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GUINEA-BISSAU | ECONOMIC UPDATE - SPRING 2024

Retiring the Fiscal Risk

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Acknowledgments

The Guinea-Bissau Economic Update monitors significant recent economic developments in the country, highlighting the key structural challenges Guinea-Bissau faces in its pursuit of inclusive and sustained growth.

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Executive Summary

Economic growth that matches potential continues to evade Guinea-Bissau as the international cashew market conditions remain testing. Another difficult cashew campaign limited the translation of high production into economic growth. While cashew production reached 260 thousand tons, the highest production yield on record, only 170 thousand tons were exported by the end of 2023. It is estimated that the remaining 90 thousand tons were smuggled out of the country into neighboring Senegal and Guinea. Consequently, economic growth remained below potential at 4.2 percent. Inflation remained stubbornly high at 7.2 percent y/y for 2023, but remittances and tax evasion from cashew smuggling limited the impact of this on disposable income and helped contribute to private consumption.

The weak export performance of the cashew campaign put pressure on the fiscal situation as total revenues fell causing the fiscal deficit to widen to 7.6 percent. Total revenues fell from 15.2 percent of GDP in 2022, to 13.9 percent in 2023 driven by poor export volumes of cashew, the introduction of rice subsidies financed by exempting the private sector from import tax duties to set the price of rice below market value, and lower grant financing. Although some domestic revenue mobilization efforts increased in nominal terms, as a percentage of overall tax revenue they remained the same as in 2022 or fell. As is often the case in fragile countries, the lack of domestic revenue collection capacity has created a high dependency on indirect taxes, accounting for 63.1 percent of tax revenue in 2023, which are mostly collected at customs during import and export procedures.

While expenditures remained largely unchanged as a share of GDP, this masks the significant increase in discretionary spending and rising interest payments. Total expenditure reached 21.5 percent of GDP in 2023, largely unchanged from 21.3 percent in 2022. This is despite progress in rationalizing the wage bill, which fell from 6.2 percent of GDP in 2022 to 5.1 percent in 2023. Although the wage bill declined in 2023, personnel incentives as a percentage of the official wage bill increased from 14.7 percent to 18.4 percent, as well as other budget lines that contribute to the real wage bill, such as travel and pensions (see box 1.2). These payments constitute a de facto, but expensive, compensation mechanism for efforts made to reduce the official wage bill. Elections, an increase in non-budgeted expenditure, such as payments to Karpower, higher debt servicing following rising international interest rates, and poorly targeted rice subsidies with a value of 0.2 percent of GDP (see box 1.1) also contributed to the consumption of the fiscal space created by efforts made on the wage bill.

Political uncertainty, both domestically and regionally, continues to have a negative impact on the economy. Political instability inhibits the ability of the donors to support the government in its fiscal consolidation objectives in a responsive manner, and regional and international political instability only further stoke domestic tensions in Guinea-Bissau. Additionally, instability in the Middle East affecting shipping lanes to and from Asia may decrease demand and lower prices, which may have a negative impact on exports.

Public debt remained relatively high, at an estimated 77.8 percent of GDP, in 2023 despite falling from 80.4 percent in 2022 – with external debt accounting for a smaller share. The decline in the ratio is largely attributed to higher nominal GDP growth, as nominal debt levels continue to rise. This increase was driven by a higher-than-planned fiscal deficit. As in previous years, the composition of debt has shifted towards domestic financing, with external debt accounting for 34 percent of GDP. According to the latest joint debt sustainability analysis by the World Bank and IMF (November 2023), debt is assessed to be sustainable but remains at high risk of debt distress. Interest rate increases to curb inflation have increased the cost of domestic financing. The IMF has supported the government's efforts to reduce non-concessional debt by implementing a policy of a zero ceiling on new non-concessional debt.

The current account deficit (CAD) remained broadly unchanged from 2022, driven by the high costs of food and energy imports. The country is highly dependent on imports for most sectors, such as staple foods, fuel, medication and building materials. Inflationary pressure on essential goods and services that Guinea-Bissau imports eased in the second half of the year supporting a slight improvement of the CAD despite poor cashew export performance. Consequently, the CAD fell from 9.6 percent in 2022 to 9.4 percent in 2023.

The IMF special drawing rights (SDR) allocation for Guinea-Bissau represented 2.4 percent of GDP in extra resources. Guinea-Bissau received an SDR allocation of US$D 38.4 million (2.4 percent of GDP) in August 2021 which contributed to closing the external financing gap and allowed the government to pre-pay some BOAD debt. In November 2023, the IMF board approved an increase to 140 percent of the quota to continue supporting Guinea-Bissau's financing needs in a context of low revenue from a weak cashew campaign and EAGB arrear payments driving up expenditure.

State-owned enterprises (SOEs) continue to represent a large fiscal risk to the government. There is limited transparency in the SOE sector, especially with the national utility company and state-owned enterprise (SOE) Electricity and Water of Guinea-Bissau (*Eletricidade e Águas da Guiné-Bissau*, EAGB), which managed to accrue significant public debt in 2023 (Box 1.3). A lack of transparency in the SOE sector makes the identification of contingent liabilities more difficult, which increases the fiscal risks in a country with very little debt absorption capacity for additional shocks. The port of Guinea-Bissau is also a loss-making SOE, but it is unclear how much of a loss it is making or how this loss is being financed, for example. However, efforts by the government to improve this in recent years have been supported by the World Bank's Sustainable Development Finance Policy Framework and the government's annual debt bulletin publishes statistics on debt for EAGB and the airport SOEs.

The fragile banking system also represents a contingent liability and fiscal risk for the government, made worse by an undercapitalized bank. A systemically important bank (SIB) holds approximately 40 percent of all deposits in the country, but its low capitalization and very high level of non-performing loans (NPLs) pose a threat to macro-financial stability. The Government began looking for a strategic investor in 2021 and a potential buyer has shown interest, despite the bank only managing to recover approximately 10 percent of its NPLs, but the political instability post-December 2023 will make this task difficult. These issues as well as the lack of depth in the financial markets limit financial inclusion and development.

Poverty continues to be widespread in Guinea-Bissau increasing by 2.8 percentage points (equivalent to over 80,000 additional poor) between 2018 and 2021. Data from the 2018/19 and 2021/22 EHCVM surveys showed that poverty increased from 47.7 percent in 2018 (equivalent to about 0.802 million poor persons) to 50.5 percent in 2021 (equivalent to over 0.886 million poor). This is equivalent to over 80,000 additional poor. Over the same period, other measures of poverty increased in Guinea-Bissau. The poverty gap (which measures the extent to which individuals on average fall below the poverty line) increased from 13.7 percent in 2018 to 15.2 percent in 2021. Similarly, the poverty severity index (which puts more weight on the poorest households, measured by squaring the poverty gap) has also increased, from 5.4 to 6.2 over the same period. The increase in these indicators illustrates the increasing intensity of poverty in Guinea-Bissau during the period. Recovery from the COVID-19 pandemic has been constrained by additional shocks-notably spillover effects of the war on Ukraine resulting in disruptions in global supply chains and rising food prices. The combination of agricultural growth and high food prices is expected to have left poverty unchanged between 2022 and 2023 at about 26 percent (based on the international poverty line of $2.15 in 2017 PPPs), with population growth implying over 10,000 additional poor people. Additionally, low cashew farmgate prices in

2023 have also undermined progress in poverty reduction. The combined effects of rising food prices and low returns from cashew production are expected to have disproportionately affected the well-being of the poor (who spend nearly 55 percent of their expenditure on food).

Early signs indicate that the 2024 cashew campaign promises to be strong, which will support real economic growth of 4.7 percent. Cashew production is expected to be strong again due to favorable weather conditions and as government investments into agricultural inputs over the last few years pay dividends. In contrast to the previous two years, however, exports should markedly improve as nine overland border routes become authorized for exports, curtailing smuggling. Historically, only cashew exports via the port of Bissau were authorized so this should contribute to the growth of processing in neighboring countries, potentially creating new export options. Global geopolitical developments may also create domestic opportunities for growth in Guinea-Bissau. Maritime disruptions in the Middle East have driven rising Asia-Europe freight costs which has translated into a growth in demand for cashew from Africa. This disruption allows a premium of 0.2 to 0.3 USD US$/kg over cashew of Vietnamese origin on spot contracts. This demand for African cashew to avoid Middle East trade lines coupled with cheap electricity from OMVG (Box 1.3) could stimulate expansion of the processing sector in Guinea-Bissau where the capacity to transform cashew is currently limited to 10,000 tons. This presents a potentially positive step towards increasing the value chain of the main productive sector in the country. Despite maritime trade risks, Chinese firms should enter the market for processing in Asia, competing with India and Vietnam for Bissau-Guinean cashew, creating new trade links.

Resolution of the Karpower contract situation could result in fiscal savings equivalent to the health sector budget and help ensure medium-term debt sustainability. The fiscal deficit is projected to narrow in 2024 to 4.8 percent of GDP (on a commitment basis), from 7.6 percent. This assumes that the OMVG electricity line from neighboring Guinea is activated and remains activated, progress is made in the public financial management reform space, and commitments to grant grant-funded budget support materialize. OMVG will reduce the overspending on EAGB and Karpower-related non-budgeted expenses that have driven the fiscal deficit. Annulation of the fixed cost capacity contract with Karpower will result in huge fiscal savings, approximately equal to the entire health sector expenditure for 2023, and cheaper electricity for consumers in the country, removing one of the main constraints on private sector development which should result in higher fiscal revenue. The resolution of this contract issue and donor-supported expenditure control and DRM reforms should reduce debt to WAEMU regional convergence criteria in the medium term.

Risks continue to be centered around political instability, shocks to the international cashew market, and climate change. The constitutional crisis from December 2023 and the uncertain electoral calendar has caused political instability. Political stability is crucial to maintain the authorities' commitment to a stringent macroeconomic policy framework, including: (i) fiscal consolidation; and (ii) prudent borrowing, to put debt on a consistent downward trend and achieve debt sustainability in the medium term. Additionally, weaker cashew nuts exports and lower-than-expected donor support may impact the outlook. Financial stress in state-owned enterprises, such as EAGB (Box 1.3), and banking sector fragilities could also generate contingent liabilities adding to fiscal pressures. An increased severity of the prolonged Russian invasion of Ukraine could impact the economic outlook if it continues to cause supply chain disruptions. Furthermore, if disruptions to commodity trade routes to Asia worsen owing to an escalation in the Middle Eastern conflicts, this could have a negative impact on the growth outlook.

The second chapter shows that the main challenge faced by the public sector pension schemes is one of governance but with very high fiscal consequences. Pension payments disproportionately benefit a very small fraction of beneficiaries while discretionary changes deviating from the rules are made to individual pension amounts. Furthermore, pension payments are made using the general budget exacerbating already high budget rigidity and adding additional challenges to the fiscal consolidation objectives of the government. An analysis of the 2016 and 2023 payroll databases appears to suggest that pension payments are "captured" by those responsible for the implementation of the schemes.

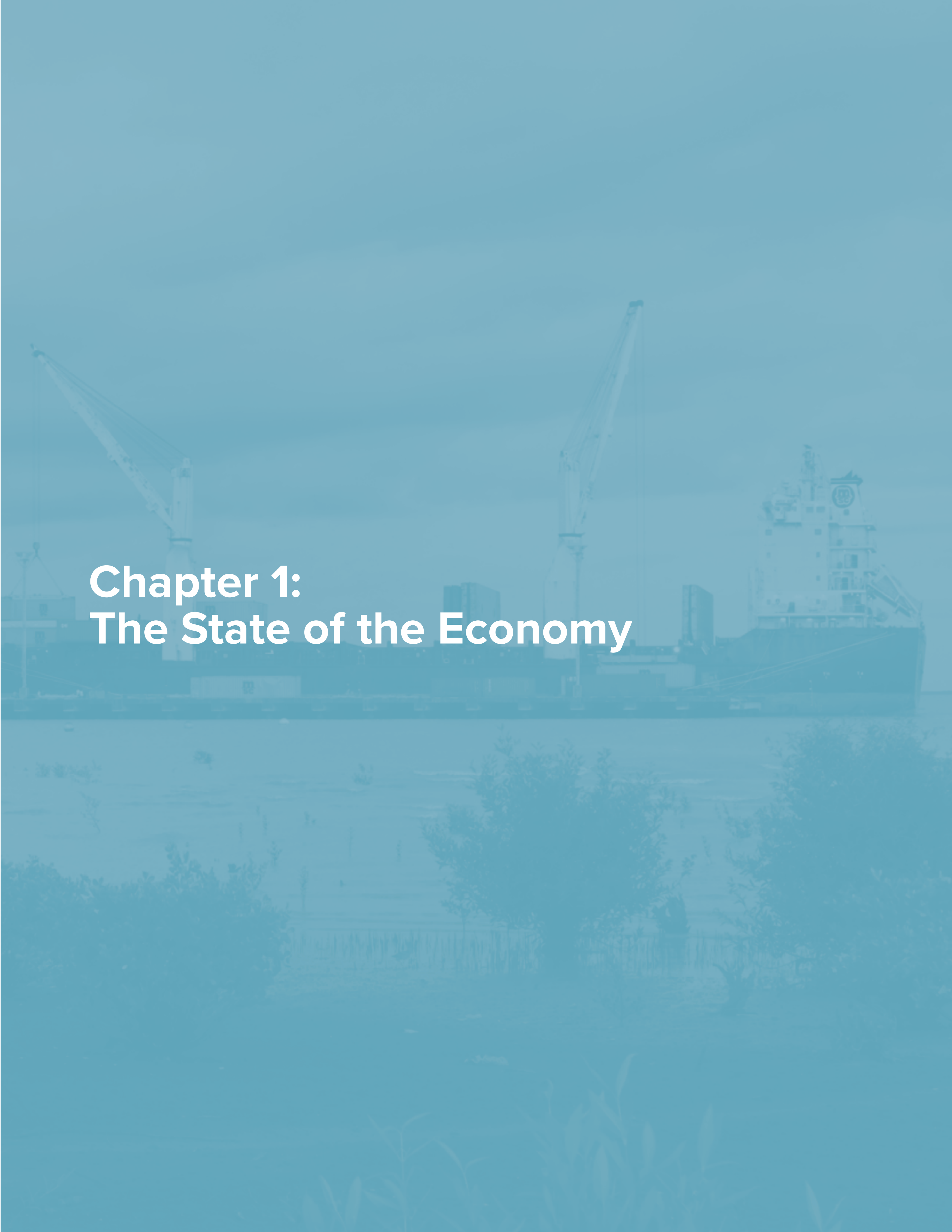
The analysis shows that the current parametric design of the public sector pension scheme is unaffordable in its present form, compromising the fiscal sustainability of the scheme. An accrual rate of 2.8 percent is much higher than the regional average (2.2 percent) and a contribution rate of 6 percent is far lower than it needs to be (16.8 percent) if the accrual rate is to remain at 2.8 percent. Additionally, calculating a civil servant's pension based on an average of the last two years of base salary makes the pension much more expensive as it creates incentives to maximize salaries just before retirement.

The analysis also shows that it is not recommended for Guinea-Bissau to set up a pension fund for the public service pension scheme at this stage. Although the 2015 Budget Law envisaged creating a pension fund, its current financing (6 percent of payroll) would not be enough to pay existing pensions. Importantly, creating a pension fund in a weak governance environment is extremely risky while the establishment of a strong regulatory framework would be a prior condition for the implementation of such a pension fund. As such, establishing a pension fund for the public service employees would bring significant administrative and fiscal challenges and therefore is not in the interest of the pensioners.

Some measures could be taken immediately to improve the public services pension schemes. These measures include clarifying the parameters of the pension schemes, reviewing and updating the list of pensioners, establishing a "proof of life" procedure, systematically making pension payments through the banking system, and, importantly, conducting an institutional assessment of the unit responsible for managing the public pension schemes.

Maintaining current governance structures supporting the public pensions sector and instead investing efforts to improve them is the best course of action for Guinea-Bissau. The Government of Guinea-Bissau is advised to maintain the current institutional structure of the public service pension schemes, immediately introduce the outlined measures including an institutional assessment of the unit responsible for managing the public pension schemes to improve governance, and consider a coherent reform package on the basis of a model like PROST to introduce parametric reforms to improve equity and ensure fiscal sustainability.

Additionally, to attenuate the large fiscal risk that materializes annually owing to a lack of information, such as incomplete birthdates, and a lack of government-led forward-looking analysis in the pension space, the government may also want to consider systematically using a model as part of its pension administration. The World Bank's PROST toolkit could fill this space by: (i) assessing the fiscal costs of the current scheme, and (ii) evaluating different pension reform options. The World Bank's pension reform options simulation toolkit, PROST, models pension contributions, entitlements, system revenues, and system expenditures over a long period. It is designed to help policymakers make informed policy decisions. PROST was used for the preparation of the pensions chapter in the recent Public Expenditure Review for Guinea-Bissau (World Bank, 2022). The World Bank could provide technical assistance to provide the government of Guinea-Bissau with such a model although the ability to usefully employ it will depend on data availability and quality as well as completeness for both current civil servants and pensioners. This would support the government with planning and efficient, proactive mobilization of resources, rather than the current reactive approach.



Chapter 1:
The State of the Economy

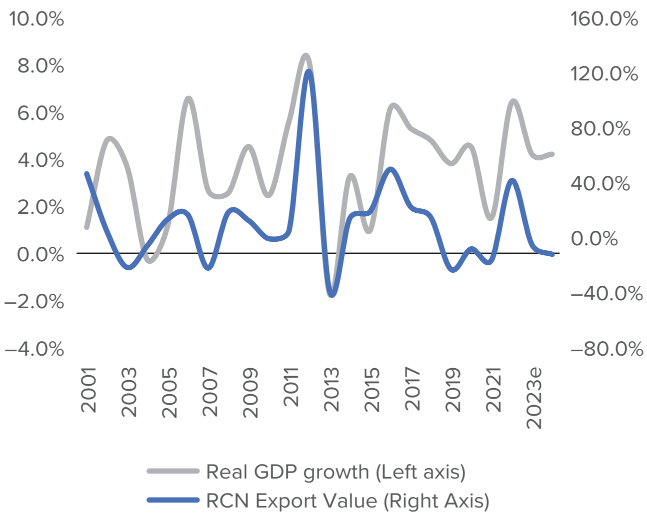
1.1. Context

Guinea-Bissau faces several important structural challenges to improve growth prospects including reoccurring political instability. A poor national road network, a low-production seaport, and costly access to the internet hamper efficient access to markets and the development of national and regional value chains. A challenging business environment, paired with policy uncertainty and weak institutions, undermine private sector investment, preventing progress in economic diversification.

The economy remains highly dependent on the export of raw cashew nuts. These make up around 90 percent of export value and provide income to around 80 percent of the population, mainly smallholder farmers and temporary harvest workers. Only around 3 percent of domestic output of raw cashew nuts is processed locally into eatable cashew nut kernels. As a result, economic growth is inherently linked to the export performance of the crop (Figure 1.1). This dependency makes the country susceptible to external shocks, including from highly volatile international prices, and adverse climatic conditions, such as irregular rainfall or floods.

Guinea-Bissau lacks a conducive enabling environment for private sector-led growth due to low levels of infrastructure, human capital, and public services. This situation is compounded by strong elite competition for rents and a weak public administration. The investment climate does not have a conducive business environment, with the Heritage Foundation's business freedom indicator falling from 36.9/100 in 2021 to 31.6/100 in 2023, compared to a world average of 60.3/100. Firms and households struggle to obtain access to finance, and the functioning of markets is undermined by the absence of public investments in foundational economic services, and public goods. Transport, logistics, electricity, water, and telecommunications infrastructure are in a poor state, which raises the cost of doing business. Member states in the Economic Community of West African States (ECOWAS) region typically exhibit fragmented telecommunications markets and relatively very high prices for Information Communication Technologies (ICT) services. The persistent absence of these key public goods and services—through direct public investments or effective public-private partnerships (PPP)—severely limits the ability of private firms to invest and of poor households to participate in economic activity, either through more productive autonomous activities or through accessing the employment opportunities that could be generated by a thriving private sector.

