International Monetary Fund

Central African Republic and the IMF

Press Release:
IMF Executive Board Approves US$54.5 Million PRGF Arrangement for the Central African Republic
December 22, 2006

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Central African Republic: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

November 30, 2006

The following item is a Letter of Intent of the government of the Central African Republic, which describes the policies that the Central African Republic intends to implement in the context of its request for financial support from the IMF. The document, which is the property of the Central African Republic, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Bangui, November 30, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, DC 20431
USA

Dear Managing Director:

The democratic elections in mid-2005 marked an important transition for the Central African Republic. Since that time, the government has managed to improve the political and social situation which has allowed for an increased focus on economic management.

With the support of the International Monetary Fund (IMF) in particular, and the international community more generally, we have begun the difficult task of transforming our post-conflict economy and achieving sustained growth. While we recognize that this process is still in its early stages, we are encouraged by the results so far—a modest recovery is underway after a prolonged period of weak activity. We are determined to build on this performance and to establish the foundations for an acceleration of growth that will lead to a reduction in poverty and making progress towards the Millennium Development Goals.

In this regard, financial and technical assistance from the IMF is critical to the successful implementation of our medium-term economic strategy. This strategy is detailed in the Memorandum of Economic and Financial Policies (MEFP) attached to this letter, which is consistent with the government's Poverty Reduction Strategy Paper (PRSP) that is now being finalized. A PRSP preparation status report is being forwarded under a separate cover.

In support of our medium-term objectives and policies, the government of the Central African Republic hereby requests a three-year arrangement covering 2007-09 under the Poverty Reduction and Growth Facility (PRGF) in an amount equivalent to SDR 36.2 million (65 percent of quota), including a disbursement equivalent to SDR 17.6 million upon Executive Board approval of this arrangement. In line with our external debt management strategy, we will use these resources to repay outstanding—and relatively high cost—Emergency Post-Conflict Assistance loans and maintain sufficient resources in our SDR Account to meet PRGF obligations falling due until the third quarter of 2007—at which time, we hope to reach the Decision Point under the enhanced Heavily Indebted Poor Countries Initiative. Also, as a way of demonstrating the Central African Republic's commitment to maintain its creditworthiness, we intend to keep a balance in our SDR Account sufficient to cover obligations falling due to the IMF over the coming six months, on a rolling basis.

We are aware that Executive Board discussion of the government's request for a three-year PRGF arrangement is contingent upon successful implementation of the prior action detailed in Table 2 of the attachment. Disbursements during the first year of the program will be linked to program reviews based on biannual quantitative performance criteria for end-June and end-December 2007 included in Table 1, and structural performance criteria and benchmarks for 2007 outlined in Table 2.

The government of the Central African Republic believes that the policies and measures set forth in the attached MEFP are adequate to achieve the objectives of the program, but we will take any further measures that may become appropriate for that purpose. During the implementation of the arrangement, we will consult with Fund staff on the adoption of any measures that may be appropriate, at the initiative of the government or whenever the Fund staff requests such a consultation.

The government intends to make the contents of this letter and those of the attached MEFP, as well as the staff report accompanying its request for a three-year PRGF arrangement, available to the public and authorizes the IMF to arrange for them to be posted on the IMF website, subsequent to Executive Board approval of its request.

We can assure you, Mr. Managing Director, that the government of the Central African Republic is determined to fully implement the program supported by the PRGF arrangement, and hopes to move to the Decision Point under the enhanced Heavily Indebted Poor Countries Initiative as soon as possible.

Yours sincerely,

/ s /
Elie Doté
Prime Minister
and Minister of Finance and Budget

Attachment
Memorandum of Economic and Financial Policies, 2007-09

ATTACHMENT I: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES, 2007–09

November 30, 2006

I. INTRODUCTION

1. Since the government took office in July 2005, a strengthening of political and social stability has allowed us to focus on macroeconomic and financial policies. This renewed focus has supported a modest economic recovery after a prolonged period of weak activity, which is also being helped by an improvement in the terms of trade. In the period ahead, we aim to consolidate macroeconomic stability and lay a strong foundation for an acceleration of growth and poverty reduction. This is essential if we are to make progress towards meeting the Millennium Development Goals (MDGs) and to maintain widespread support for economic and financial reform. In so doing, we recognize the challenges we face—the Central African Republic (C.A.R.) is a landlocked and primarily agriculture-based economy, with a narrow export base which makes it vulnerable to external shocks.

