inadequate climate conditions. In addition, the extreme difficult fiscal situation as well as the lack of infrastructure, especially for energy and transport, continue to hold down private businesses. Inflation has remained low, although the continued rise of international oil prices in 2007 and recent surge in food prices could push inflation rate slightly above the WAEMU targeted rate of 3 percent .

6. The erosion of donor support, the difficulties experienced in exports of cashew as well as in imports, and the lower capacity in fiscal management led to a substantial deterioration of the fiscal stance at end 2006 and throughout the first half of 2007. The authorities resorted to borrowing from commercial banks and issuing of treasury bills in order to cover the financing shortfalls. These solutions could not stem the cash flows difficulties leading to the accumulation of large domestic and external arrears, notably the civil service salaries. To reverse this situation, the new government undertook to restore fiscal stability through implementation of policy measures that increase revenue collection, institute tight control on discretionary spending, abolish tax compensation for tax collectors, re-instate and strengthen the Treasury Committee to monitor cash flow, and improve transparency and financial management. Consequently, tax revenues were some 28 percent higher in July-October 2007 than during the same period in 2006, and current expenditure were brought down to 27 percent of GDP from 29 percent in 2006. Importantly, discretionary spending were kept within budget and the government was able to fully pay government wages, thereby lowering the risks of further civil unrest.

7. While disbursements of donor pledges resumed in the second half of 2007, some were delayed to early 2008 awaiting, among other things, the adoption of an EPCA program. To cover up the financing shortfalls, in addition to the delayed disbursement of EU fishing compensation following the tardy conclusion of related agreement, the government negotiated the rescheduling of domestic commercial debts, and eventually could not avoid some accumulation of domestic arrears. The authorities plan to clear a portion of these domestic arrears once the delayed donor support is disbursed in early 2008 and intend to mobilize additional donor assistance for clearing the remaining portion, as well as for other domestic arrears accumulated over the past years, after their audit.

## **III. Policy agenda for 2008 and beyond**

8. Over the medium-term, the authorities' program aims at pursuing the fiscal stabilization, shoring up donor support so as to increase international aid inflows and laying groundwork for the implementation of strategies and structural reforms that would revive economic growth, reduce poverty and achieve long-term fiscal and external sustainability. In line with these reforms, the program for 2008 targets a real GDP growth of 3.3 percent on ground of expected improvement in agriculture, particularly in the cashew sector, and an increase in public investments. Owing to the continued prudent monetary policy conducted by the regional central bank BCEAO, to which my authorities will continue to adhere to, inflation is

expected to decline to levels below the 3 percent regional convergence criteria. The current account deficit is expected to widen slightly from 11 percent of GDP in 2007 to 12 percent - nonetheless a strong improvement compared to the 25 percent of 2006 - owing to expected higher prices for rice and oil imports and lower export volume of cashews.

9. The encouraging progress made in the implementation of the emergency fiscal program and the approval by parliament of the 2008 budget, which is in line with the macroeconomic framework agreed for EPCA, reflect the authorities' strong commitment to implement bold measures meant to boost fiscal revenue mobilization, restrain public expenditure and promote a transparent financial management. The authorities intend to keep up the momentum and, on the **fiscal front**, they plan to achieve an overall fiscal balance (excluding grants) of about 21 percent of GDP in 2008, which is lower than in previous years. To this end, revenues are projected to increase by 5 percent to about 21 percent of GDP compared to 16 percent last year, owing mainly to the disbursements of fishing compensation and to tax collections projected to remain at the same share of GDP of last year. On the expenditure side, the program aims at a nominal freeze of current expenditure, including the wage bill, and at maintaining expenditures within available resources, both domestic and external. My authorities consider the nominal wage freeze as only temporary, and major steps have been undertaken in the design of strategies as well as action plans for the civil and military service reforms.

10. On the **financing side**, the authorities have already secured financial resources 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 increased support to their overall reform agenda and intend to hold a meeting in the course of this year to follow up on the November 2006 Donor Round Table conference. Furthermore, they remain ready to making further efforts to re-negotiate the rescheduling of domestic debts to the extent of any shortfalls in the external financing in 2008.

11. Building on the recommendations made by recent FAD and West AFRITAC technical assistance missions, the government will further implement policy measures to address the remaining structure weaknesses in their **public financial management**. Key among them are measures to improve accounting and information flows of all Treasury transactions, strengthen the inspection capabilities of the General Audit Department of the Ministry of Finance and the Financial Control Unit of the Budget Office, adoption of new state budget classification system in line with WAEMU and finalize the merger of the payroll databases. In view of the capacity constraints facing the country, my authorities are hopeful that the international community, especially the Fund and World Bank, will continue to provide their assistance in institutional and capacity building. My authorities are thankful to the recent missions from the World Bank and the Fund, which have identified technical assistance needs in all areas of public financial management as well as macroeconomic statistics. They look forward to working with the two institutions in these endeavors.

#### **IV. Conclusion**

12. My authorities are aware that the main challenges they face are to build up public institutions in order to sustain the socio-political environment, and to revive economic growth. In this regard, obstacles to growth and poverty reduction have been identified through the country's PRSP, and policies and measures to address all the challenges need to be urgently implemented. Among these obstacles are the unsustainable fiscal situation, the

lack of resources to finance basic public services notably in infrastructure as well as in the legal and judiciary sectors, and the low skills base of the labor force. My authorities' approach is to urgently restore the sustainability of the fiscal stance and build the necessary fiscal space that would enable them to tackle the more difficult challenges above.

My Bissau-Guinean authorities highly value the support they continue to receive from the international community as well as the constructive dialogue with the Fund over the past years. They consider the EPCA program as key in helping them to catalyze this momentum, and would appreciate Board's approval.