Figure 1.1. Annual change in real GDP and annual change in raw cashew nut (RCN) exports (2000–2023)



Source: The Ministry of Finance and World Bank.

1.2. Recent developments

1.2.1. Real sector

Growth remained unchanged at 4.2 percent in 2023 as challenges in export performance limited the translation of record-high cashew production into growth. Headline inflation remained high at 7.2 percent, with rising food prices prompting the authorities to introduce price controls and subsidies on key goods

Guinea-Bissau's cashew campaign was not disrupted by the 2023 legislative elections as much as anticipated,

[1] The level of smuggling is estimated to be around 90 thousand tons.

but weak international demand and high levels of smuggling kept economic growth below potential at 4.2 percent. A difficult cashew campaign limited the translation of high production into economic growth. While cashew production reached 260 thousand tons, the highest production yield on record, only 170 thousand tons were exported by the end of 2023. Poor export performance was partly driven by low international demand and prices, but also due to a monopoly on shipping containers early in the campaign which drove container prices up and led to high levels of smuggling into neighboring Guinea and Senegal to avoid the additional cost.[1] Although a second shipping container company eventually entered the market and international demand rose later in the campaign, the already high levels of smuggling meant there was a lack of stock to take advantage of this. Low prices on the international market translated into low farmgate prices which were as low as 150CFA/kg in some regions for most of the campaign, and well below the government-determined benchmark of 375CFA/kg. However, cashew smugglers benefited from tax evasion, giving them an additional margin that likely translated into higher-than-market-prices for cashew producers, and this, coupled with higher remittances, limited the extent to which private consumption was constrained in a high inflation context and allowed the economy to grow by 4.2 percent. Consequently, private consumption's contribution to growth only contracted slightly as compared to 2022 and elections and urban road infrastructure investment supported government consumption.

Headline inflation averaged at 7.2 percent (y/y), though this masks the underlying trend in monthly data as inflationary pressures driven by the Russian invasion of Ukraine begin to ease.[2] Inflation averaged 10 percent between January and June 2023, up from 7.9 percent in 2022. However, international inflationary pressures started to ease in June, coinciding with when households began to receive income from the cashew campaign, thus increasing their purchasing power and supporting private consumption. Despite this, prices for some staple foods continued to increase underscoring household vulnerabilities to commodity price swings, highlighting the country's dependence on food imports and raising food security concerns. This prompted the authorities to introduce price controls on staple foods and a rice subsidy which cost an estimated 0.2 percent of GDP (Box 1.1). Consequently, both November and December had y/y inflation rates of 3 percent and the yearly average fell to 7.2 percent.

1.2.2. Fiscal and debt dynamics

Fiscal consolidation efforts were derailed as higher-than-planned discretionary spending and lower customs receipts widened the fiscal deficit to 7.6 percent of GDP in 2023 (from 6.1 percent in 2022)

The fiscal situation worsened in 2023. Despite the government's commitment to a fiscal consolidation program that preserves medium-term sustainability, the overall fiscal deficit widened to 7.6 percent of GDP in 2023, from 6.1 percent in 2022 (on a commitment basis).[3] This reflects poor revenue performance and higher-than-expected discretionary spending, which have also contributed to the widening of the primary balance (from 4.7 percent of GDP to 5 percent in 2023). While ongoing fiscal consolidation efforts have crowded in grant commitments, not all have materialized. Consequently, grants reached just 2 percent of GDP in 2023, down from 3.4 percent in 2022, reflecting a significant decline in budget support. Inherently, political instability inhibits the ability of the donors to support the government in its objectives in a responsive manner, and regional and international political instability only further stoke domestic tensions in

[2] Inflation data from the National Statistics Institute for January to September and remittance data from the BCEAO for January to September.

[3] The fiscal consolidation program is supported by an ongoing three-year IMF program under the Extended Credit Facility (ECF) which began in January 2023 following the successful completion of a Staff Monitored Program (SMP). The ECF program includes quantitative performance criteria (QPC) and indicative targets (IT) that support fiscal consolidation and debt sustainability, such as a floor on tax revenue, a ceiling on wage bill spending, a floor on the domestic primary balance, a ceiling on non-concessional borrowing as well as arrears clearance. Program performance is currently being tested, as the time of writing.

Guinea-Bissau[4]. As a result, financing of the budget deficit has relied on borrowing from the regional debt market – which has become increasingly costly.

Total revenues fell in 2023, driven in part by a fall in tax revenue. Total revenues fell from 15.2 percent of GDP in 2022, to 13.9 percent in 2023 driven by poor export volumes of cashew, the introduction of rice subsidies financed by exempting the private sector of import tax duties to set the price of rice below market value, and lower grant financing. Despite a poor cashew campaign, tax revenue remained unchanged at 9.3 percent of GDP in 2023.[5] Guinea-Bissau's tax-to-GDP ratio still remains one of the lowest in the world owing to a small tax base and poor tax administration. Excessive bureaucracy also harms the efficiency of tax collection as tax payments still mostly rely largely on human interactions and paper-based exchanges. The government is engaged with the international donor community, which provides technical assistance to support reforms and domestic revenue mobilization efforts to mitigate these shortcomings. Corporate income tax increased 13.9 percent in nominal terms in 2023 but remained approximately the same as in 2022 in percentage of overall tax revenue terms, increasing from 17.8 percent to 18.1 percent. Direct taxation also increased in nominal terms by 6.7 percent but as a percentage of overall tax revenue, it fell from 38.7 percent to 36.9 percent. As is often the case in fragile countries, the lack of domestic revenue collection capacity has created a high dependency on indirect taxes, accounting for 63.1 percent of tax revenue in 2023, which are mostly collected at customs during import and export procedures.[6]

While expenditures remained largely unchanged as a share of GDP, this masks the significant increase in discretionary spending and rising interest payments. Total expenditure reached 21.5 percent of GDP in 2023, largely unchanged from 21.3 percent in 2022. This is despite progress in rationalizing the wage bill, which fell from 6.2 percent of GDP in 2022 to 5.1 percent in 2023. The peak in the wage bill in 2022 was driven by a government census in Q2 of 2022 with the objective of removing irregular civil servants and ghost workers. [7] However, the census process erroneously regularized the irregular workers numbering over 1,500 health professionals who were hired outside of the budget and without the authorization of the Minister of Finance during the pandemic.[8] Despite the decline in the wage bill in 2023, personnel incentives as a percentage of the official wage bill increased from 14.7 percent to 18.4 percent, as well as other budget lines that contribute to the real wage bill, such as travel and pensions (see Box 1.2). These payments constitute a de facto, but expensive, compensation mechanism for efforts made to reduce the official wage bill. Elections, an increase in non-budgeted expenditure, such as payments to Karpower, higher debt servicing following rising international interest rates, and rice subsidies with a value of 0.2 percent of GDP (see Box 1.1) consumed the additional space created by efforts with the wage bill. Conversely, capital spending fell to 5.3 percent of GDP from 6.1 percent as large investments in road infrastructure work began to conclude.

Despite this slippage, steady progress is being made to strengthen domestic revenue mobilization, rationalize the wage bill, and improve overall expenditure control

The authorities remain committed to implementing measures to strengthen domestic revenue mobilization (DRM) with notable steps taken in 2023. Ongoing tax reforms including the continuation of the rollout of the online tax payment system, *Kontaktu,* and enhanced

[4] Chapter 1 of the Country Economic Memorandum (2020) analyses the impact chronic political instability has had on economic development in Guinea-Bissau.

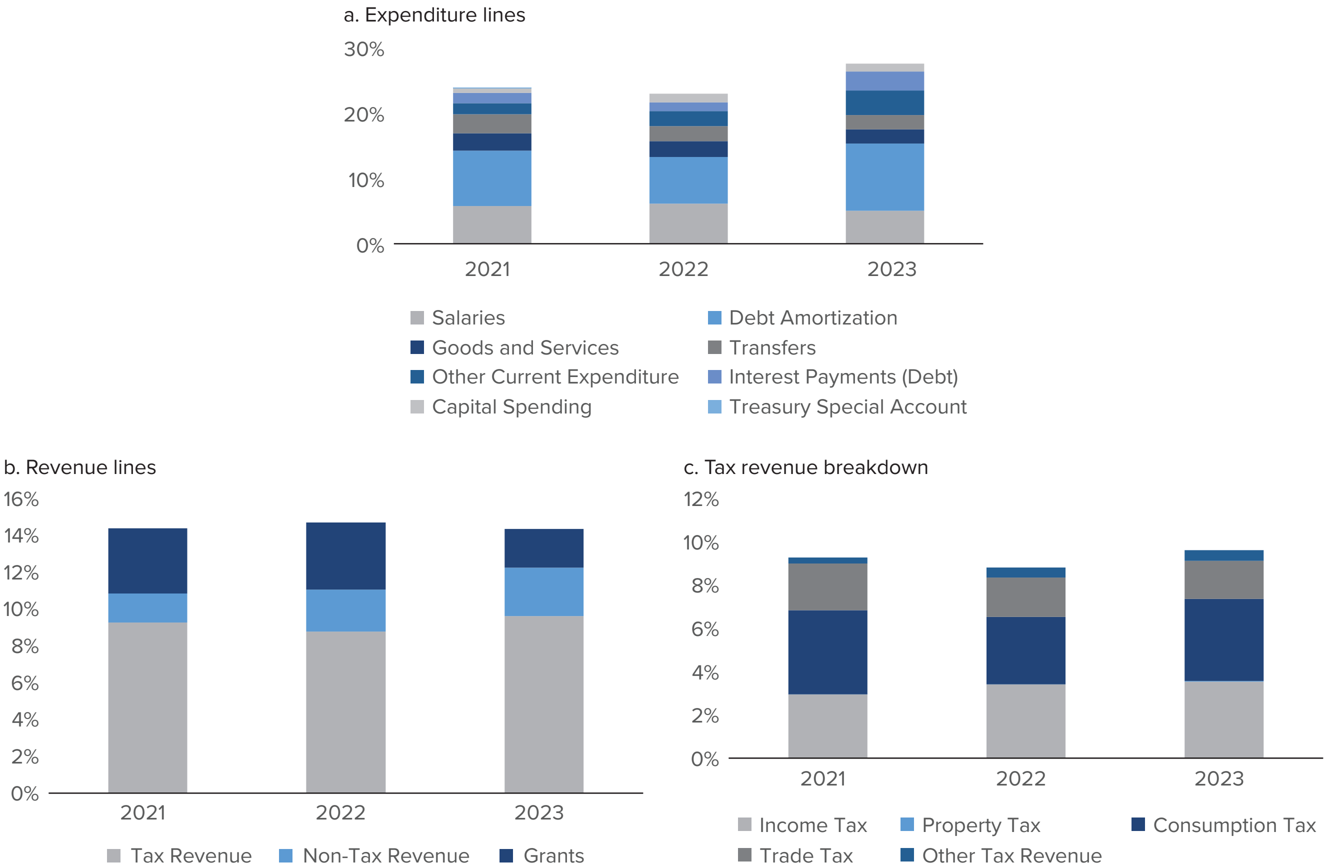
[5] The overwhelming majority of cashew producers are informal sector smallholders and so do not pay corporate tax or any other fiscal contribution. This responsibility falls on the shoulders of the intermediary buyers and the exporters.

[6] Due to the ease of charging taxes at customs, some direct taxes are also collected during importation or exportation. They include a contribution to corporate taxes (*Anticipação de Contribuição Industrial*) and cashew nuts specific income taxes (*Contribuição Predial Rustica*), among others.

[7] The 2022 budget gave the Minister of Finance the exclusive authority to hire new staff in the public administration.

[8] Consistent with the discussion in Box 1.2, the Country Economic Memorandum for Guinea-Bissau calculates that when considering non-salaried remuneration and other benefits that are hidden in other budget categories, this number is actually greater than 10 percent of GDP.

Figure 1.2. Expenditure lines, revenue lines, and tax revenue breakdown as percent of GDP



Source: Bissau-Guinean Ministry of Finance.

tax compliance as well as the adoption of measures to improve internal control procedures of customs and tax directorates are key to strengthening tax performance.[9] In 2023, the government announced a tax package to simplify and enhance transparency of the tax system. Work on the implementation of value-added tax (VAT) is also ongoing, supported by technical assistance (TA) from the IMF, the Portuguese government, and the World Bank which is envisioned to be rolled out in May 2024. The fiscal yield from implementation is expected to be 2.6 percent by 2029.

Rationalizing the wage bill and improving overall expenditure control are also key priorities. Expenditure on salaries narrowed to 5.1 percent of GDP in 2023 from 6.2 percent in 2022, driven by wage bill execution reaching only 88 percent of the budgeted amount (Box 1.2).[10] Spending consolidation has been supported by the continued

[9] The *Kontaktu* electronic system allows fiscal contributors to pay taxes online, facilitating payment efficiency and reducing paperwork. However, an end-2023 World Bank financed taxpayer perception survey in Guinea-Bissau showed that 81 percent of formal sector firms in the sample were not aware of *Kontaktu*, underscoring the need to communicate the platform to the business community.

[10] A wage bill analysis was done as part of the World Bank's 2019 Public Expenditure Review for Guinea-Bissau and concluded that the real wage bill was much higher than the official wage bill once incentives and other benefits, such as incentives, travel and international healthcare, were considered. For 2023, the real wage bill was approximately 84 billion CFA, compared to the official age bill of 58 billion CFA. The real wage bill (official wage bill) accounts for 12.1 percent of GDP (6.8 percent) and 120.7 percent of tax revenues (67.6 percent). This is much higher than the WAEMU criteria of a wage bill-to-tax revenue ratio of 35 percent.

Box 1.1. Rice subsidy impact

Price controls on staple foods were introduced in August 2023 to abate the negative impact of high inflation and the poor cashew campaign on real household incomes. The first Council of Ministers meeting of the then newly elected government introduced a series of measures to safeguard the poorest in Guinea-Bissau against a cost-of-living crisis driven by high inflation and low household income due to a poor cashew campaign. These measures included price controls on 30,000 tons of imported rice, the main staple food of Guinea-Bissau, and more specifically on broken rice (17,500CFA per 50kg bag) and scented rice (22,500CFA per 50kg bag). The fiscal cost of these measures is estimated at 2 billion CFA. The 2023 Budget Law allocates just 1 billion CFA for internally financed public investment and 615 million CFA for recurrent costs for the Ministry of Agriculture and Rural Development highlighting the disproportionately high opportunity cost for this policy.

The measures may have unexpected implications, both positive and negative, on the economy. Some traders with older stock of imported rice that was bought at higher prices, before the measures were introduced, are holding back this stock in anticipation of the price controls subsiding. This affects the supply and demand mechanism for rice and artificial scarcity could potentially encourage higher priced black-market trading which may undermine the price controls and negatively impact the poorest in the country. Additionally, although the traditional practice of trading cashew for imported rice at a ratio of 2:1 has reduced in recent years, increased food insecurity and inflationary pressures have fostered desperation and driven a resurgence in the practice, at a ratio of 3:1 in some areas of the country. Reduced imported rice prices through price controls may improve the bargaining power of cashew farmers and allow for more equitable trade, reducing the predatory 3:1 ratio. Furthermore, the subsidies may be benefitting neighboring countries who purchase the discounted rice in Guinea-Bissau and sell it for a higher price or consume it in their own countries.

The policy may reinforce binding constraints to economic diversification away from cashew production. Domestic rice accounts for 55 percent of rice consumption in Guinea-Bissau but domestically produced rice costs 20 percent more than imported rice varieties, a statistic that will be exaggerated with this policy. Domestically produced rice is especially commonplace in rural areas but has limited market presence with two thirds of its consumption being the subsistence farmers who produce it. Imported rice accounts for just 45 percent of consumption but is far more present on the market, boasting 80 percent of all rice transactions in the country. This policy will contribute to a successive series of policies that sideline domestic production and stunt the growth potential of the sector and undermine efforts to diversify the economy.

Information in Box 1.1: Rice Subsidy Impact is the work of both the author and work taken from Akong, C. (2023) "Scented Relief" UNRCO Guinea-Bissau

Box 1.2. What lies beneath – The Guinea-Bissau wage bill

The official wage bill in Guinea-Bissau is somewhat small relative to GDP and in line with those of peer countries, but it remains far above the WAEMU convergence criteria of 35 percent of tax revenues. The official wage bill accounted for 50.1 percent of tax revenues over 2021–2023. According to official figures, wages and salaries have decreased steadily, from 6.1 percent of GDP in 2021 to 5.1 percent in 2023. The share of wages and salaries allocated to the social sectors has grown substantially on the back of higher spending on education. Wages in the education sector account for the highest contribution to the wage bill, at 48.4 percent of the total and equivalent to 2.5 percent of GDP in 2023.

Box 1.2. What lies beneath – The Guinea-Bissau wage bill (*Continued*)

However, official figures do not provide a complete picture of total government employment and compensation such as pensions and incentive bonuses. Several spending items, including pensions, bonuses, travel benefits, salary top-ups, overseas health benefits, and salaries of staff in autonomous state institutions are classified under different budget lines and therefore not included in official figures. When these items are considered, the total government employee compensation amounts to approximately 1.6 times the official wage bill (2021–2023 average). This puts Guinea-Bissau's true wage bill among the highest when compared to structural and regional peers, such as Kenya, Senegal, Rwanda, Timor-Leste, Mauritius, and Uganda as a percentage of GDP and all of the above as well as South Africa as a percentage of tax revenue (Public Expenditure Review, 2019). Incentive bonuses paid to MEF staff to incentivize tax collection (*incentivos*) are disproportionately high and equate to 9.8 percent of total tax revenue 2021–2023. For 2023, incentives expenditure was 121 percent of expenditure for the whole health sector and 28 percent of overall social sector spending (Table Box 1.2). However, the contributions of these incentive bonuses to raising tax revenue is questionable as they are not linked to individual performance. Another large component of the real wage bill is pensions, whose lack of transparency and weak management create an annual fiscal risk as pension payments come out of the general budget rather than a fund or ringfenced sum of money. This topic is discussed in greater detail in the next chapter.

Table Box 1.2. Incentive expenditure compared to social sector spending ('000s CFA)

	2021	*2022*	*2023*
Incentives	8,883,841	9,944,880	10,596,028
Ministry of Education (incentives %)	26,704,433 (33%)	32,412,527 (31%)	28,331,506 (37%)
Ministry of Health (incentives %)	9,463,681 (94%)	13,854,258 (72%)	8,767,884 (121%)
Ministry of Women, Family and Social Solidarity (incentives %)	1,100,027 (808%)	196,485 (5,061%)	179,736 (5,895%)
Total Social Sector Spending (incentives %)	37,268,141 (24%)	46,463,270 (21%)	37,279,126 (28%)

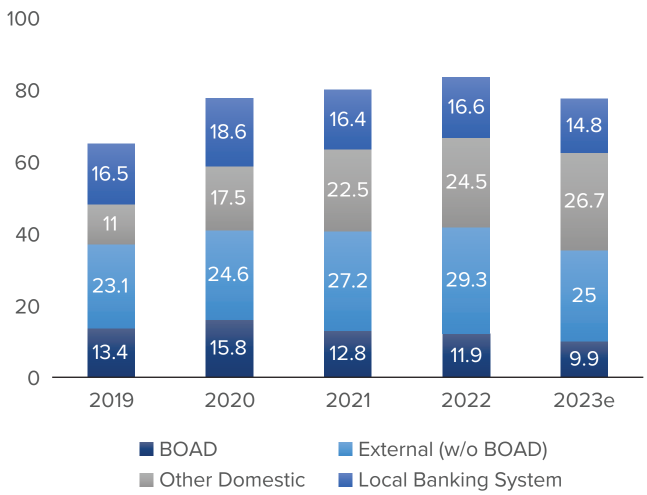
Source: Ministry of Finance.

rationalization of the wage bill with measures introduced over the last two years including the freezing of public sector salaries and new hires, and the removal of two-thirds of advisor positions at the Presidency, Prime Minister's Office, the Presidency of the National Assembly, and the Presidencies of the Constitutional and Audit Courts. Preparation for both an IMF-led blockchain solution and a World Bank financed biometric civil service census are underway to further support the government's efforts to rationalize the wage bill but are not expected to be rolled out until end-2024.