2. Our medium-term economic and financial strategy will be guided by a Poverty Reduction Strategy Paper (PRSP) that is now being prepared in consultation with stakeholders and our development partners. The PRSP will be finalized by mid-2007 and the main pillars of the strategy will include: the consolidation of peace and domestic security; macroeconomic stability; enhanced private-sector led growth, particularly through agricultural and natural resource development; good governance and effective use of public resources; and rehabilitation of the country's human and physical capital. Implementing this agenda will require firm economic management but also extensive financial and technical assistance from the international community.

Economic Performance and Policies Since the Elections

3. The government is cautiously optimistic that a sustained, albeit modest, economic recovery is underway. During 2005, real GDP growth was high enough to reverse the trend of declining real per capita income experienced since the late-1980s. For this year, real GDP growth of about 3½ percent should allow for some improvement in the standard of living. Economic activity has been supported by our main exports (diamonds and timber) and this activity has broadened to the secondary (manufacturing) and tertiary sectors (telecommunications, transport, and commerce), which is important for enhancing domestic resource mobilization from the formal sector. Inflation has been generally contained—reflecting mainly the benefits of the C.A.R.'s membership in the Central African Economic and Monetary Community (CEMAC) with its regional central bank (BEAC)—but it has accelerated recently, because of the increase in world oil prices that led to an upward adjustment of domestic petroleum product prices earlier this year, and supply constraints for foodstuffs. However, we anticipate that food supply conditions will improve, leading to a decline of inflation through the rest of the year.

4. We have experienced a significant rebound in the volume of exports and an improvement in the terms of trade that has helped mitigate the impact of high world oil prices on the trade balance. Nonetheless, lower official transfers and a higher oil-import bill are likely to lead to a widening of the current-account deficit this year. Up to now, the deficit in the overall balance of payments was financed through the accumulation of external payments arrears, except to the Fund. However, the external payments arrears to the World Bank have now been cleared and we expect those to the African Development Bank to be cleared ahead of the Executive Board's discussion of our request. We continue to accumulate external payments arrears to official bilateral and commercial creditors but we have approached them to reschedule the C.A.R.'s external liabilities. In the period ahead, we intend to regularize our relations with all creditors, remain current with our external obligations, and to seek debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDRI) Initiatives.

5. The improvement in macroeconomic performance has been underpinned by a recent strengthening of fiscal policy. This strengthening is primarily due to our determined efforts to enhance public financial management, with the help of technical assistance from the Fund and other development partners. On the revenue side, we project an increase in tax collection above the target for this year (by about 0.2 percent of GDP), bringing tax revenue to the highest level since 2002. Reforms in tax administration, such as the audit and control of large taxpayers, efforts to improve tax payer compliance, and new tax measures have helped improve the situation. On the expenditure side, spending is projected to decline sharply this year because the government has taken measures to reduce the wage bill, there was a rollback of the election-related spending seen last year, and foreign-financed investment fell with the completion of several projects. However, there is likely to be some spending slippages related to external factors─associated with the regional conflict in the north of the country and increased petroleum-related subsidies designed to offset high world oil prices─and the decision to provide a small subsidy (0.2 percent of GDP) to jump-start the cotton sector. Nonetheless, in comparison with 2005, the fiscal stance is expected to improve significantly this year, moving from a primary deficit of 3½ percent of GDP to a domestic primary surplus of nearly ½ percent.

6. Since the new government was formed, the focus of structural reform has been centered on areas critical to consolidating peace and security, and to bolster the credibility of fiscal policy. In this regard, we have made efforts to enhance public financial management as noted above, improve transparency of public sector operations, and strengthen the ability of the legal system to address financial and commercial crime. A wide range of data including on public finance, activity in the forestry and mining sectors, as well as information on progress in combating corruption and impunity, are now published and updated regularly on the government's web site. Also, the State Judicial Agent and the financial unit in the Ministry of Justice, which is in charge of prosecuting financial corruption, are operational, although their work is hampered by the lack of resources. Had resources and technical assistance been available, the authorities would have liked to pursue structural reforms in

other areas, such as the restructuring of state-owned enterprises and the judiciary more generally. We intend to address these and other impediments to growth and poverty reduction in the period ahead, in consultation with the private sector through the recently established Permanent Consultation Framework.

II. Medium-Term Objectives and Policy Framework

7. The PRSP provides the foundation for the government's medium-term policy framework, which aims at reviving business confidence and a resumption of private domestic and foreign investment. As will be elaborated in the PRSP, this policy framework is based on a number of considerations that are critical for accelerating growth and poverty reduction. First, we believe that establishing peace and strengthening security is essential. Second, while we recognize that private sector development will be needed to sustain growth over the medium term, a well functioning public sector is a key prerequisite. In this regard, the government must foster a change in the business culture and climate, through the timely and regular payment of its own liabilities, the recognition and enforcement of private property rights, intolerance of corruption both within and outside government, and enhancing the effectiveness of the judicial system. Third, while we face challenges on a number of fronts, financial, administrative, and institutional constraints will require the prioritization of our policy efforts which implies a narrow focus in a few key sectors, at least over the medium term. In this regard, a recovery of agriculture and enhancing conditions for investment in forestry and mining are imperative, as is allocating resources to reverse the decline in our human capital. A further priority is the rehabilitation of our basic economic and social infrastructure (especially the transportation network), which has suffered from many years of conflict and disinvestment. Unfortunately, our prospective resource envelope does not allow us to begin to address this situation in any meaningful way. We believe that well designed policies and strong program implementation will lead to resumption, and more importantly, a substantial increase in aid inflows.

8. With these considerations in mind, economic policies over the medium term will be aimed at:

- Achieving annual real GDP growth of 4-5 percent through 2009, which would result in per capita income growth of about 2 percent and modest progress toward reaching the income MDG.

- Maintaining annual inflation below the CEMAC convergence criterion of an average of 3 percent, consistent with the long-term inflation trend in the Euro area to help maintain the country's international competitiveness.

- Improving the environment for private sector development by: opening the economy to international trade; financial sector reforms that would increase credit to the private sector; by restructuring state-owned enterprises; and enhanced governance in the natural resource sector, including more reliable property rights and contract enforcement.

- Pursuing fiscal consolidation to gradually reduce the overhang of domestic debt that currently limits the room to maneuver in providing resources for growth-enhancing and poverty-reducing social policies. The government intends to accomplish this by maintaining domestic primary surpluses achieved with the help of stepped up efforts to mobilize domestic resources. We will repay costly commercial banks credit and refrain from further borrowing from commercial banks, and will use some external financing to retire domestic debt. This will require concerted efforts to enhance public financial management, reorient our expenditure priorities away from less productive uses and toward social spending, particularly on health and education, and reducing the budgeted level of wages and salaries through a reform of the civil service.

- Securing external debt sustainability by regularizing relations with external creditors and benefiting from debt relief. We will strive to improve external debt sustainability by pursuing grant financing and limiting foreign borrowing to only highly concessional loans.

- Building administrative and institutional capacity in a broad range of areas—policy design, monitoring and evaluation, public financial management, debt management, and statistics—to mitigate program risks and improve policy implementation and effectiveness. In this regard, we look forward to the opening of the central African Technical Assistance Center and invite more intensive technical assistance from our development partners.

9. The successful implementation of this medium-term program will provide a firm foundation for economic development of the C.A.R. On its own, however, the program is unlikely to lead to the acceleration of growth and poverty reduction needed to make rapid progress toward meeting the MDGs. This is because the domestic resource envelope will remain comparatively small, even with enhanced efforts to mobilize domestic resources. Moreover, until the C.A.R. reaches the completion point under the enhanced HIPC Initiative, debt relief will not free resources for public-investment spending since no debt service is currently being paid, other than to the Fund. A significant scaling up of aid inflows is required and we appeal to the international community for more support.

III. THE PROGRAM FOR 2007

10. Building on the momentum generated during the past year, the challenge for 2007 will be to support a further increase in the rate of growth which we hope, will begin to lift the country out of poverty. Unfortunately, we expect a deterioration of the terms of trade next year which will create some headwinds for sustaining the recovery. Nonetheless, the prospects for increased output in the forest and mining sector, a rebound in agriculture

supported by enhanced internal security, and externally-financed public investment should increase real GDP growth to about 4 percent, the highest rate since the late-1990s. Inflation is projected to fall to about 3 percent, as the impact of the pass-through of petroleum-product price increases earlier this year drop out of the consumer price index. To achieve these objectives, the fiscal stance will be tightened to address the overhang of domestic debt, financial policies will be directed at alleviating institutional and financial constraints to credit creation, external policies will aim at improving sustainability and trade liberalization, and structural policies will support public financial management reform.