Public debt remains above the WAEMU convergence criteria, and fiscal risks – particularly from SOEs – persist.

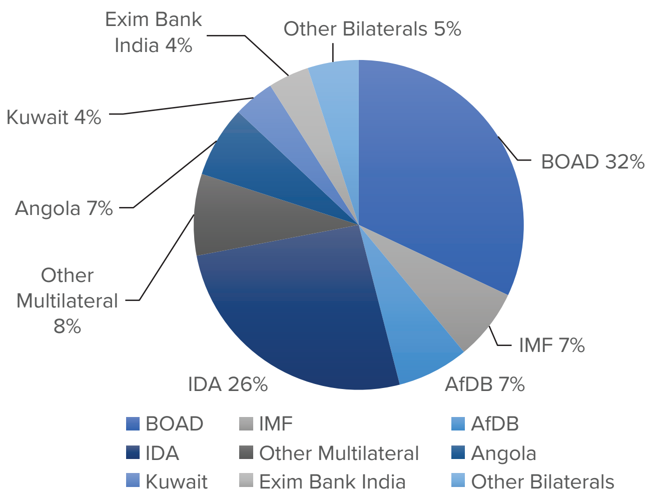
Public debt remained relatively high, at an estimated 77.8 percent of GDP, in 2023 despite falling from 80.4 percent in 2022 – with external debt accounting for a smaller share. The decline in the ratio is largely attributed to higher nominal GDP growth, as nominal debt levels continue to rise. This increase was driven by a higher-than-planned fiscal deficit. As in previous years, the

Figure 1.3. Guinea-Bissau public debt (percent of GDP)



Source: Guinea-Bissau authorities and IMF and WBG staff calculations.

Figure 1.4. Guinea-Bissau external debt end–2022 (percent of total)



Source: Guinea-Bissau authorities and IMF and WBG staff calculations.

composition of debt has shifted towards domestic financing, with external debt accounting for 34 percent of GDP. According to the latest joint debt sustainability analysis by the World Bank and IMF (November 2023), debt is assessed to be sustainable but remains at high risk of debt distress. Interest rate increases to curb inflation have increased the cost of domestic financing. The IMF has supported the government's efforts to reduce non-concessional debt by implementing a policy of a zero ceiling on new non-concessional debt (Figures 1.3 and 1.4).

State-owned enterprises (SOEs) continue to represent a large fiscal risk to the government. There is limited transparency in the SOE sector, especially with the national utility company and state-owned enterprise (SOE) Electricity and Water of Guinea-Bissau (*Eletricidade e Água da Guiné-Bissau*, EAGB), which managed to accrue significant public debt in 2023 (Box 1.3). A lack of transparency in the SOE sector makes the identification of contingent liabilities more difficult, which increases the fiscal risks in a country with very little debt absorption capacity for additional shocks. The port of Guinea-Bissau is also a loss-making SOE, but it is unclear how much of a loss it is making or how this loss is being financed, for example. However, efforts by the government to improve this in recent years have been supported by the World Bank's Sustainable Development Finance Policy Framework and the government's annual debt bulletin publishes statistics on debt for EAGB and the airport SOEs.

1.2.3. Balance of payments

High food and energy import costs maintained the CAD at the same level as in 2022 but the IMF SDRs were increased by 140 percent to continue support financing needs

The current account deficit (CAD) remained broadly unchanged from 2022, driven by the high costs of food and energy imports. The country is highly dependent on imports for most sectors, such as staple foods, fuel, medication and building materials.[11] Inflationary pressure on essential goods and services (Figure 1.5) that Guinea-Bissau imports eased in the second half of the year supporting a slight improvement of the CAD despite poor cashew export performance (Figure 1.6). Consequently, the CAD fell from 9.6 percent in 2022 to 9.4 percent in 2023.

[11] Although Guinea-Bissau used to be a net rice exporter in the past, now more than half of local rice consumption depends on rice imports.

Box 1.3. EAGB: the national utility SOE: A persistent fiscal risk

Public energy provision in Guinea-Bissau is mainly limited to the capital region. The state-owned utility Electricity and Water of Guinea-Bissau (EAGB), founded in 1983 and located in the capital Bissau, has the objective to provide production, transport and distribution of electricity and water in the national territory. However, only less than 20 percent of the population, most of whom live in Bissau, have access to the electricity and water network of EAGB. Some provinces have larger generator sets but power supply is limited and unstable. In February 2019, EAGB signed an electricity supply contract with KARPOWERSHIP, which installed a floating power station off the shores in the harbor of Bissau. The boat now produces and supplies all the electricity that EAGB sells to its customers. The contract, due to last five years, agreed to gradually take production capacity up to 24MW over this period.

Longstanding business management weaknesses and accounting irregularities affected EAGB financial stability and caused a technical bankruptcy in 2018. On the one hand, EAGB's operating expenses are high mainly because of its high wage bill. The company employs around 530 people, whose wages are above the national-average and benefit from free electricity and water provision. On the other hand, revenue collection is low as EAGB does not have the capacity to take readings in a timely manner or sometimes does not account for water and electricity consumption. It is estimated that electricity bills of around 4 billion CFA from companies and individual customers are still outstanding. EAGB's resulting high debt levels are estimated at 63 billion CFA (4 percent of GDP), of which 44 billion CFA is current debt and 19 billion CFA is historical debt. This includes salary arrears and liabilities to the public treasury, commercial banks, and the National Institute for Social Security (INSS). The Government transfers annually around 6 billion CFA to help clear debt.

A Portuguese consortium of specialists took over the management of EAGB in 2018. EAGB receives technical assistance from a consortium led by "*Energias de Portugal*" (EDP) to implement a management improvement and financial restructuring plan. Around 18 technical experts and specialists are tasked to modernize the customer service and billing system in Bissau. However, at the outbreak of the pandemic, the consortium returned to Portugal and switched to a teleworking regime. Consequently, the Government of Guinea-Bissau unilaterally suspended their contract on a temporary basis, effective 1st June 2020 with them not returning until July 2021. The contract with the consortium ended in June 2023 and 5 new international experts were hired and started working in January 2024 to manage and continue the operational improvement of EAGB.

EAGB is considering significant measures and has started to restructure their debt to form a path towards sustainability. EAGB is expected to take firm measures to improve its financial situation. These should include payroll control to reduce the wage bill as well as an expansion of pre-paid meter installations. A commission to collect outstanding bills has started recovering outstanding electricity bills. EAGB successfully negotiated a debt restructuring with National Institute for Social Security (INSS), which allowed around 100 workers of retirement age to retire and receive their pension. An 8-year debt service restructuring agreement with a local commercial bank was achieved. The company has been strictly complying with the debt amortization schedule. However, potential fiscal costs of EAGB's future operational losses presents a high risk to the government's debt situation.

A new tariff bilaterally agreed by the government with Karpower makes EAGB a large fiscal risk. The government agreed a longer, more expensive contract with Karpower which would take their production up to 70MW over a period of 10 years. When the Portuguese consortium returned from Portugal, they found that monthly payments to Karpower had increased, starting from January 2021, but that reforms to increase revenue, such as receiving payment from the government for the electricity it uses, were still finding resistance. This resulted in an unsustainable business model leading to four months of arrears to Karpower. In response, the Government held a roundtable in March 2022 with EAGB to discuss potential solutions. The World Bank attended these meetings as an observer and financed technical assistance in the form of an international lawyer to support the process. Despite this, Karpower activated a letter of credit worth three months of

(*continues*)

Box 1.3. EAGB: the National Utility SOE: A persistent fiscal risk (*Continued*)

arrears that was signed at the beginning of the contract. The value of these arrears was over US$6 million. A new letter of credit was signed, postponing but not solving the problem. The donor community continues to support the Government in finding a solution to the problem and the new contract was sent for legal analysis to evaluate its validity. The result is pending.

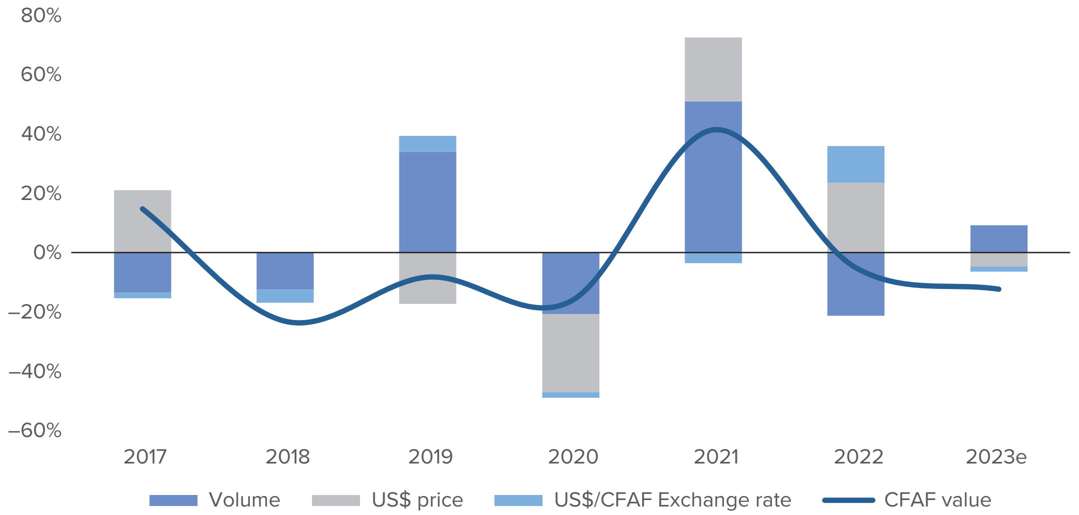
Guinea-Bissau is in a vulnerable position with respect to its energy security and needs to diversify its energy mix beyond Karpower. In October 2023, Karpower cut the power supply to EAGB for two days to demand the payment of six months of invoices from late 2022 and early 2023 totaling US$14.2 million. To recover the power supply, the government and EAGB paid US$10 million of invoices through a government transfer (US$3.9 million) and EAGB's short-term borrowing (US$6.1 million). The remaining invoices will be paid from a concessional project loan (US$4.2 million) in 2024. As the transfer was already included in the 2023 budget and the borrowing is within the existing line of government guarantees, this intervention created no additional fiscal costs for 2023.

The OMVG regional project can help give the government some breathing space whilst a solution is found to the Karpower contract situation. The technical work for *L'Organisation pour la mise en Valeur du Fleuve Gambie*/The Gambia River Basin Development Organization (OMVG) has almost concluded but can be brought online now whilst the remaining work is finalized. The Karpower contract is divided into two parts. One part is a contracted capacity fixed cost agreement. EAGB has to pay Karpower for contracted capacity irrespective of how much is consumed. Contracted capacity is currently 30 megawatts but will increase to 70 megawatts on a tiered basis over the life of the contract, which ends in 2030. Guinea-Bissau currently has average usage needs of 20 megawatts, but peaks at 24 megawatts, meaning there would be substantial unused capacity that needs to be paid for by EAGB but cannot be used. However, a cement factory in Bissau is estimated to require 6 megawatts alone and the World Bank and other development partners are financing projects to expand electricity access in the country, The second component is the variable consumption cost and is additional to the fixed cost contracted capacity. Current contracted consumption unit prices are US$0.11/kwh for OMVG and US$0.23/kwh for Karpower (Figure 1.13). This means that the fixed cost contracted capacity with OMVG consumption, as opposed to consumption from Karpower, will create significant temporary fiscal space and breathing room, assuming it is not turned back off if/when once online.

Figure 1.5. Price developments of main import commodities: Rice and oil (Jan 2019–Feb 2024)

Note: The figure presents prices in US$.
Source: World Bank Pink Sheet.

Figure 1.6. Changes related to cashew nut exports (y/y)



Note: The figure presents y/y changes of components of the cashew nut export value.
Source: Guinea-Bissau authorities and WBG staff calculations.

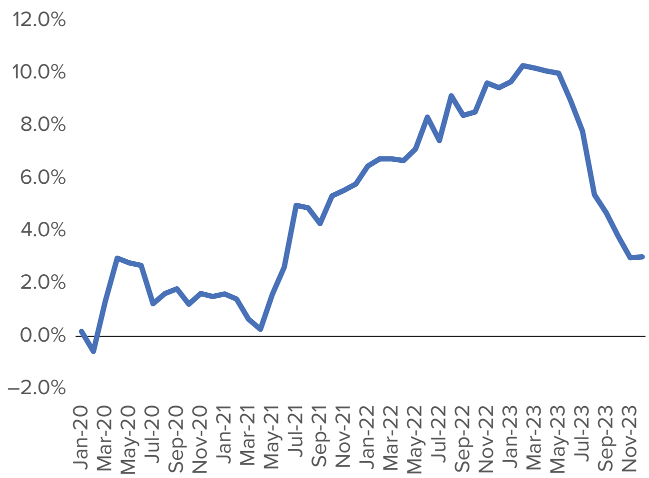
The IMF special drawing rights (SDR) allocation for Guinea-Bissau represented 2.4 percent of GDP in extra resources. Guinea-Bissau received an SDR allocation of US$38.4 million (2.4 percent of GDP) in August 2021 which contributed to closing the external financing gap and allowed the government to pre-pay some BOAD debt. In November 2023, the IMF board approved an increase to 140 percent of the quota to continue supporting Guinea-Bissau's financing needs in a context of low revenue from a weak cashew campaign and EAGB arrear payments driving up expenditure.

1.2.4. Monetary policy and the financial sector

The stock of credit to the private sector remains below the WAEMU average and credit to the economy grew but decelerated in 2023. The banking sector remains fragile

Inflationary pressures began to ease in the second half of 2023, possibly supported by price controls on staple foods that were driving inflation. Inflationary pressure increased after the pandemic driven by supply chain disruptions and a global increase in commodity prices caused by the Russian invasion of Ukraine. Fuel shortages in the region in 2022 exacerbated this problem, as transport costs increased owing to a rise in haulage times, but price controls and normalization of global events negatively impacting inflation have driven a reduction in headline inflation in the second half of 2023 (Figure 1.7). Consequently, inflation in 2023 averaged at 7.2 percent y/y, down from 7.9 percent in 2022.

Figure 1.7. Headline inflation 2020–2023 (y/y)



Source: World Bank figures and National Statistics Institute data.

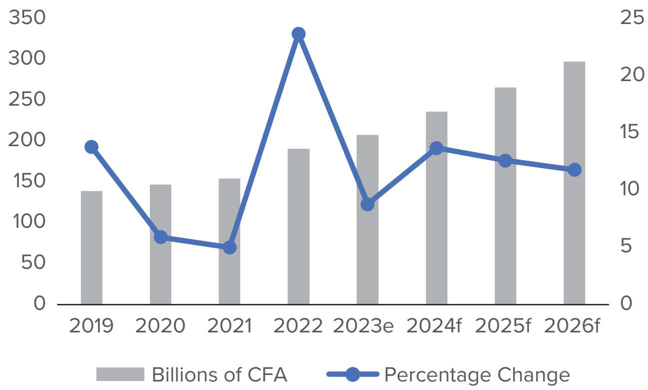
Despite appreciating in recent years, the real effective exchange rate (REER) remains around 2010 levels. The CFA peg to the euro has kept the REER relatively stable since 2010. REER changes tend to follow the nominal effective exchange rate (NEER), as the inflationary differential with trading partners is minimal. The REER has appreciated about 4 percent since 2019 but remains around 2010 levels.

Shallow financial markets limit financial inclusion and development. Access and use of financial services have increased in the last decade, fostered by the government's decision to pay salaries only through the banking sector, but it remains low. Recent data in this area is difficult to obtain in Guinea-Bissau but the stock of credit to the private sector was approximately 15 percent of GDP end-2021, below the WAEMU average of 22 percent of GDP. Increasing the use of mobile phone services could advance financial inclusion by giving people outside of Bissau access to financial services. The liquidity of the banking system was supported by the accommodative stance of the BCEAO, and credit to the economy grew but decelerated in 2023 (Figure 1.8).

The fragile banking system represents a contingent liability and fiscal risk for the government, made worse by an undercapitalized bank. A systemically important bank (SIB) holds approximately 40 percent of all deposits in the country, but its low capitalization and very high level of non-performing loans (NPLs) pose a threat to macro-financial stability.[12] The Government began looking for a strategic investor in 2021 and a potential buyer has shown interest, despite the bank only managing to recover approximately 10 percent of its NPLs, but the political instability post-December 2023 will make this task difficult.

Long-standing structural issues in the banking sector persist. These stem from the 2012 political crisis and a sharp decline in cashew prices in 2013, which damaged two banks highly exposed to the cashew sector, resulting in very high levels of NPLs. While one bank recovered,

Figure 1.8. Credit to the economy



Source: IMF and World Bank estimations.

the SIB remains undercapitalized, with negative capital levels since 2017. Since December 2018, the solvency ratio in the financial sector has been negative despite a government recapitalization of SIB in December 2019.[13]

Financial soundness indicators show that the banking sector, excluding the SIB, has recovered. Gross NPLs to total loans declined from 19.4 percent in 2021 to 10.4 percent in 2022 mainly due to the settlement of cross-arrears by the government with debtors of the undercapitalized bank. The financial vulnerabilities stemming from the sovereign debt and exchange rate exposures in the banking sector remain low. Nevertheless, the sector depends on the accommodative stance of the BCEAO, which may be indicative of chronic liquidity constraints.

1.2.5. Poverty

Poverty has followed an upward trend in Guinea-Bissau since 2018 and is more pronounced in rural areas than urban areas because of low productivity agricultural production.

Poverty continues to be widespread in Guinea Bissau-increasing by 2.8 percentage points (equivalent to over 80,000 additional poor) between 2018 and 2021. Data

[12] There is no NPL data for 2022 at the time of writing. NPLs in 2021 were 16.6 percent (6.3 percent excluding the undercapitalized bank).

[13] The minimum requirement for the solvency ratio set by the BCEAO is 8.25 percent. In December 2019, the WAEMU average solvency ratio was 11.35 percent. Guinea-Bissau's solvency ratio was -2.0 percent, the only country in the WAEMU with a negative ratio.

from the 2018/19 and 2021/22 EHCVM surveys showed that poverty increased from 47.7 percent in 2018 (equivalent to about 0.802 million poor persons) to 50.5 percent in 2021 (equivalent to over 0.886 million poor)[14]. This is equivalent to over 80,000 additional poor. Over the same period, other measures of poverty increased in Guinea-Bissau. The poverty gap (which measures the extent to which individuals on average fall below the poverty line) increased from 13.7 percent in 2018 to 15.2 percent in 2021. Similarly, the poverty severity index (which puts more weight on the poorest households, measured by squaring the poverty gap) has also increased, from 5.4 to 6.2 over the same period. The increase in these indicators illustrates the increasing intensity of poverty in Guinea-Bissau during the period. Recovery from the COVID-19 pandemic has been constrained by additional shocks- notably spill-over effects of the war on Ukraine resulting in disruptions in global supply chains and rising food prices. The combination of agricultural growth and high food prices is expected to have left poverty unchanged between 2022 and 2023 at about 26 percent (based on the international poverty line of $2.15 in 2017 PPPs), with population growth implying over 10,000 additional poor people. Additionally, low cashew farmgate prices in 2023 have also undermined progress in poverty reduction. The combined effects of rising food prices and low returns from cashew production are expected to have disproportionately affected the well-being of the poor (who spend nearly 55 percent of their expenditure on food).

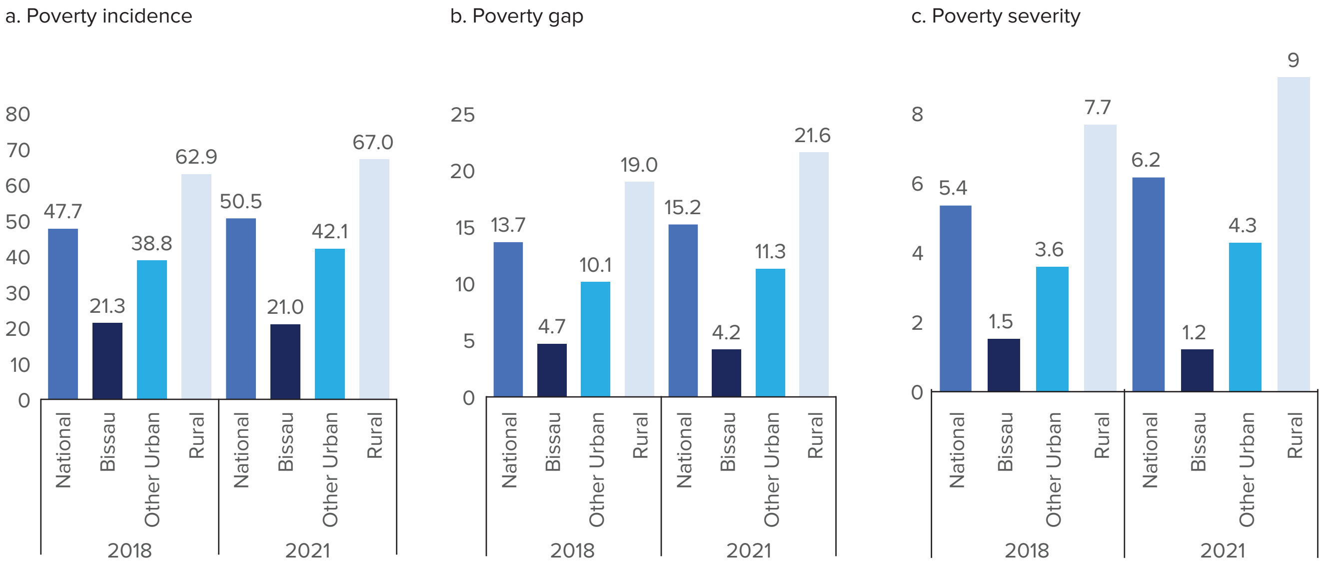
Trends in poverty between 2018 and 2021 have largely gone in the same direction in urban and rural areas but remain higher in rural areas. In rural areas more than half of the population is poor. The incidence of poverty increased by 4.1 percentage points over the period to reach 67 percent in 2021. In the capital city, Bissau poverty remained relatively unchanged at 21 percent; but in other urban areas, poverty increased by 3.3 percentage points between 2018 and 2021 to reach 42 percent. Poverty is most severe in rural areas as shown by higher and larger increases in both poverty gap and severity indicators over the period. Therefore, not only is poverty more of a rural phenomenon in Guinea Bissau, but the rural poor are also furthest away from the poverty line compared to their counterparts in urban areas.

This is partly because the rural economy continues to be dominated by low-productive agriculture – mainly raw cashew nut production. Over 70 percent of households rely on cashew production in Guinea-Bissau, for whom income from the sale of cashew nuts is an important source of livelihood. Despite improvements in cashew yields (supporting growth in agriculture from 4.3 percent in 2018 to 5.4 percent in 2021), cashew farmgate prices remain lower than export prices due to governance and market failures; thereby undermining the pace of rural income growth and progress in reducing rural poverty.[15] Between 2000 and 2020, official government estimates indicate that the average export price of a kilo of cashew nuts was 491CFA. However, during the same period, average farmgate prices for a kilo were almost 200CFA lower than the average export price - 298CFA per kilo. Furthermore, although recent data shows rising cashew prices, the gap between export and farmgate cashew prices has increased reaching 356CFA per kilogram in 2020 constraining the income growth of farmers and reducing their ability to escape poverty.

[14] A new national poverty line was constructed in 2021/22 instead of using inflation to update the 2018/19 line because the fixed CPI basket doesn't allow for any substitution effects, which could overstate poverty rates given the price shocks experienced between 2018 and 2021. The poverty line is constructed in two stages. A basket of goods of the country's food consumption that allows an individual to satisfy his daily nutritional needs of 2,300 kilocalories is retained and valued to provide a food poverty line. The non-food-poverty line is a portion of the non-food consumption expenditure of households located around the food poverty line. The sum of the two poverty lines gives the national poverty line. The timing of the implementation of the 2018/19 and 2021/22 surveys was not identical. In addition, the 2021/22 welfare aggregate excludes hospitalization expenditures and the rent imputation method for rural areas differs from 2018/19.

[15] The recent World Bank Systematic Country Diagnostic (SCD) update- September 2023, discusses in detail the extent to which lack of inclusiveness and low rural productivity continue to constrain growth, inclusion and sustainability- https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099110323163018763/bosib0f7d3f3e401e0a2a3015c9e962aff5

Figure 1.9. Changes in monetary poverty indicators 2018/19–2021/22 by area of residence



Source: World Bank calculations based on EHCVM 2018 and 2021.

The rural-urban disparities in well-being may also have been further exacerbated by the faster post-COVID-19 recovery of the services sector – which employs most of the urban households. For instance, the services sector grew by 7.5 percent in 2021 – from 0.35 in 2020 and 3.2 in 2018; mitigating the adverse effects of the COVID-19 pandemic thereby resulting in a smaller increase in poverty in urban areas relative to rural areas.

Regional disparities in monetary poverty trends persist with the highest incidence of poverty observed in the regions of Oio, Gabu Quinera. The region of Oio continues to record the highest incidence of poverty with 72 percent of the population being poor in 2021– about an 8.3 percentage point increase from its 2018 levels (see Figures 1.10a and 1.10b). The lowest incidence of poverty is reported in the Bissau region where 21 percent of the population are poor – relatively the same rate in 2018. The largest increase in poverty between 2018 and 2021 was recorded in the regions of Gabu and Biombo where poverty increased by 14 and 12.3 percentage points during the period (Figure 3b)- resulting in Gabu becoming the region with the second-highest incidence of poverty as of 2021. Despite overall increases in poverty, the regions of Cacheu, Bolama/Bijagos, and Bafata experienced reductions of 7.5, 5.6, and 2.3 percentage points respectively in the incidence of poverty over the period.

More than half (55 percent) of the poor are concentrated in the regions of Oio, Gabu, and Bafata. In addition to having a high incidence of poverty, the regions of Oio and Gabu are home to 23.7 and 17.1 percent of the poor people in Guinea Bissau respectively (Maps 1.1a and 1.1b). Both regions recorded an additional over 30,000 poor persons each in 2021. Furthermore, the region of Bafata has the third highest share of the poor population (14.6 percent) despite a 2.3 percentage point decline in poverty during the period. Similarly, Bissau which has a low incidence of poverty, has a slightly higher share of the poor -11.5 percent of the poor. In contrast, the decline in poverty in the regions of Cacheu and Bolama/Bijagos resulted in over 10,000 and 1,000 fewer poor persons respectively (Figures 1.10c and 1.10d).

1.3. Outlook and risks

Early signs indicate that the 2024 cashew campaign promises to be strong, which will support real economic growth of 4.7 percent. Cashew production is expected to be strong again due to favorable weather conditions and as

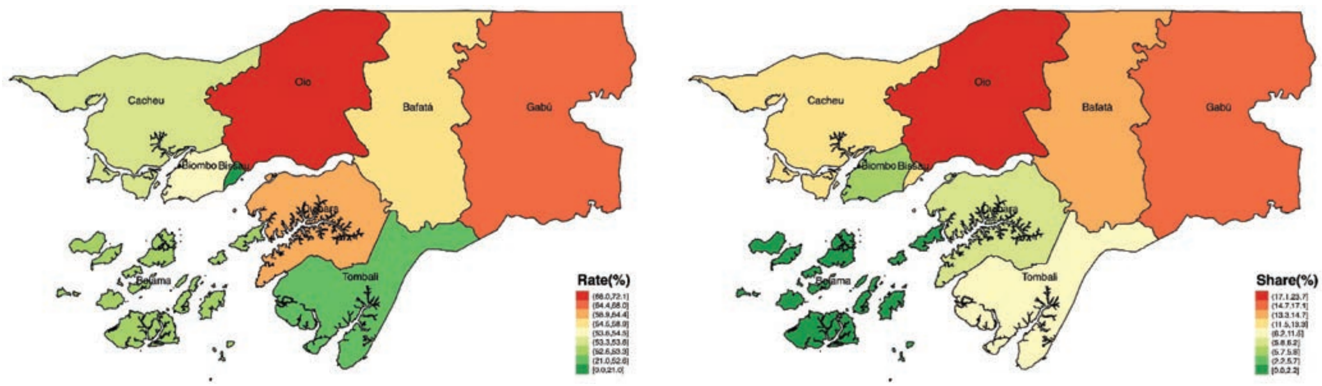
Figure 1.10. Poverty trends by region: 2018/19–2021/22

Source: World Bank staff calculation based on EHCVM 2018/19 and 2021/22.

Map 1.1. Poverty indicators by region (EHCVM 2021)

a. Poverty rate

b. Share of poor population



Source: World Bank calculations based on EHCVM 2021/22. A new national poverty line was constructed in 2021 instead of using inflation to update the 2018 line because the fixed CPI basket doesn't allow for any substitution effects, which could have otherwise overstated poverty rates given the price shocks experienced between 2018 and 2021.

government investments into agricultural inputs over the last few years pay dividends. In contrast to the previous two years, however, exports should markedly improve as nine overland border routes become authorized for exports, curtailing smuggling.[16] Historically, only cashew exports via the port of Bissau were authorized so this should contribute to the growth of processing in neighboring countries, potentially creating new export options.[17] Global geopolitical developments may also create domestic opportunities for growth in Guinea-Bissau. Maritime disruptions in the Middle East have driven rising Asia-Europe freight costs which has translated into a growth in demand for cashew from Africa.[18] This disruption allows a premium of 0.2 to 0.3 US$/kg over cashew of Vietnamese origin on spot contracts.[19] This demand for African cashew to avoid Middle East trade lines coupled with cheap electricity from OMVG (Box 3) could stimulate expansion of the processing sector in Guinea-Bissau where capacity to transform cashew is currently limited to 10,000 tons.[20] This presents a potentially positive step towards increasing the value chain of the main productive sector in the country. Despite maritime trade risks, Chinese firms should enter the market for processing in Asia, competing with India and Vietnam for Bissau-Guinean cashew, creating new trade links.

Easing inflationary pressures along with strong demand for cashew will drive growth on the demand side. On the demand side for the cashew sector, most Western and Chinese importers are covered for their first-quarter needs

[16] To be legal, they must pass through specific customs posts: i) East (Bafata - Cambadju, Pitche, Pirada and Bruntuma); ii) North: (São Domingos, Djeguê, Oio/Farim (Dungal); iii) Sul (Tombali - Quebo).

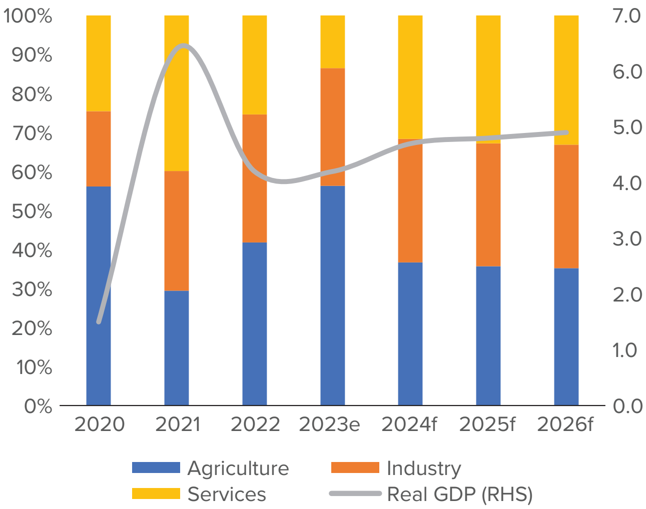
[17] It is unclear how the borders will be monitored given how remote they are, potentially opening the door to inaccurate reporting of trade figures. Some of the hundreds of reforms requested by donors in exchange for aid commitments after the 2014 Brussels Roundtable included additional monitoring of customs outposts at land borders but there was little political will to implement these reforms.

[18] An escalation of political tensions in the Middle East has resulted in Houthi attacks on international merchant ships in the region, prompting a military response from select Western countries.

[19] Vietnam is the world's largest exporter of processed cashew.

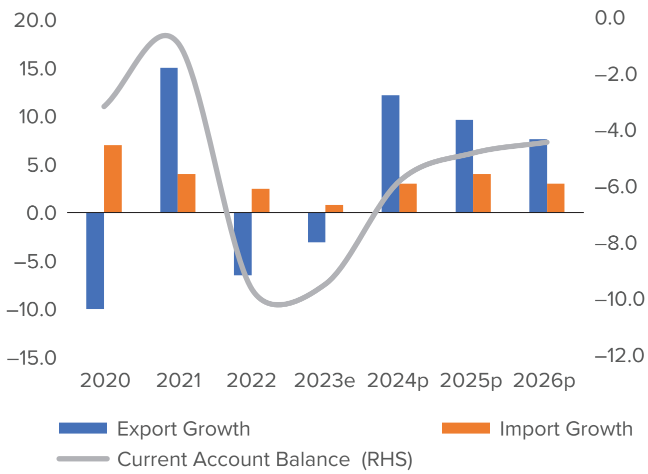
[20] Guinea-Bissau currently has the second most expensive electricity tariff in Africa, and this is widely seen as an impediment to private sector development.

Figure 1.11. Sectoral share of GDP



Source: World Bank estimates.

Figure 1.12. Current account balance (Percent of GDP)



Source: World Bank calculations.

and are also awaiting information to complete their orders for the second and third quarters of 2024. Vietnam has released strong figures for cashew imports and exports in 2023, indicating that there will be high demand for the 2024 campaign. Additionally, the access road to the port has been restored which should remove a barrier to exports from the 2023 campaign. The access road is part of a larger urban road investment program which will stimulate the construction sector. On the demand side more broadly, inflationary pressures will continue to ease, stimulating private consumption.

Following the worldwide trend, inflation is expected to have already peaked and is projected to fall to 4.5 percent in 2024. Inflation stabilized in 2023, as supply disruptions abated, and fuel and energy prices stabilized. Over the mid-term, the country's membership in the WAEMU economic and monetary zone, which provides a strong nominal anchor with its peg to the euro, and the government's commitment to fiscal consolidation will keep inflation contained, converging to an estimated 2 percent by 2026. The monetary stance is expected to remain accommodative, with the BCEAO helping to maintain liquidity in the banking sector by increasing domestic credit in the economy in the mid-term, growing 13.7 percent in 2024 to 236.4 billion CFA and increasing to 297.5 billion CFA in 2026. This may exacerbate problems with NPLs within the banking sector.

Decreased external pressure in 2024 as fuel and food prices stabilize as well as improved cashew exports will cause the CAD to contract to 5.7 as a percent of GDP. As inflation falls, the costs of imports for essential goods, such as food and fuel, as well as the capital goods needed for investments in road recovery will complement the expected higher cashew exports and cause the CAD to narrow. Despite higher cashew nut exports, the high dependence on imports for basic needs and investments prevents quick changes in the CAD. As such, the CAD is projected to only marginally decrease in 2025 and 2026, at 4.7 and 4.4 percent respectively, as import costs fall (Figure 1.12).

The authorities are committed to fiscal consolidation to ensure medium-term debt sustainability. The fiscal deficit is projected to narrow in 2024 to 4.8 percent of GDP (on a commitment basis), from 7.6 percent. This assumes that the OMVG electricity line from neighboring Guinea is activated and remains activated (Figure 1.13), progress is made in the public financial management reform

Figure 1.13. Karpower vs OMVG costs (millions of dollars per month)

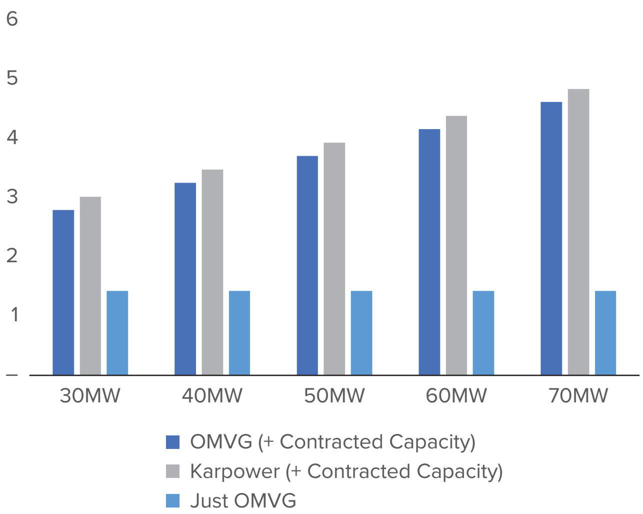
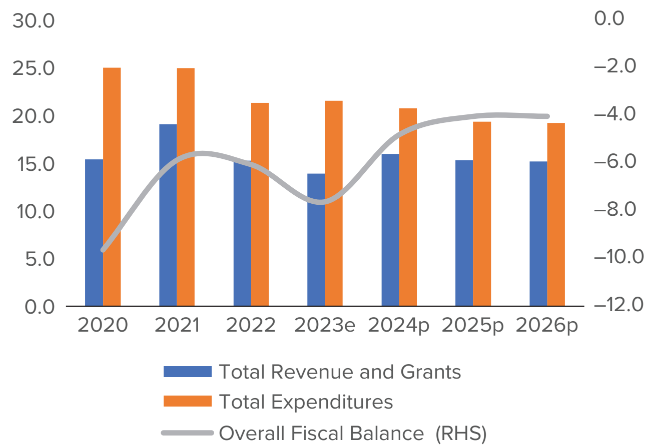


Figure 1.14. Fiscal performance (percent of GDP)



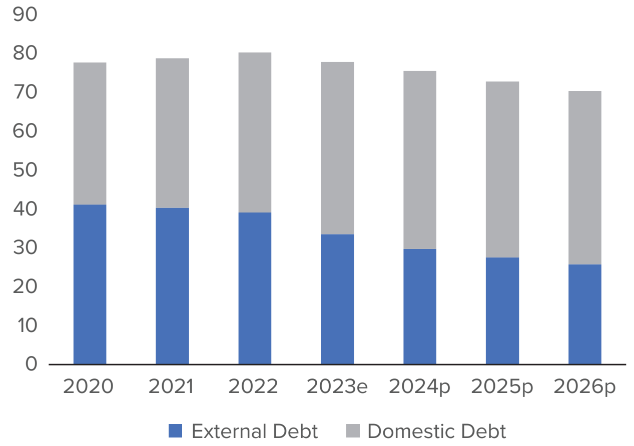
Source: World Bank calculations.

space,[21] and commitments to grant-funded budget support materialize. OMVG will reduce the overspending on EAGB and Karpower-related non-budgeted expenses that have driven the fiscal deficit. Annulation of the fixed cost capacity contract with Karpower will result in huge fiscal savings, approximately equal to the entire health sector expenditure for 2023, and cheaper electricity for consumers in the country, removing one of the main constraints on private sector development which should result in higher fiscal revenue (Box 3). Concurrently, the World Bank has begun supporting the government's fiscal consolidation commitment with a governance project aimed at rationalizing expenditure, controlling the wage bill, and improving cash management by supporting the government with the implementation of a treasury single account. Similarly, to support the same objectives, the ongoing IMF ECF program will support the implementation of needed structural reforms to bolster domestic revenue collection and reduce expenditure. The fiscal deficit is still set to eventually narrow to 3 percent and the debt ratio to 70 percent of GDP in the mid-term, aligning with the WAEMU convergence criteria (Figures 1.14 and 1.15).

There is untapped potential for economic diversification and additional revenue sources. The government has revisited the possibility of allowing the mining of bauxite and phosphate reserves in the country, which will help diversify exports and has the potential to positively impact the country's growth and fiscal revenue. However, there is reluctance to begin investment and extraction as there is no legal framework in place to ensure environmental protection, due to the location of the reserves in the bend of a river. Despite this, a mining project with an investment of US$200 million has begun near Farim. The company has started building temporary accommodations for the workers and relocating locals, but progress has stopped because of changes to the mining agreement. Although uncertain, if the project goes ahead, estimates suggest that

[21] The graph shows three scenarios: 1) monthly cost of continued usage of Karpower for electricity consumption plus the fixed cost contracted capacity payment that EAGB has to pay to Karpower, even if no Karpower generated electricity is consumed; 2) monthly cost of OMVG generated electricity for consumption plus the fixed cost contracted capacity Unit costs for electricity are all factual and confirmed; and 3) monthly cost of electricity consumed solely from OMVG and if a resolution to the Karpower contract is found, removing the fixed cost contracted capacity. However, some assumptions have been made: i) the contract conditions remain the same as they are at present, including length of the contract, fixed cost production capacity, and unit costs; ii) a 30-day month; iii) electricity demand of 30mw – currently energy demand averages at 20mw and peaks at 24 but the cement factory alone uses 6mw and World Bank financed projects are working to expand electricity access around the country, increasing demand.

Figure 1.15. Debt performance (percent of GDP) using the latest DSA*



Source: Joint World Bank/IMF DSA.
*This version of this DSA reclassifies BOAD debt as external debt.

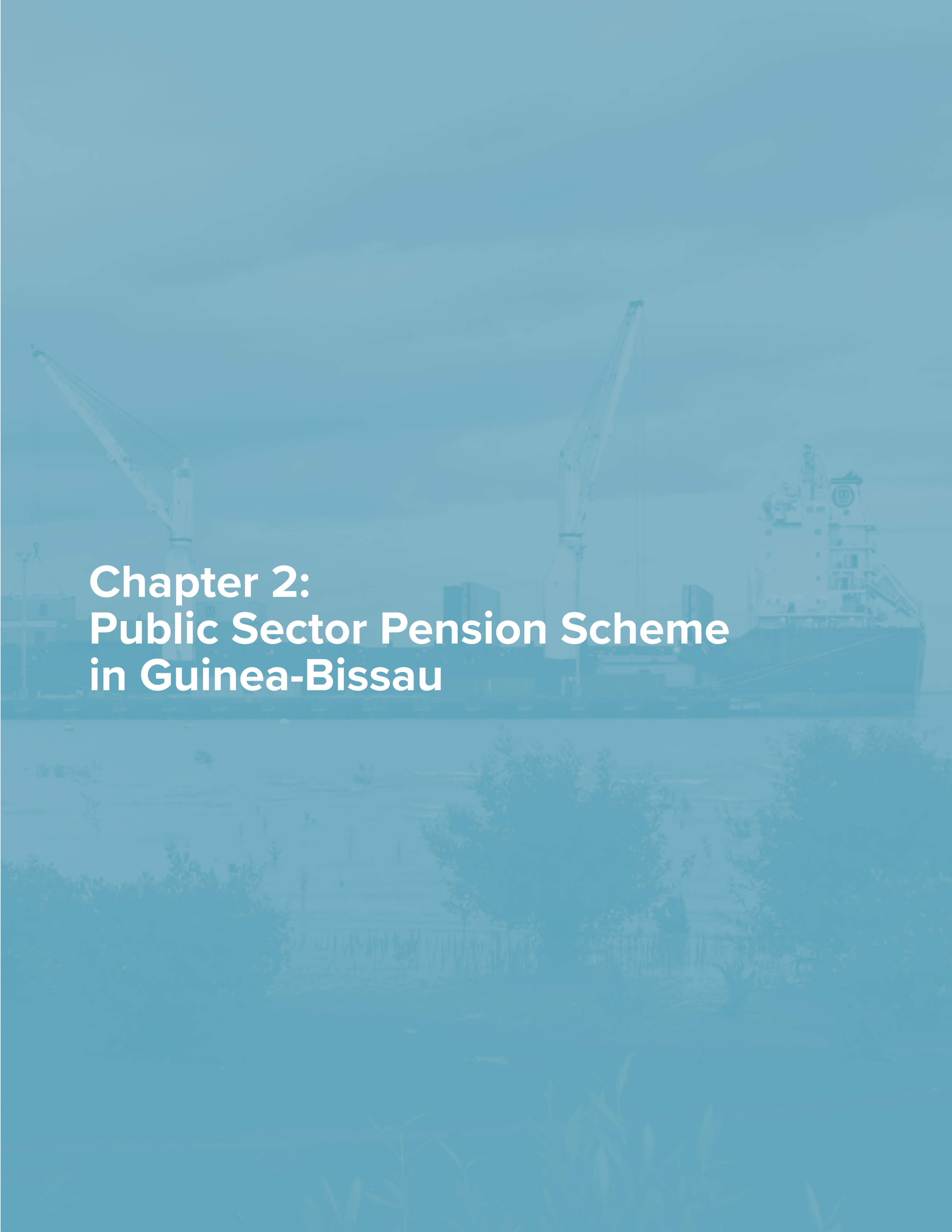
the project could increase GDP by 8 to 16 percent and fiscal revenues by about 50 to 80 percent during the exploration years, both in nominal increase terms. EAGB and the SIB continue to represent large fiscal risks, as outlined above.

Public debt is expected to fall to 75.6 percent of GDP in 2024 and meet WAEMU convergence criteria by 2026. Despite the projected economic growth, the financing requirements will remain high over the mid-term, with a financing gap of approximately 0.7 percent of GDP each year due to the large wage bill, and a considerable rise in interest payments and investments to ensure economic development. This gap is expected to be covered mainly by grants and external concessional loans, as the government looks beyond BOAD, whose loans to date are almost entirely non-concessional[22]. In the mid-term, the government is committed to filling the financing requirement from multilateral external creditors on concessional terms. Strengthened investment planning and execution to ensure value for money and better alignment with the budget process will also contribute to the decline in public debt.

The outlook is uncertain and subject to substantial downside risks related to political instability, global geopolitical tensions, and climatic shocks. Political stability is crucial to maintain the authorities' commitment to a stringent macroeconomic policy framework, including: (i) fiscal consolidation; and (ii) prudent borrowing, to put debt on a consistent downward trend and achieve debt sustainability in the medium term. Political instability from a constitutional crisis in December 2023 resulting in the dissolution of parliament could also affect political support for revenue mobilization and expenditure containment measures, as well as deterring both domestic and international private investment. There is an unknown electoral calendar for both legislative and presidential elections. It is not clear how both elections will be financed, and this could also create instability. Recent regional and international geopolitical uncertainty only threatens to stoke domestic tensions further.

Global commodity market shocks, SOEs, and the banking sector also present potential risks. In addition to risks arising from volatile global food and oil prices, weaker cashew nuts exports and lower-than-expected donor support may impact the outlook. Financial stress in state-owned enterprises, such as EAGB (Box 1.3), and banking sector fragilities could also generate contingent liabilities adding to fiscal pressures. An increased severity of the prolonged Russian invasion of Ukraine could impact the economic outlook if it continues to cause supply chain disruptions. Furthermore, if disruptions to commodity trade routes to Asia worsen owing to an escalation in the Middle Eastern conflicts, this could have a negative impact on the growth outlook. If downside risks materialize, social tensions could increase, constraining fiscal adjustment, reform implementation, and increasing debt vulnerabilities. There are also downside risks related to weather events, particularly drought or flooding, severely impacting the agriculture sector.

[22] BOAD debt constitutes 17 percent of overall debt and is the country's largest creditor.



Chapter 2: Public Sector Pension Scheme in Guinea-Bissau

2.1. Introduction

Tight fiscal space and rising debt levels have limited crucial investments in economic and human capital to advance Guinea-Bissau's economic growth and development goals. The authorities' economic program to overcome this issue involves ambitious objectives to strengthen the fiscal position and move towards fiscal consolidation. The challenges are significant including a costly public service pension system, which consumed 6.8 percent of overall expenditure in 2023, equating to approximately 10 percent of fiscal revenue or a third (32.9 percent) of overall social sector spending.[23]

The current pension system in Guinea-Bissau consists of two parallel systems: (i) public sector schemes which consist of a contributory public service pension scheme for public sector workers, the military[24] and political office bearers and a non-contributory public pension scheme for veterans; and (ii) a contributory social security pension scheme that covers private-sector employees and employees of state-owned enterprises. The public sector schemes are managed by the Pensions Unit in the Ministry of Finance while the private sector scheme is managed by the National Social Security Institute (INSS).

In 2015, the authorities took initial steps to reform the public service pension scheme. The 2015 budget law included provisions to deduct 6 percent from the payroll of all public employees and deposit the amounts in a special account jointly managed by the Ministry of Public Administration and the Ministry of Finance. A decree in 2015 also mandated the creation of a Special Pension Fund to provide one-off payments and pensions to the Defense and Security Forces. However, to date, the implementation of these reforms has not materialized including the provisions of the 2015 Budget Law.

The objective of this note is to analyze recent developments, challenges, and prospects for public sector schemes including fiscal sustainability, adequacy, and administrative challenges. This note does not cover the scheme for the private sector which is analyzed in other documents including a note on pension (World Bank, 2016) and the more recent Public Expenditure Review for Guinea-Bissau (World Bank, 2022). Also, this note does not include two schemes that are not related to old age: (i) the social assistance program which transfers 10,000CFA on a monthly basis to invalid persons (368 beneficiaries in June 2023); and (ii) a program that pays military and paramilitary officers who are retired but can be called upon at any time (*Reserva*) (1,082 beneficiaries in June 2024).[25]

The note relies on detailed payroll datasets for the month of June 2023 provided by the Ministry of Finance. It also uses the January 2016 payroll data used in the 2016 note on pension to analyze the recent evolution of the schemes as well as an August 2021 database used for the 2022 Public Expenditure Review.[26]

This note is structured as follows. The first section discusses the characteristics of the public sector pension schemes. The second section presents an analysis of these schemes, focusing on coverage, cost, and sustainability. The analysis presents medium and long-term fiscal expenditure scenarios based on available information. Finally, the third section presents some concluding remarks and policy recommendations.

[23] Social sector spending is defined here as expenditure for the Ministry of Education, the Ministry of Health, and the Ministry of Women, Family and Social Solidarity.

[24] Military personnel only started contributing to the pension scheme in 2018.

[25] The August 2019 payroll database included 1,145 reservists paid 284.51 million CFA (equivalent to US$446,000) while the June 2023 payroll database included 2,082 reservists paid 282.01 million CFA (equivalent to US$462,000). Consequently, the payment to reservists per annum can be estimated to hover around US$5.5 million (US$462,000 x 12 months).

[26] The data for 2016 and 2023 are perfectly comparable as the two datasets were retrieved from the same source: the payroll data from the Ministry of Finance. It is however noteworthy that information retrieved for 2023 is more complete, as it contains more information for each individual in the dataset (for example date of entry into the payroll system). The comparability between these two datasets and the data for 2021 is however more restricted. The data for 2021 relies on other sources besides the payroll data from the Ministry of Finance.

2.2. The public sector pension scheme: Description

The public sector pension system in Guinea-Bissau consists of two pension schemes: (i) a contributory[27] public service pension scheme that covers civil servants, the military, and political office bearers; and (ii) a non-contributory public pension scheme for veterans. It is structured as an earnings-related, defined benefit, pay-as-you-go scheme[28] where 6 percent of civil servants and military personnel base salaries are deducted from their paycheck. Although the system is contributory, the contribution is notional, and pensions are paid out of general fiscal revenues. In practice, there is no transaction of funds corresponding to the civil servants' 6 percent payroll deduction. Also, in practice, the percentage of **contribution depends on the beneficiary in an unexplained manner**.[29] The Government does not formally contribute to a pension fund to back up its liabilities and there is no ring-fenced fund in which these contributions accumulate, nor is there an explicit subsidy from the government for pensions.

There are three categories of pensioners in the public sector pension schemes, as follows:

a. **Regular pensioners** (*Pensões Reforma*): These are retired public servants (civil servants, the military personnel, and political office bearers)[30] who are receiving a pension under the public service pension scheme.
b. **Pending pensioners** (*Pensões em Situação de Reforma*): Pending pensioners are retired public servants who have retired and applied for a pension but whose pension has not been fully processed.
c. **Veteran pensioners** (*Pensões Combatentes*): These pensioners include individuals who fought during the War of Independence and their ascendents and descendants.

2.2.1. Design parameters

The **regular pension scheme** is a defined benefit scheme. The system's parameters feature a retirement age of 60, a minimum of 15 years of service requirement to get a pension (this is called the vesting period), a 2.8 percent increase per year of service (this is called the accrual rate), and a pension base equal to the average of the last two years of service (Table 2.1).[31] Thus, the minimum replacement rate a retiree can get is 42 percent of the average of the last two years of service (i.e., 2.8 percent times 15 years of service), while someone with 36 years of service in the public sector receives a lifetime pension equivalent to 100 percent of the average of the last two year's salary. After 36 years of service, the accrual rate decreases to 2.5 percent up to a maximum of four years. This implies that someone who works in the public sector can receive a maximum pension equal to 110 percent of his average base salary during his last two years of service.[32]

The **pending pension scheme** is a transitory scheme for retired public servants until their pension request has been fully processed at which time, they are transferred to the regular pension scheme. Pensioners in the pending pension

[27] Contributory means that participating employees in the pension scheme are required to support the scheme with contributions.

[28] Earnings-related means that pensions are based on the beneficiary's earnings. Pay-as-you-go (PAYG) in its strictest sense, is a method of financing whereby current pensions are paid out of current revenues from contributions. When revenues are higher than expenditures (which is not the case in this particular scheme) some reserves could be accumulated, hence PAYG could be fully or partially funded. Defined benefit (DB) means the pensions are calculated based on a prescribed formula (benefit formula) that usually considers several factors - mostly length of employment and salary history.

[29] In practice, pension contributions vary between 0.3 percent and 17.8 percent, despite the well-established rule of 6 percent contributions from all individuals that receive from the Public Treasury. There was no discernable relationship established between the characteristics of different contributors and contributions made.

[30] This includes the members of parliament who receive a life pension after completing two electoral cycles. Their pension is transferred to their survivors (children and spouse).

[31] The regular scheme and pending pension schemes do not provide for survivor benefits. Nor do they provide benefits in case of illness or accident. However, the cost of a trip is covered on a case-by-case basis for illnesses that require travel abroad, to Dakar for example.

[32] $100\% + 2.5\% \times 4$ years = 110%.

Table 2.1. Parameters of the regular public sector pension scheme

Parameter	Value
Contribution rate	Employer: 6 percent, Employee: 0 percent
Retirement age	60 years
Minimum years of service required for benefit eligibility	15 years
Maximum years of service	36 years
Accrual rate	Accrual rate: 2.80 percent Pension = Base salary × years of service/36
Pension base	Average of last two years' base salary
Indexation of pension	None
Survivor pension	The survival benefit for civil servants upon death is six months of salary/pension. For politicians, survival benefits are 75 percent of salary/pension split between spouse (40 percent) and children (60 percent).

Source: Ministry of Finance.

scheme receive a pension equal to 80 percent of their pre-retirement salary. Transfers to the regular pension scheme depend on the lengthy process that takes place between claiming the benefits and receiving payments but also the overall availability of public funding.

The **veteran pension scheme** is similar to the regular pension scheme with two exceptions. First, years worked before April 25, 1974 (year of independence) are counted as double the actual years of service, and the years worked by non-war veterans before September 9, 1974, are counted as 1.2 times the actual years of service. Second, survival benefits extend to spouses and children and also to the veteran's ascendants and descendants. Today, there is no direct (even notional) contribution to this scheme as the former combatants and veterans who benefit from this scheme have retired long ago).

2.2.2. Administration of the public service pension scheme

The process of receiving a pension is a complex and lengthy manual process, with many steps and stakeholders. The retiree starts by filing a retirement claim with the supervising ministry. Then, the process involves the Ministry of Finance, the Prime Minister's Office, the Ministry of Public Administration, the Council of Ministers, the Budget Department, the Court of Accounts, and the General Directorate of the Public Service (Table 2.2). Each institution works on the retirement file in succession, and the process leads to the issuance of a pension under the pending pension scheme while the procedure continues with the reconciliation of the career history. In the end, several double checks and signatures are needed before the final pension is issued. Also, if for whatever reason the paperwork is lost by either side, which anecdotally happens a lot, the pending pensioner has to start the whole process again.

There is no legislation that establishes a systematic process to request proof of life. The last mass requests to deliver proof of life were done in 2017 and 2023. Otherwise, the removal of individuals from the pensions lists is only done if someone reports the death of the pensioner or if there is an issue identified through the banking system.

There are no revisions of the value of the pension from the regular pensioners. Once established, this value is fixed. However, the value for the veteran's pension is indexed to the minimum wage, while the pension for members of parliament is indexed to the current salary.

All pension payments that exceed 28,000CFA are paid using the banking system. However, for pension payments below 28,000CFA it is not mandatory to use the banking system. Alternatives such as mobile money can be used to make these payments. Additionally, the Ministry of Former Combatants distributes the former combatants' pensions directly in certain locations across the country, as there is also no mandatory requirement to use the banking system.

Table 2.2. Procedure to process a public sector pension

Step	Entity	Activities
1	Retiree's supervising ministry	• Collection of pension files • Issuance of notes to the Ministry of Finance for calculations
2	General Secretariat, Ministry of Finance	• Issuance of statement certificate
3	Prime Minister	• Validation of seniority • Setting of pending annual pension • Publication in the Official Journal
4	Ministry of Public Administration, Labor, Employment, and Social Security	• Process compliance validation • Seniority calculation • Fixing pending annual pension • Producing financial statement of retiree's position
5	Prime Minister, Council of Ministers Secretariat	• Sign financial statement of retiree
6	Ministry of Finance, Budget Department	• Receipt of retiree's financial statement • Production of budget cover note
7	Court of Accounts	• Approval of budget cover note
8	General Directorate of the Civil Service	• Extract from financial statement given to retiree • Publishing extract and accompanying note in the Official Journal
9	General Directorate of Operations, Ministry of Finance	• Database registration
10	Ministry of Finance, Treasury Department	• Payment of retiree's pension

Source: World Bank.

2.3. The public sector pension scheme: Analysis and challenges

2.3.1. Design parameters

The 60-year retirement age under the public service pension schemes is in line with international yardsticks. Life expectancy at retirement age determines the length of time during which people collect pensions. Retirement age for the public service pension scheme in Guinea-Bissau is 60 for both men and women while life expectancy at age 60 currently stands at 15.5 years on average.[33] This is in line with the international yardstick of 15 years for the "ideal" duration of pension benefits. As such, the current retirement age of 60 is not particularly low relative to life expectancy.[34] Also, legislation allows for civil servants aged

[33] There is a lack of data in Guinea-Bissau allowing for an accurate life expectancy at 60 but the WHO Global Health Observatory data repository calculates the life expectancy at 60 for Bissau-Guineans to be 15.5 years (13.9 men and 16.7 women) in 2019. Civil servants may expect to live longer however, owing to privileged access to state-financed health care in Portugal and Senegal and a higher-than-average salary and therefore standard of living in Guinea-Bissau.

[34] It is however important to note that reviewing the retirement age as life expectancy increases in the country is useful. The same WHO data repository shows that life expectancy at 60 was 15 years in 2015 (13.4 for men and 16.3 for women), 14.6 in 2010 (12.9, 16), and 13.8 in 2000 (12.1, 15.4). Thus, it is reasonable to assume that this will need reassessment in the near future as life expectancy at 60 continues to increase. Note that considering life expectancy at 60 years old to be 15.5 years, the contribution rate to match the 2.8 percent accrual rate would have to be 43.4%. See Annex 1.

at least 35 years old and with 15 years of service to qualify for pension benefits. The data indicates that there are people exercising this option as there are pensioners below the statutory retirement age of 60.

The public service pension benefit formula leads to generous benefits relative to pre-retirement salary. At 2.8 percent, the accrual rate of the public service pension scheme is one of the highest in the Africa region. The accrual rates in high-income countries (1.2 percent on average), which are fiscally sustainable and international best practice, are nearly half the average accrual rates of 2.2 percent in fifteen Sub-Sahara African countries, and less than half the accrual rate in Guinea-Bissau (Table 2.3). Annex 1 shows that a contribution rate of 6 percent is much too low to cover future pension payments when the accrual rate is 2.8 percent, or equivalently, that an accrual rate of 2.8 percent is much too high to cover future pensions when the contribution rate is 6 percent. In fact, for the pension system to be in balance, the contribution rate should be increased from 6 percent to 16.8 percent if the accrual rate is maintained at 2.8 percent or the accrual rate should be decreased from 2.8 percent to 1 percent if the contribution rate is maintained at 6 percent.[35]

Calculating the public service pension based on the average of the last two years of base salary (instead of a longer period) leads to higher pensions. Salaries in the public sector tend to monotonically increase with age. The average salary of civil servants (including military and reserve personnel) who are 58 years of age (158,258CFA) is 27.2 percent above that of civil servants who are 25 years of age (124,463CFA) while the median salary remains broadly unchanged (Figure 2.1).[36] However, this average salary jumps by 40.3 percent (from 158,258CFA to 222,089CFA) in only two years just before retirement from the age of 58 to the age of 60. Using the average of the last two years of salary as the basis for pension calculation generates perverse incentives to inflate wages or seek higher compensation just before retirement. Salaries during the last few years of work increase abnormally when these last few years of salaries determine the pension amount. This may result from administrative norms or habits, collusive behaviors between supervisors and workers, or incentives for opportunistic behavior by employees who look for higher-remunerated jobs a few years before retirement. The latter possibility does not seem to apply in

Table 2.3. Accrual rates of public sector pension schemes in selected Sub-Sahara African countries (2023)

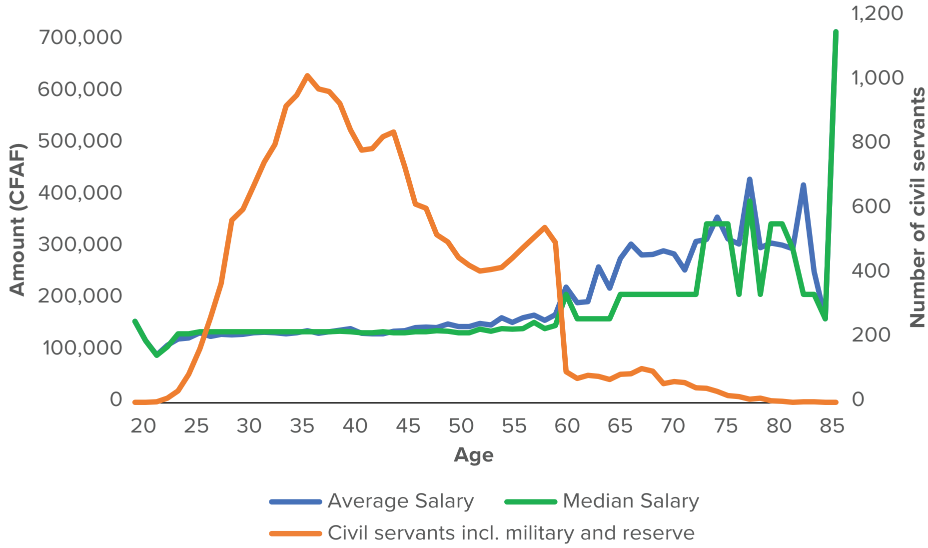
Country	*Accrual Rates*
Cabo Verde	2.9%
Mozambique	2.9%
Guinea-Bissau	**2.8%**
Mauritania	2.7%
Togo	2.5%
Uganda	2.4%
Namibia	2.4%
Cameroon	2.0%
Burkina Faso	2.0%
Madagascar	2.0%
Zambia	1.8%
Senegal	1.8%
Cote d'Ivoire	1.8%
Tanzania	1.7%
Mauritius	1.7%
Average	**2.2%**

Source: World Bank.

[35] The current system is by design unsustainable. Financial sustainability of a defined benefit pension scheme financed on a pay-as-you-go basis is achieved by balancing retirement benefits with the contributions paid to earn the pensions rights. There is a fundamental misalignment of the low contribution rate with the promised benefits at the current retirement age.

[36] This trend raises serious incentive issues and may explain the general low motivation of public servants whose salaries in real terms are eroded as they accumulate experience.

Figure 2.1. Average monthly (net) salary and total number of civil servants including military and reserve by age



Source: June 2023 payroll data. Ministry of Finance.
Note: Average salary of active civil servants: 142,808CFA; Std. Dev: 94,627.3; N: 27488.

Guinea-Bissau as only 2 percent of individuals have changed job category between 2021 and 2023.[37]

2.3.2. Pensioners and expenditures

The three public service pension schemes pay widely different pension amounts. According to the payroll database, the Ministry of Finance paid 7,045 pensioners in June 2023 (Table 2.4). Of the total number of pensioners, 28 percent (1,964 individuals) were regular pensioners, 48 percent were pending pensioners (3,385 individuals), and 24 percent (1,696 individuals) were veterans. The ratio of pending pensioners to regular pensioners was 1.72. Total monthly payments made under the three schemes amount to 862 million CFA (equivalent to US$1.4 million at the exchange rate of 611CFA/US$).[38] The average monthly pension amounted to 122,307CFA (US$200). In Guinea-Bissau's context, this amount is substantial: it is almost three times per capita GDP and represents 86 percent of the average public sector salary. The average monthly pension received by regular pensioners (208,350CFA) is more than twice that received by pending pensioners (102,498CFA) which is itself 65 percent higher than that received by veterans (62,204CFA). The average pension for veterans, the category with the lowest average pension, still represents 1.4 times per capita GDP despite representing only 44 percent of the average public sector salary. Pending pensioners are expected to collect higher pensions once their pensions are processed and classified as regular pensioners.

According to the June 2023 payroll data, annual expenditure on the three public service pension schemes can be estimated to hover around 10.3 billion CFA (around US$16.9 million) (Table 2.5).[39] This amount represents

[37] Matching the active and retires population between 2021 and 2023 shows that 524 individuals have changed category between these two dates.

[38] The exchange rate of 611CFA/US$ is used throughout the paper.

[39] There is a discrepancy between the pensions payment data on the payroll and the pensions payment data in the system that collates executed expenditure, SIGFIP. The latter reports 10.9 billion CFA for 2023 for public sector pensions for the whole year and just 5.3 billion CFA until the month of June.

Table 2.4. Public service pension schemes (June 2023)

Schemes	Pensioners		Monthly Pension Payment		Average Monthly Pension (CFA) (B/A)	Average Pension (% of Per Capita GDP) 1/	Average Pension (% of Average Public Sector Salary)
	Number (A)	Percentage of Total	CFA Million (B)	Percentage of Total			
Regular pension	1,964	28%	409.2	47%	208,350	481%	146%
Pending pension	3,385	48%	347.0	40%	102,498	237%	72%
Veteran pension	1,696	24%	105.5	12%	62,204	144%	44%
Total	**7,045**	**100%**	**861.7**	**100%**	**122,307**	**282%**	**86%**

1/ Per-capita GDP (2023) = 519,895 CFA (World Development Indicators and IMF 2022 Article 4).
2/ Average monthly public sector salary of 142,808 CFA from the June 2023 Payroll database.
Source: June 2023 payroll data from the Ministry of Finance.

Table 2.5. Public expenditures on pensions

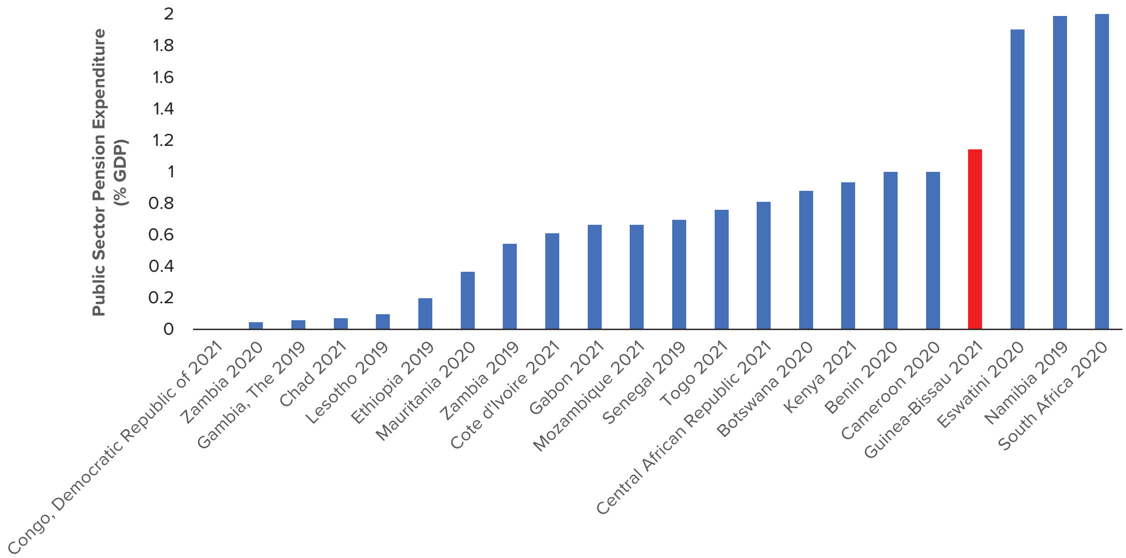
	2016	2021	2023
Pension payments (CFA billion) 1/	8.0	10.8	10.3
% of GDP	1.14	1.14	0.96
% of domestic revenue (tax and non-tax)	9.5	9.4	6.9
% of public expenditures	5.5	5.2	4.4
% of wages and salaries	23.0	19.0	17.9
Memo:			
Nominal GDP at market prices (CFA billion) 2/	698.7	943.7	1081.3
Domestic revenue (tax and nontax) (CFA billion) 2/	84.3	114.9	149.9
Public expenditures (CFA billion) 2/	144.5	206.1	237.4
Wages and salaries (CFA billion) 1/	25.6	37.1	47.1

1/ Monthly pension payments and wages and salaries from the January 2016, August 2021 and June 2023 databases multiplied by 12 months.
2/ From IMF 2018 and 2022 Article 4 (Tables 2.1 and 2.3).
Sources: January 2016, August 2021 and June 2023 databases from the Ministry of Finance and IMF.

9.9 percent of fiscal revenue and 4.3 percent of total expenditure. It is also equivalent to 18 percent of wages and salaries. Therefore, a 6 percent contribution rate is largely insufficient to finance public pensions. In fact, 18 percent of active public servants' (net) wages and salaries would be needed to fully fund the current pensions. This contribution rate could be shared between the public servants and the state.

Expenditures on public pensions dramatically increased from 2016 to 2021 but then decreased from 2021 to 2023 (Table 2.5). Public expenditures on pensions increased

Figure 2.2. Expenditures on public pension (percent of GDP in selected Sub-Saharan Africa economies)



Source: World Bank.

from 8.0 billion CFA in 2016 (representing 1.14 percent of GDP) to 10.8 billion CFA in 2021 (1.1 percent of GDP) but decreased to 10.3 billion CFA in 2021 (1.0 percent of GDP).[40]

At 1.14 percent in 2016 and 2021,[41] **spending on public service schemes as a percentage of GDP is comparable to that of other countries in the region** including middle-income and high-middle-income countries (Figure 2.2). As shown in Figure 2.2, Guinea-Bissau is among the countries with the highest expenditures on public pension as a percentage of GDP.

2.3.3. Very few pensioners benefit from the bulk of pension payments

Importantly, pension payments overly benefit a very small fraction of beneficiaries (Figure 2.3). In 2023, the 71 pensioners with the highest pension under the regular pension scheme (they are mostly retired judges or people who held political offices) represent 3.6 percent of the 1,964 persons who benefit from this scheme while their pensions represent 25 percent of all pension payments made under this scheme. Their average monthly pension is 1.4 million CFA (approximately US$2,324). In fact, under the regular pension scheme, 14 percent of all pensioners (representing 277 individuals) receive half the total pension paid under the scheme while the remaining 86 percent (representing 1,687 individuals) receive the second half. The other schemes also largely benefit a few: one-quarter of the pending pensioners receive half of all payments made under the pending pension scheme while 20 percent of the veterans get 40 percent of all payments made under the veteran scheme.

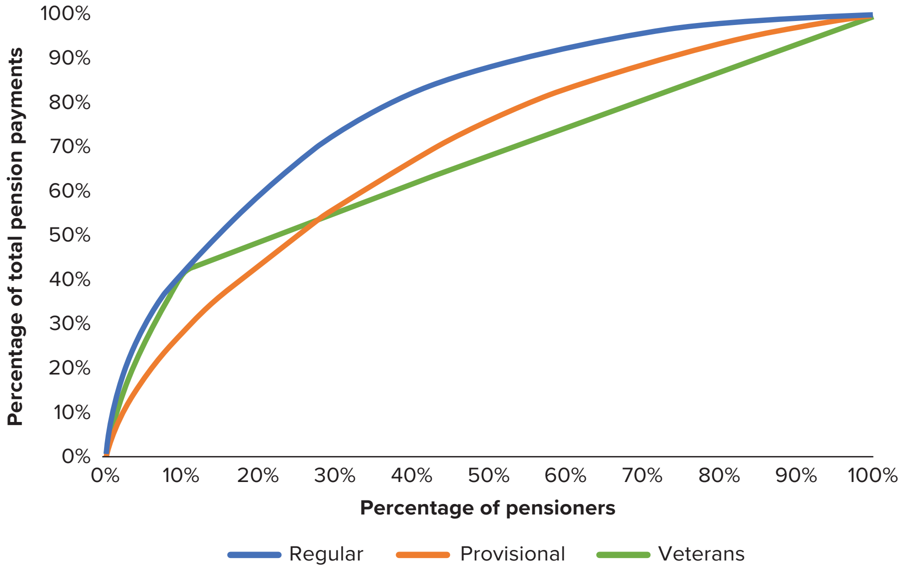
2.3.4. Age of pensioners

The payroll database from the Ministry of Finance does not include the birthdate of a large number of pensioners. In 2023, the birthdate of about 70 percent of

[40] One possible explanation for this variation is the change in the total number of pensioners. From 2016 to 2021 this number increased. From 2021 to 2023 this number decreased to a lower number than in 2016.

[41] Table 2.5 reports that expenditure on public pension is 0.96 percent of GDP in 2023. However, this is a provisional number based on forecast.

Figure 2.3. Percentage of pension payments as a percentage of pensioners (by pension scheme, 2023)



Source: June 2023 payroll data. Ministry of Finance.

all pensioners is recorded (53 percent of regular pensioners, 98 percent of pending pensioners, and 42 percent of veteran pensioners) while the birthdate of 30 percent of all pensioners is not recorded (Table 2.6). The fact that the percentage of pending pensioners with a recorded birthdate is increasing is a positive development. However, the fact that the birthdate of many pensioners is not recorded remains a critical issue.

Almost all pensioners with a recorded birth date (93.5 percent) are over 60 years of age. The percentage of pensioners above 60 is 94 percent for the regular pension scheme, 96 percent for the pending pension scheme, and 65 percent for the veteran scheme. In 2023, the average age of pensioners with a recorded birth date is 63.4 years (69.3 years under the regular pension scheme, 64.5 years under the pending pension scheme,

Table 2.6. Recorded birth date

	2016			2021			2023		
Pensioners	*Number*	*Recorded Birth Date*	*Percentage*	*Number*	*Recorded Birth Date*	*Percentage*	*Number*	*Recorded Birth Date*	*Percentage*
Regular pensioners	2,467	998	40.5%	2,591	1,166	45.0%	1,964	1,043	53.1%
Pending pensioners	1,791	702	39.2%	3,185	2,882	90.5%	3,385	3,315	97.9%
Veteran pensioners	3,585	1,409	39.3%	2,158	848	39.3%	1,696	709	41.8%
Total	**7,843**	**3,109**	**39.6%**	**8,441**	**4,896**	**58.0%**	**7,045**	**5,067**	**71.9%**

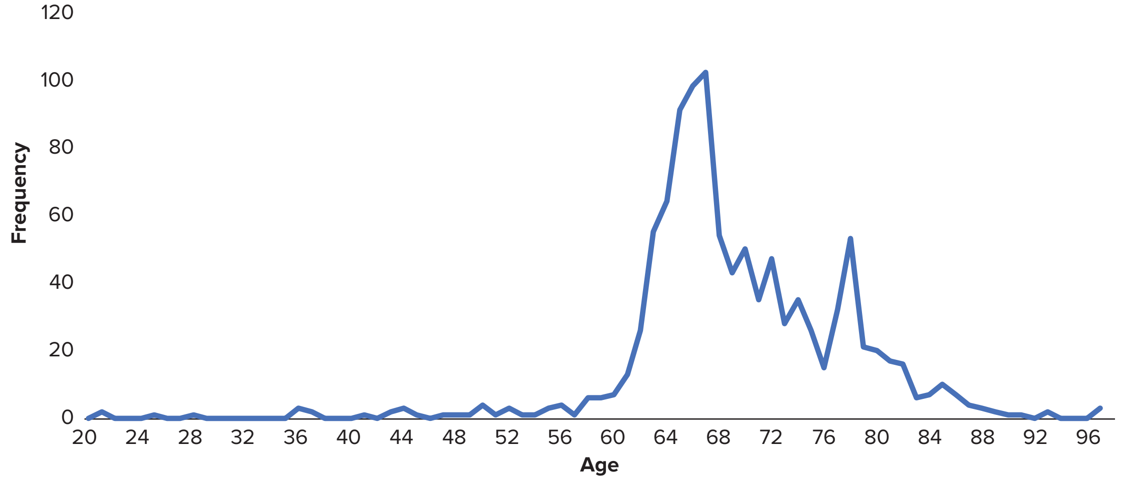
Source: January 2016, August 2021, and June 2023 payroll data from the Ministry of Finance.
Note: Pensioners with a recorded birth date who are older than 18 years. It does not include six regular pensioners, one pending pensioner and one veteran pensioner who are below 18 years of age and two pensioners with erroneously reported birthdate in the future.

and 63.4 years under the veteran scheme). Figures 2.4, 2.5, and 2. 6 show the age distribution of the pensioners with a recorded birthdate under the three public pension schemes. Figure 2.4 (regular pensioners) and Figure 2.6 (veteran pensioners) need to be interpreted with caution as the birthdates of approximately half of these pensioners are missing. More than a quarter (27 percent) of the veteran pensioners with a recorded birthdate are currently 53 years of age.[42]

2.3.5. Beneficiary coverage

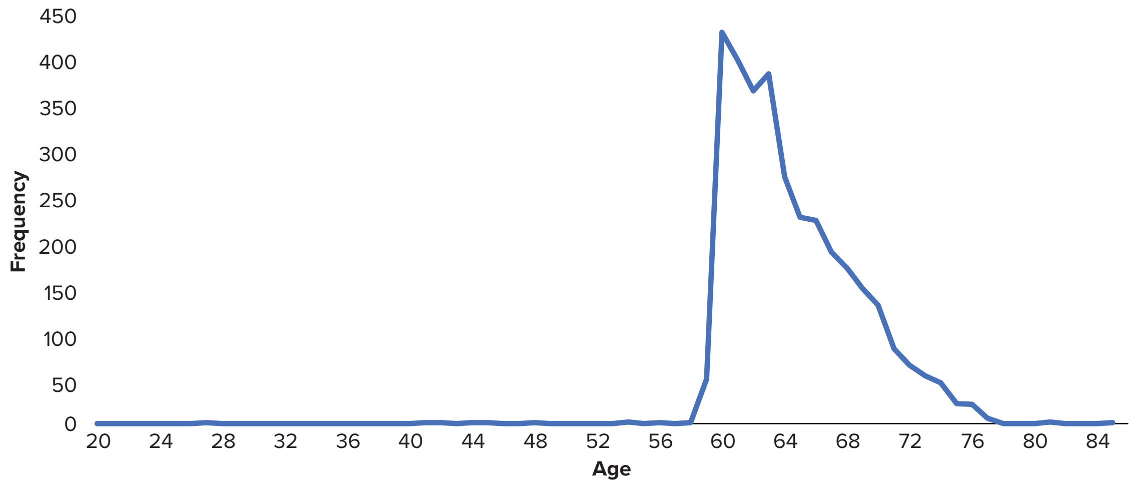
The public service pension schemes benefit a very small share of the elderly. Assuming that all pensioners have

Figure 2.4. Age distribution of pensioners under the regular pension scheme



Source: June 2023 payroll data. Ministry of Finance.
Note: Age calculated from May 31, 2023. Observations = 1,043.

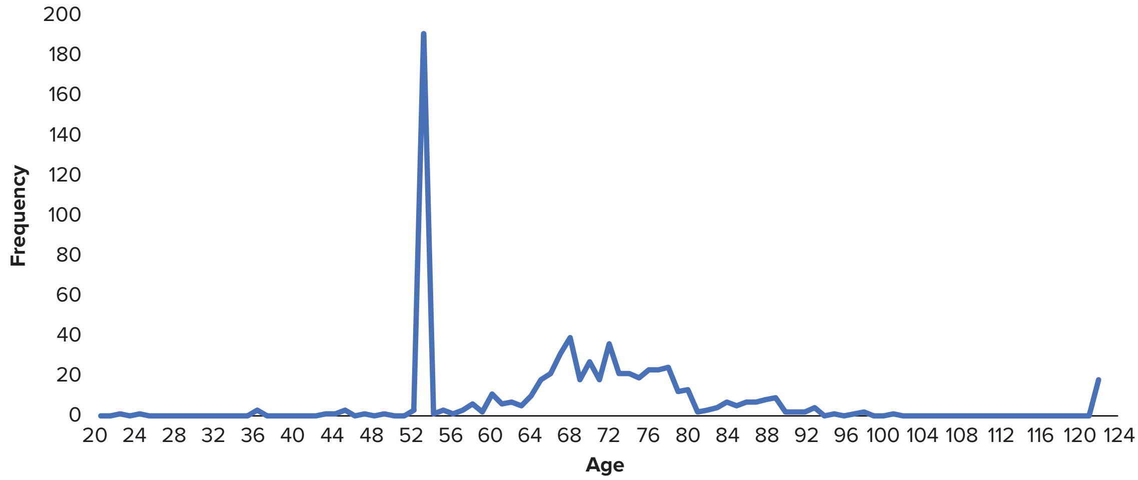
Figure 2.5. Age distribution of pensioners under the pending pension scheme



Source: June 2023 payroll data. Ministry of Finance.
Note: Age calculated from May 31, 2023. Observations = 3,315.

[42] The bulge at 53 years old might be caused by the default date that the system reports when no birthdate information is provided for the individual.

Figure 2.6. Age distribution of pensioners under the veteran pension scheme



Source: June 2023 payroll data. Ministry of Finance.
Note: Age calculated from May 31, 2023. Observations = 709.

the same age structure as those whose birth date is available in the payroll database, then the three schemes can be estimated to provide pensions to 6,198 individuals who are over 60 years of age (Table 2.7). Thus, in 2023, it can be estimated that 8.0 percent of the elderly defined as persons above 60 years of age benefit from a public pension (2.4 percent benefit from a regular pension and 4.2 percent from a pending pension).[43] This is very low by international standards. For example, Cabo Verde covers 14.4 percent of the population over the age of 60. This is in the context of very limited, almost non-existent social protection safety nets for the elderly in Guinea-Bissau.

Table 2.7. Pension coverage (2023)

Schemes	*Pensioners (Number)*	*Pensioners 60+ (Number) 1/*	*Pensioners 60+ (% of Population 60+)*
Regular pension	1,964	1,846	2.4%
Pending pension	3,385	3,250	4.2%
Veteran pension	1,696	1,102	1.4%
Total	7,045	6,198	8.0%
Memo:			
Population (60+)	77,168		

1/ Under the assumption that pensioners without a reported birthdate have the same age structure as pensioners with a reported birthdate.
Source: Payroll data from the Ministry of Finance and World Development Indicators.
INE, November 2022, Rapport de présentation des projections de la population de la Guinée-Bissau 2014–2063.

[43] "Reserva" which is constituted by military and paramilitary officers who are retired but can be called upon at any time was not considered for this analysis. However, it is worth noting that given the age distribution of this group, it would increase the coverage of the elderly by the public service sector.

2.3.6. Active worker pension contributions

In 2023, it is estimated that about 6.5 percent of the labor force contribute to a pension scheme. This coverage has been calculated using the following assumptions: (i) 27,488 civil servants paid by the government in June 2023 are accumulating rights to a public service pension; (ii) 32,886 workers contribute to the social security pension scheme managed by INSS[44]; and (iii) labor force is 924,300 (Table 2.8).

2.3.7. System dependency ratio[45]

The ratio of the number of pensioners to the number of contributors (system dependency ratio) has steadily decreased since 2016. The system dependency ratio decreased from 40 percent in 2016 to 28 percent in 2021 and 26 percent in 2023 (Table 2.8). In 2023, there are approximately four active civil servants per pensioner compared to 2.5 active civil servants per pensioner in 2016. If veteran pensioners are not taken into account, then the dependency ratio decreased from 22 percent in 2016 to 19 percent in 2023.[46] Improvement in the system dependency ratio is due to a 10 percent decrease in the number of pensioners (from 7,843 in 2016 to 7,045 in 2023) combined with a sharp 42 percent increase in the number of civil servants between 2016 and 2023.[47]

The system dependency ratio is unlikely to increase until the mid-2030s. Figure 2.7 shows the 2016 and 2023 age distribution of civil servants whose birthdate is available in the payroll database. It needs to be interpreted with caution as only 51 percent of civil servants had a recorded birth date in 2016 (83 percent in 2023). However, it shows a drastic change in the age distribution of civil servants with a bulge in the recruitment of civil servants between the ages of 30 and 47 between 2016 and 2023, consistent with the findings of the Public Expenditure Review (2022) pensions chapter for Guinea-Bissau. These bulge cohorts will become eligible for retirement starting in 2036 so the system dependency ratio is unlikely

Table 2.8. Pensioners and contributors

Schemes	*2016*	*2021*	*2023*
Pensioners (Regular, pending and veteran) (A)	7,843	7,934	7,045
Pensioners (Regular and pending) (B)	4,258	5,776	5,349
Number of civil servants including military and reserve (C)	19,398	27,918	27,488
Dependency ratio (Regular, pending and veteran) (%) (A)/(C)	40%	28%	26%
Dependency ratio (Regular and pending) (%) (B)/(C)	22%	21%	19%
Memo:			
Labor force (15–59)	827,494	895,571	924,300

Source: Payroll data from the Ministry of Finance and World Development Indicators.
INE, November 2022, Rapport de présentation des projections de la population de la Guinée Bissau 2014–2063.

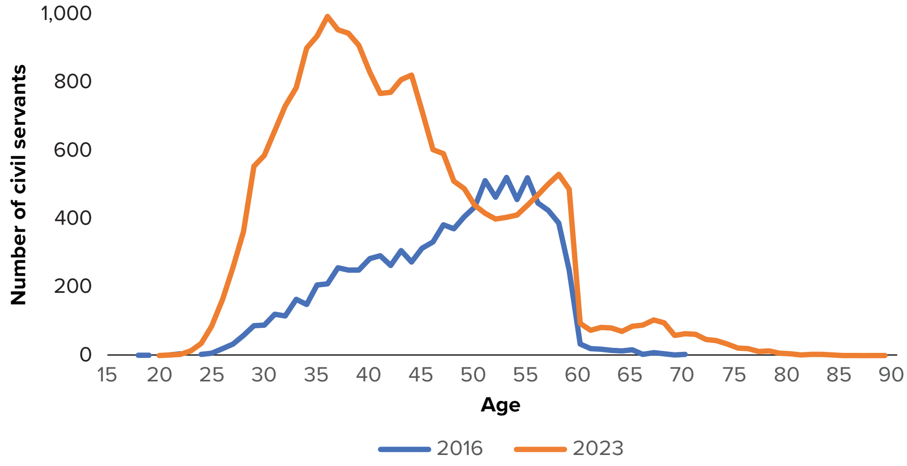
[44] The 32,886 figure is the most up to date and comes the publicly available INSS 2020 report. The number of beneficiaries totaled 4,329 effective 5th March 2024 (source: INSS)

[45] There are two types of dependency ratio: i) the old age population dependency ratio (old people/young people) and ii) the system dependency ratio (beneficiaries/ contributors). This discussion focuses on the latter.

[46] The veteran scheme does not have any contributor while the number of veteran pensioners is steadily decreasing as veterans are passing away while most of their descendants do not benefit from the scheme.

[47] The August 2023 payroll payment module from the Budget Department at the Ministry of Finance includes 27,488 civil servants who account for 3.0 percent of the Bissau-Guinean labor force (Table 2.8).

Figure 2.7. Age distribution of civil servants including military and reserve by age (2016 and 2023)



Source: January 2016 and June 2023 payroll data. Ministry of Finance.
Note: Age calculated from December 31, 2015, and May 31, 2023. Observations = 9,948 (2016) and 22,741 (2023).

to increase until then[48]. This, combined with the fact that salaries in the public sector (on which pensions are based) do not tend to increase with age (Figure 2.1) leads to the conclusion that **pension payments are not expected to increase substantially in the coming year**s.

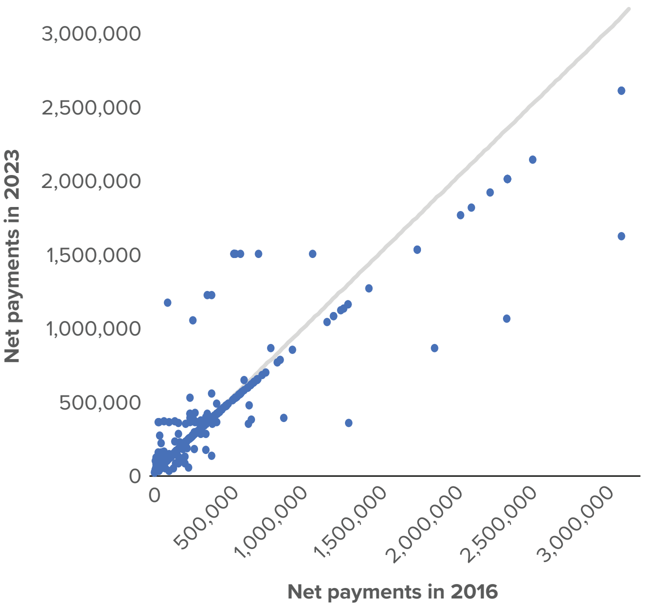
2.3.8. Administration of the schemes

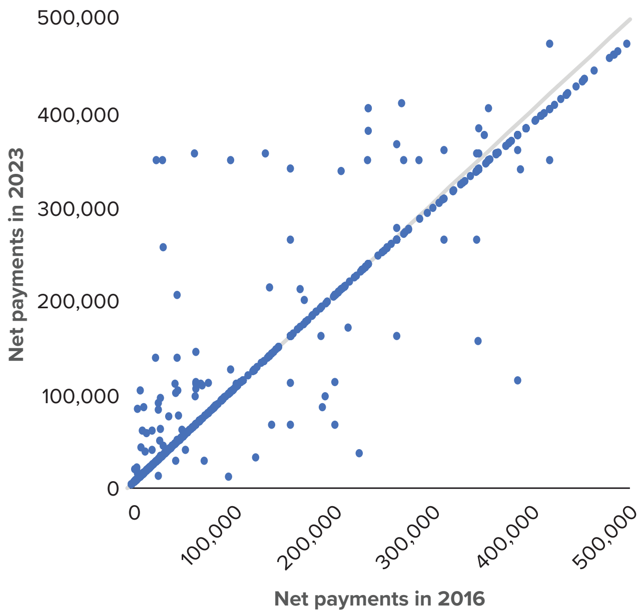
The administration of the public sector pension schemes faces significant challenges. First, important discretionary changes to individual pension amounts were made between 2016 and 2023. Although the amount of pension received by each pensioner is supposed to be fixed during retirement (Table 2.1 indicates that it is not indexed), a comparison of the pension amounts received by the same pensioners in 2016 and 2023 shows that their pensions changed in a discretionary manner between the two dates. Figure 2.8 compares the net pension amount paid in 2016 (x-axis) and 2023 (y-axis) to the 1,098 regular pensioners who received a pension in both 2016 and 2023 (the figure on the right magnifies the left figure focusing on payments below 500,000CFA). If the pension amount had remained fixed between 2016 and 2023 then all the dots should fall along the first diagonal (y = x). In fact, none of the 1,098 individuals who received a regular pension in both 2016 and 2023 received the same pension in both years. More precisely, 83 individuals had an increase in their net pension which averaged 181,798CFA per pension (approximately US$300), while 1,015 individuals had a decrease in their net pension (for 982 of them, their net pension in 2016 became their gross pension in 2023 while the net pension of 33 others decreased by 247,069CFA on average (approximately US$400). The same applies to the pending and veteran pension schemes (Figures 2.9 and 2.10).[49]

The average monthly pension for the 3,511 individuals who were pensioners in both 2016 and 2023 increased by 4.3 percent between 2016 and 2023 (Table 2.9). The total increase represented 182.56 million CFA (about US$300,000).[50]

[48] It should be noted as well that dependency ratios can also increase due to the increase of life expectancy at old age.
[49] A different example that might show imbalances in the way that pensioners are inputted in the system is the significant difference in the net pension between individuals who have a birthdate registered and those who do not. This statistical difference is true for the civil service, pending pensioners, and veteran pensioners.
[50] (103,865–99,532) × 3,511 individuals × 12 months = 182.56 million CFA.

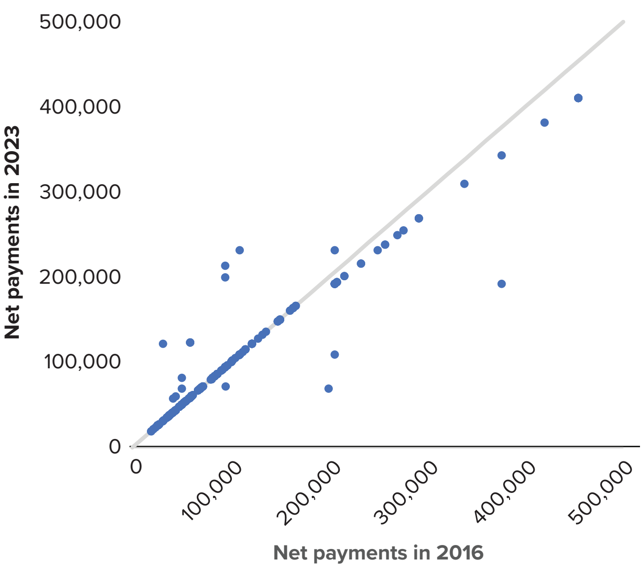
Figure 2.8. Net monthly pension payments in 2016 and 2023 for the regular pension scheme (CFA)





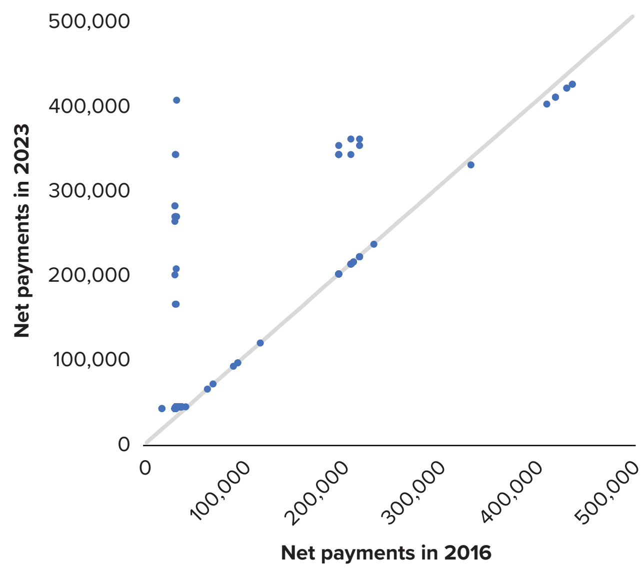
Source: January 2016 and June 2023 payroll data. Ministry of Finance.
Note: Number of observations: 1,097. A pensioner with a net monthly pension of 5,000,000CFA in 2016 and 4,111,527CFA in 2023 is not included as it is an outlier.

Figure 2.9. Net monthly pension payments in 2016 and 2023 for the pending pension scheme (CFA)



Source: January 2016 and June 2023 payroll data. Ministry of Finance.
Note: Number of observations: 796.

Figure 2.10. Net monthly pension payments in 2016 and 2023 for the veteran pension scheme (CFA)



Source: January 2016 and June 2023 payroll data. Ministry of Finance.
Note: Number of observations: 1,617. A pensioner with a net monthly pension of 432,600CFA in 2016 and 1,008,152CFA in 2023 is not included as it is an outlier.

Table 2.9. Number and pensions of individuals who are pensioners in both 2016 and 2023

Pension Schemes	*Number of Individuals*	*Average Monthly Pension in 2016 (CFA)*	*Average Monthly Pension in 2023 (CFA)*
Regular pension	1,098	210,084	206,604
Pending pension	796	65,209	64,142
Veteran pension	1,617	41,360	53,657
Total	**3,511**	**99,532**	**103,865**

Source: January 2016 and June 2023 payroll data. Ministry of Finance.

The creation of the pending pension scheme is becoming the new norm for retirement. The pending pension scheme was originally created as an ad-hoc mechanism to post the new pensioners until their pensions were fully processed as it could take several years between the time a pension request was initiated and the time when the first payment occurred. It has become the new norm as 73 percent of the 3,534 individuals who became pensioners between 2016 and 2023 were still under the pending pension scheme in 2023 (Table 2.10). The pending pension scheme has de facto led to a reduction in pension payments amounting to 25,625CFA per month per person (approximately US$42 per month or US$500 per annum) compared to a situation where all pensioners would have immediately benefitted from a regular pension.[51]

Processing of pension applications and subsequent pension payments largely depends on the applicant's personal connections within the administration who can "facilitate" the process. As a result, the application of some public servants is processed quickly while the application of others can take years.

Gathering proof of work is very time-consuming, as only hard copies of administrative records are available. In the end, the employment history may be difficult

Table 2.10. Pensioners and pension amounts (2016 and 2023)

	2016		*Deceased Between 2016 and 2023*		*New Pensioners Between 2016 and 2023*		*2023*	
Pension Schemes	*Number of Pensioners*	*Average Monthly Pension (CFA)*	*Number of Pensioners*	*Average Monthly Pension (CFA)*	*Number of Pensioners*	*Average Monthly Pension (CFA)*	*Number of Pensioners*	*Average Monthly Pension (CFA)*
Regular pension	2,467	160,400	1,369	120,552	866	210,564	1,964	208,350
Pending pension	1,791	70,584	995	74,884	2,589	114,290	3,385	102,498
Veteran pension	3,585	40,196	1,968	39,239	79	237,141	1,696	62,204
Total	**7,843**	**84,945**	**4,332**	**73,123**	**3,534**	**140,628**	**7,045**	**122,307**

Source: January 2016 and June 2023 payroll data. Ministry of Finance.

[51] Without the 20% discount applied to pending pension, total monthly payments under the pending pension scheme would be 128,123CFA (102,498CFA/80%) so that the discount leads to a "savings" of 25,625CFA per month (128,123CFA – 102,498CFA = 25,625CFA).

to evidence, and it may be eventually necessary to estimate the period of service. The Ministry of Public Administration may not have the necessary computers and software to automate the pension amount or may be unwilling to do so. As a result, the calculation of the pension amount is done manually which leaves the door open to errors and possible fraud in the absence of any control.

Eventually, the final approval by the Budget Department at the Ministry of Finance depends on whether the funds are available – although what happens when no sufficient funding is available remains unclear. The budgeting process does not adequately project and budget for new retirements in any given year. This lack of planning is – de facto – a fiscal risk that materializes annually.[52] The public sector pension scheme has never benefited from an actuarial assessment to determine its ongoing viability, or the amount of liabilities incurred to date. In fact, an actuarial assessment may be difficult to implement considering the ad-hoc discretionary changes to individual pension amounts made by those responsible for the management of the pension schemes.

Efforts to gather the necessary data are limited. In 2023, the birthdate of 28 percent of the pensioners and 17 percent of the civil servants is still missing. There is no systematic process to validate that a pensioner is still alive (i.e., an annual "proof of life"). The database includes beneficiaries with unrealistic ages (below 18 or more than 100 years) and people who have died (5 of the 30 individuals with the highest pension in June 2023 were reportedly dead at this time).

Although most pension payments are made through the banking system**, some payments are still made in cash with little associated control.**[53,54]

2.4. Public service pension schemes: Recommendations for improvement

The main challenge faced by the public sector pension schemes is not its costs. As evidenced above, the pension system has been able to reduce spending through the creation of the pending scheme (which de facto reduced pension by 20 percent) and ad-hoc discretionary changes to individual pensions while the dependency ratio is unlikely to deteriorate in the coming years.

The main challenge is one of governance and design of the pension schemes.

a. **Governance:** the pension rules are not systematically applied. The management of the schemes makes important discretionary changes to individual pension amounts which do not comply with the rules. This finding combined with the fact that pension payments overly benefit a very small fraction of beneficiaries is unsettling. It gives the perception that pension payments are "captured" by those responsible for the implementation of the schemes. Benefits should be secure and non-discriminatory, schemes should be managed in a sound and transparent manner, and for confidence to exist, good governance is essential.
b. **Design:**
    i. The base wage for pension calculation (reference salary) includes only the 2 last years: this is not only costly but inequitable (by design). Including all (valorized) wages (entire career) in the pension's calculation would be the fair way to do it between people with different patterns of pay over the career and would also avoid distortions to people's requesting wage increases just before retirement.

[52] Solely from the lack of birthdates in the system (and considering that individuals will transition into a pending pensioner scheme) the government in unable to predict approximately 450 million CFA in pension payments until 2050.

[53] The unions express concern that for some pensioners, the cost of receiving the pension is equivalent to the pension and that pension payments should be decentralized. In fact, when the payments are made in cash, they do not always reach the intended beneficiaries while a fraction of the cash amount is withdrawn to pay the payers and the unions. This is also the case for the payment of teachers' salaries.

[54] There is also some concern that two pension laws are being simultaneously used to pay pensions – i.e., the old pre-2012 law and the new post-2012 law. This requires further investigation.

ii. Pensions indexation: not automatically indexing pensions already represents a challenge. If pension payments are not regularly adjusted, then the living standards of retirees are eroded by inflation. Pensions should be increased regularly and automatically, linked to changes in economic variables (not ad hoc or discretionarily). Typically, they should be increased based on prices and/or average earnings.

iii. Accrual rate: in fact, there are two features of the pension system – accrual rate structure and maximum replacement rate – that should be considered together, and best practice is to have an 'affordable' and linear accrual rate (where retirement income accumulates at the same proportion of earnings for each and every year of contributions) with no maximum.

iv. Early retirement: a good practice would include penalizing early retirement with an actuarial neutral factor (that would equalize the net present value for early vs normal retirement age).

The creation of a pension fund is not likely to resolve the governance challenge. It is not clear how the deposit of 6 percent from the payroll of all public employees into a special account (or pension fund) jointly managed by the Ministry of Public Administration and the Ministry of Economy and Finance as stipulated in the 2015 Budget Law would improve the management of the schemes. Furthermore, as outlined in the Public Expenditure Review (2022), substantial reforms to overhaul the governance of INSS would first be needed before this could even be seriously considered as an option.

2.4.1. Measures to improve the public service pension system

Table 2.11. Policy options to improve the public pension system

Reform Challenges	*Policy Options*		*Cost of Inaction (or of keeping the status quo)*
	Short-term	*Medium/Long-term*	
Poor public sector pension governance	Review the list of pensioners, complete the database with the correct birth date of each pensioner, obtain "proof of life" and set up a mechanism to update them on a yearly basis. Systematically pay pensions through the banking system to avoid irregularities associated with cash payments and request that the commercial banks send proof of pension payment to the Treasury. Conduct a study into the feasibility of using mobile money for pension payments to reduce cost of distribution and cost of receipt. Conduct a functional review of the pensions department within the Ministry of Finance.		Inadequate soft infrastructure limiting information available to properly manage the public sector pension system. Continuation of potentially expensive irregularities related to pension payments. A lack of reliable diagnostics to guide and inform reform efforts.

Table 2.11. Policy options to improve the public pension system (*Continued*)

Reform Challenges	*Policy Options*		*Cost of Inaction (or of keeping the status quo)*
	Short-term	*Medium/Long-term*	
Poor design of the public sector pension system	Clarify the parameters of the pension schemes including the indexation, reviewing retirement age as Bissau-Guinean life expectancy increases and the criteria to be eligible into the veteran scheme and the mechanism to transfer pensioners from the pending to the regular pension scheme.	The introduction of parametric reforms, benchmarked to appropriately selected peer countries, to the public sector pension scheme to provide more equitable rule-based pension benefits and limit fiscal costs into the future.	An inequitable and opaque pension system
Limited fiscal space	Develop a system to keep individual records of current civil servants with their birthdate, positions, and salaries to anticipate and manage future pension payments.	Introduce, train staff on and institutionalize an independent model in the Ministry of Finance to help inform the expected impacts of reform alternatives on fiscal costs and benefit levels.	The continuation of an annual fiscal risk in the form of pension payments Inability to forecast and adequately plan for the bulge of pensioners which will have a massive fiscal impact

2.4.2. Considerations for setting up a pension fund[55]

Although the 2015 Budget Law envisages creating a pension fund, the assessment of current conditions suggests it is not recommended at this juncture. The main reasons are: (i) the fiscal costs of creating a pension fund are considerable; (ii) creating a pension fund in a weak governance environment is extremely risky; and (iii) the implementation of a pension fund requires as a prior condition the establishment of a strong regulatory framework.

The fiscal cost of creating a pension fund would go much beyond the 6 percent payroll contribution included in the 2015 Budget Law. As already mentioned, under the current public service pension scheme, 6 percent is deducted from the gross salary of civil servants. However, this is currently just a notional paper transaction with no corresponding financial transaction.[56] In 2023, the total annual wage bill of the 27,488 civil servants is 47.1 billion CFA (equivalent to approximately US$77 million) (see Tables 2.4 and 2.5), so that the notional amount corresponding to 6 percent of payroll represents 2.83 billion CFA (US$4.6 million). Currently, the total annual pension payment is 10.3 billion CFA (US$16.9 million) (see Table 2.5). Consequently, even if the 6 percent payroll withdrawal (equivalent to 2.83 billion CFA) were to be transferred into a special account, this amount would fall very short of the amount required to pay current pensions (10.3 billion CFA). **Consequently, the government would not only need to transfer in cash to the pension fund the notional 6 percent payroll reduction (2.83 billion CFA) but also 7.47 billion CFA (approximately US$12 million) from general revenues so that the pension fund can pay all pensions. It would also need to cover the operating costs of the pension fund.** However, the 2015 Budget Law

[55] This section draws on: Schwarz, Anita, and Miglena Abels. November 2016. Issues for Civil Service Pension Reform in Sub-Saharan Africa. Social Protection and Labor Discussion Paper No. 1613. The World Bank Group.

[56] In other words, the 6 percent contribution is not transferred to any account.

remains silent on this critical issue: it does not specify how the pension fund would be financed beyond the 6 percent payroll contribution which, once again, falls very short of the amount necessary to pay all current (and future) pensions.

Creating a pension fund in a weak governance environment is extremely risky. First, the management of the pension fund would likely be captured by a few individuals or a political party. The INSS which manages private sector pensions is largely seen as politically captured. According to the 2015 budget law, the pension fund would be jointly managed by the Ministry of Public Service and the Ministry of Economy and Finance. However, a dedicated administration would need to be created to manage the pension fund. This would be extremely risky in the weak governance environment which currently prevails in Guinea-Bissau. Second, the administrative costs of setting up the pension fund are likely to be high. International experience shows that pension fund management can spend heavily on administrative costs including luxurious offices, cars as well as perks for their own staff. Third, any reserves accumulated by the pension fund in the future are likely to be diverted.[57] In fact, INSS reserves are currently diverted by the government and there is no reason to believe that the same would not occur with a public pension fund. International experience with pension funds shows that pension fund administrators frequently have a lot of leeway in where and how they invest pension fund reserves. Also, international experience shows that pension fund administrators have the incentive to ask for the contribution rates to be raised over time, even if they just lead to the accumulation of incremental reserves, and for deficit-running pension funds to be closed, with the corresponding deficits being passed on to the government.

The establishment of a pension fund requires a strong regulatory framework. Currently, there is no legal framework or specific institutions responsible for the regulation and supervision of pension schemes in Guinea-Bissau. This poses extremely high risks: a pension fund may not be adequately funded or be unable to protect the pension reserves to meet future pension obligations. Also, the investments of the pension fund reserves (if they materialize) would need to be regulated by possibly allowing for investments in international capital markets.

2.5. Summary

The note shows that the main challenge faced by the public sector pension schemes is one of governance. Pension payments overly benefit a very small fraction of beneficiaries while discretionary changes deviating from the pension rules are made to individual pension amounts. An analysis of the 2016 and 2023 payroll databases gives the perception that pension payments are "captured" by those responsible for the implementation of the schemes.

Some measures could be taken immediately to improve the public services pension schemes. These measures include clarifying the parameters of the pension schemes, reviewing and updating the list of pensioners, establishing a "proof of life" procedure, systematically making pension payments through the banking system, and, importantly, conducting an institutional assessment of the unit responsible for managing the public pension schemes.

The government may want to consider developing a model like the World Bank's PROST toolkit to: (i) assess the fiscal costs of the current scheme, and (ii) evaluate different pension reform options. The World Bank's pension reform options simulation toolkit, PROST, models pension contributions, entitlements, system revenues, and system expenditures over a long period. It is designed to help policymakers make informed policy decisions but the ability to develop this model would depend on data availability for both current civil servants and pensioners.

The analysis also shows that it is not recommended for Guinea-Bissau to set up a pension fund for the public service pension scheme at this stage. Although the 2015 Budget Law envisages creating a pension fund,

[57] As shown in previous paragraphs, the payments to the pension fund from the 6 percent payroll contribution are not sufficient to cover the pension payments. As such, any accumulation of reserves would require a substantial transfer from the national budget to the pension fund. This transfer would need to be above the sum of the pension payments and pension fund administrative costs.

its financing (6 percent of payroll) would not be enough to pay existing pensions. Importantly, creating a pension fund in a weak governance environment is extremely risky while the establishment of a strong regulatory framework would be a prior condition for the implementation of such a pension fund. As such, establishing a pension fund for the public service employees would bring significant administrative and fiscal challenges and therefore is not in the interest of the pensioners.

The Government of Guinea-Bissau is advised to: (i) maintain the current institutional structure of the public service pension schemes, (ii) immediately introduce the measures outlined above including an institutional assessment of the unit responsible for managing the public pension schemes to improve governance, and (iii) consider a coherent reform package based on a model like PROST to introduce parametric reforms to improve equity and ensure fiscal sustainability.

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Annex 1. Pension: A Simple Model

The following is a simple model which formed the basis for some of the theoretical analysis in the above chapter. The model offers insight into the area of accrual and contribution rates in Guinea-Bissau. However, as with any model, it has made simplifying assumptions to limit the inputs needed for the model. For example, the model does not account for returns to contributions during the contributory period and the discount rate on the retirement period. This might affect the equilibrium contribution rates it calculates by over-estimating them. Nevertheless, it effectively demonstrates the order of magnitude of and the direction of travel that pension policy must follow to reduce the proportion of fiscal space the public pension sector occupies and the consequent fiscal risk it generates each year.[58]

Consider an individual who starts working at age a_W and retires at age a_R.

Assume that his wage w is constant in real terms (the wage can easily be made to vary with time).

Assume that the contribution rate to pension is *CR*.

Then, his total contribution *TC* during his lifetime is:

$$TC = CR \bullet \left(a_R - a_W \right) \bullet w$$

Assume that the accrual rate is *AR*. Then, at retirement, he gets a yearly pension of:

$$P = AR \bullet \left(a_R - a_W \right) \bullet w$$

He gets this pension during $(LE(a_R) - a_R)$ years where $LE(a_R)$ is life expectancy at retirement which depends on retirement age a_R.

His total pension benefits *TB* are:

$$TB = P \bullet \left[LE\left(a_R \right) - a_R \right] = AR \bullet \left(a_R - a_W \right) \bullet w \bullet \left[LE\left(a_R \right) - a_R \right]$$

We say that a pension system is in balance when total contribution equals total pension benefits:

$$TC = TB$$

which can be written:

$$CR \bullet \left(a_R - a_W \right) \bullet w = AR \bullet \left(a_R - a_W \right) \bullet w \bullet \left[LE\left(a_r \right) - a_R \right]$$

which after simplification leads to:

$$CR = AR \bullet \left[LE\left(a_R \right) - a_R \right]$$

which says that for a pension system to be in balance the contribution rate should equal the accrual rate times the years of pension benefits.

Equivalently:

$$AR = \frac{CR}{LE\left(a_R \right) - a_R}$$

which says that the accrual rate should equal the contribution rate divided by the years of pension benefits.

In **Guinea-Bissau**, AR = 2.8 percent, CR = 6 percent and $[LE(a_R) - a_R]$ can be estimated at 6 years assuming a retirement age of 60 and a life expectancy at retirement of 6 years,[59] so that:

$$CR = 6\% < AR \bullet \left[LE\left(a_R \right) - a_R \right] = 2.8\% \times 6 = 16.8\%$$

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[58] The World Bank has developed a forthcoming tool which is still under development that will be able to produce a more precise indication of the equilibrium parameters in the pensions system, both in Guinea-Bissau and in other countries.

[59] Pensioners who deceased between 2016 and 2023 had an average age of 71.0 for regular pensioners, 66.3 for pending pensioners and 62.2 for veteran pensioners. Note that the life expectancy at birth for the overall population was 60 years in 2021.

which shows **that the contribution rate of 6 percent is much too low to cover future pension payments when the accrual rate is 2.8 percent, or equivalently, that an accrual rate of 2.8 percent is much too high to cover future pensions when the contribution rate is 6 percent**. In fact, for the pension system to be in balance, the contribution rate should be increased from 6 percent to 16.8 percent if the accrual rate is maintained at 2.8 percent or the accrual rate should be decreased from 2.8 percent to 1 percent if the contribution rate is maintained at 6 percent.

Any other combination presented in Table A1. below also corresponds to a balanced pension system.

The COVID-19 epidemic in 2020 disproportionately affected older people as reflected in the global pandemic mortality statistics, lowering the average age of mortality if considering a mean 2016–2023 as presented in the above calculations (Table A1). The years before COVID-19 (2016–2019) will also have had a lower life expectancy at 60, as this tends to improve with time as medical science and development in the health sector advances. These two factors will skew the average age of mortality downwards. As noted in the chapter, WHO data estimates the life expectancy at 60 to be 15.5 years in Guinea-Bissau. This might increase to 17.2 years by 2038, based on the increase from 2000 to 2019 in the same WHO dataset. This would coincide with the first bulge of retirees in 2036, noted in the chapter above, and so is an important consideration.

Another parameter that might be worse considering is changes to the retirement age. The table below presents the different scenarios for different life-expectancy considering an increase in the retirement age of 5 years using the same life expectancy at 60 assumptions.

Table A1. Pension system in balance (retirement age 60)

AR (%)	1.0	1.1	1.2	1.3	1.4	1.5	1.6	1.7	1.8	1.9
CR (%)	6.0	6.6	7.2	7.8	8.4	9	9.6	10.2	10.8	11.4

AR (%)	2.0	2.1	2.2	2.3	2.4	2.5	2.6	2.7	2.8
CR (%)	12.0	12.6	13.2	13.8	14.4	15.0	15.6	16.2	16.8

Note: Calculations performed using $LE(a_R) - a_R$ = 6 years (average time lived after retirement between 2016–23).

Table A2. Pension system in balance (retirement age 60)

LE after retirement	AR (%)	1	1.1	1.2	1.3	1.4	1.5	1.6	1.7	1.8	1.9
15.5 years	CR (%)	15.5	17.1	18.6	20.2	21.7	23.3	24.8	26.4	27.9	29.5
17.2 years	CR (%)	17.2	18.9	20.6	22.4	24.1	25.8	27.5	29.2	31.0	32.7

LE after retirement	AR (%)	2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	2.8
15.5 years	CR (%)	31.0	32.6	34.1	35.7	37.2	38.8	40.3	41.9	43.4
17.2 years	CR (%)	34.4	36.1	37.8	39.6	41.3	43.0	44.7	46.4	48.2

Table A3. Pension system in balance (retirement age 65)

LE after retirement	AR (%)	1	1.1	1.2	1.3	1.4	1.5	1.6	1.7	1.8	1.9
1 year	CR (%)	1.0	1.1	1.2	1.3	1.4	1.5	1.6	1.7	1.8	1.9
10.5 years	CR (%)	10.5	11.6	12.6	13.7	14.7	15.8	16.8	17.9	18.9	20.0
12.2 years	CR (%)	12.2	13.4	14.6	15.9	17.1	18.3	19.5	20.7	22.0	23.2

LE after retirement	AR (%)	2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	2.8
1 year	CR (%)	2.0	2.1	2.2	2.3	2.4	2.5	2.6	2.7	2.8
10.5 years	CR (%)	21.0	22.1	23.1	24.2	25.2	26.3	27.3	28.4	29.4
12.2 years	CR (%)	24.4	25.6	26.8	28.1	29.3	30.5	31.7	32.9	34.2

Annex 2. Summary of Recommendations

(Schwarz, Anita et al. 2018, p. 24)

- Keep the pension system design simple: easy to administer, easy to understand, easy to govern.
- Focus on the primary purposes of the pension system: keeping the elderly out of poverty and providing a mechanism for consumption smoothing.
  - Social objectives and capital market development are useful secondary objectives, but not at the expense of the workers and pensioners.
- Keep administrative costs low, eliminating all unnecessary expenses.
- Improve record-keeping, tying in with national ID systems where available.
- Collect data on the mortality experience of the covered population and set retirement ages so that life expectancy after retirement averages 15 years.
- Eliminate lump-sum payments given in addition to monthly pension over time.
- Index benefits to inflation, protection of retirees against cost-of-living increases.
- *Universal schemes:*
  - Keep benefits sustainable!
- *Defined contribution systems:*
  - Improve governance.
  - Enhance supervisory capacity to ensure that the funds are safe.
  - Develop investment instruments for the funds to invest in.
- *Defined benefit systems:*
  - Keep contribution rates low in line with what is needed to pay benefits until financial markets develop sufficiently to make accumulating reserves worthwhile.
  - Keep benefits modest, in line with ILO recommendation of 40% benefit after 30 years of contribution.
  - Base pensions on lifetime average salary.
  - Revalue past wages with growth in average wages.
  - Keep minimum pensions modest.
- *Civil service pension systems:*
  - Integrate with national systems if possible – can gradually move parameters closer to national system.
  - Do not impose high contribution rates – typically fall on Government as employer.
  - Unify salaries and allowances and base both contributions and benefits on the unified salary.
  - Follow recommendations for defined benefit systems.
- Informal sector workers:
  - Recognize that informal sector schemes will have to be specially designed for needs of informal sector workers.
  - Will should be a defined contribution savings scheme, with early access to a portion of the savings.
  - Will be unlikely to provide an adequate living pension but will make the individual better off than if they had not saved.
  - Low administrative costs and good investment returns crucial to success.
  - Requires careful piloting and evaluation.

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