A. Fiscal Policy

11. The government considers fiscal policy to be the cornerstone of its efforts to consolidate peace and social stability and to bring about an improvement in the business environment. We will maintain a fiscal stance appropriate to ensuring a reduction in domestic debt and the timely and regular payment of our domestic and external payments obligations. By reducing domestic debt─including payments arrears─we aim to regularize relations with creditors and reestablish the credibility of fiscal policy.

12. We have submitted to parliament a 2007 budget that is in line with understandings reached with Fund staff, and reflect the external arrears clearance operations that was recently conducted by the World Bank and is expected shortly from the African Development Bank, on our behalf. The budget for 2007 targets a domestic primary surplus of about 1 percent of GDP which is a significant improvement over last year, and nearly 5 percentage points higher than 2005. This primary surplus would be brought about by an increase in the tax revenue-to-GDP ratio and firm control over public spending.

13. A key objective of fiscal policy is to raise the tax-revenue ratio, which is among the lowest in developing countries. The 2007 budget envisages an increase in tax collections by about 1 percent of GDP to 8.6 percent compared with 2006, driven by further reforms in tax and customs administration (see below). Non-tax revenue is expected to increase sharply by about ½ percent of GDP, mainly because of receipts from telecommunication licensing fees. Also, the C.A.R.'s development partners have indicated their intention to increase the level of grants, which should be about 0.8 percentage points of GDP higher than this year. Overall, this will lead to an increase in total revenue from about 13 percent of GDP in 2006, to 15 percent next year.

14. For 2007, the government is maintaining compressed expenditures in recognition of the domestic resource constraints and limited aid inflows. Outlays on public sector energy consumption and foreign travel will be reduced, and the budgeted wage bill will be capped at CFAF 35 billion, which is the budgeted level for 2006. This cap implies a decline in the wage bill by about ½ percent of GDP next year. The wage restraint does not take account of the staffing needs in the civil service─which in the health and education sectors are significant─but rather fiscal prudence as we bring the wage bill back in line with the overall

expenditure envelope; and we will reassess the situation in the near future, in the context of reform of the civil service (developed with assistance from the World Bank). In particular, this wage restraint does not prevent the hiring of qualified teachers and health care workers who are needed to support improvement in the social sectors. Their employment could be accommodated within the budgeted wage ceiling for 2007 through attrition, early retirements, and the potential savings from completing the exercise of job reclassification to resolve improper grading and reducing salaries where credentials cannot be verified.

15. An increase in projected revenue and some spending cuts will, however, allow the government to boost spending in priority arrears. The 2007 budget envisages an increase in capital expenditures by about 1½ percent of GDP and in goods and service by about ½ percent of GDP. The increase in the latter reflects expected spending for internal security, given the ongoing instability in the north of the country. The amount allocated (CFAF 3.3 billion) includes a contingency but any spending above this amount will be offset by cuts in other areas to maintain our overall fiscal objectives. We have allocated resources to support cotton producers (CFAF 250 million), which is being augmented by a European Union grant that can be used to help clear domestic payments arrears in this sector. The preliminary analysis in the PRSP is suggesting strongly that a revival of this sector is important for accelerating growth and strengthening social cohesion; cotton growing also has important synergies with the production of food crops, which is critical for alleviating poverty in rural areas.

16. The government will continue to provide financial support to vulnerable households (CFAF 1.5 billion) through 2007, to help shield them against high world oil prices. However, we are determined to reform the structure of petroleum product pricing and the way in which financial support to the poor is now being provided; the current policies are inefficient and ineffective in targeting support, because for some products it only benefits high income consumers. We have requested technical assistance from the Fund to help in the design of these reforms. By end-December 2007, we will implement a new petroleum pricing formula with parameters set to ensure full recovery of all costs, distribution margins, and taxes, and that avoids the need for future budget subsidies (structural performance criterion).

17. The revenue targets are ambitious and the expenditure envelope remains modest. However, if there is a shortfall in domestic resources we will take any measures necessary to achieve our overall fiscal objectives for next year.

18. The government will make concerted effort to reduce domestic debt which helps anchor our medium-term fiscal strategy. The domestic debt includes commercial bank overdrafts (1.6 percent of GDP at end-September 2006), the debt to the regional central bank (7.3 percent of GDP)—which we expect to be rescheduled shortly on concessional terms—payments arrears (12.3 percent of GDP), and potential liabilities emerging from guarantees to state owned enterprises (which should be verified and validated shortly). The domestic arrears—including for wages and pensions and supplier's credits—which accrued during the

period 1998-2004 were recently verified by an internal process and will be further validated by an external audit, which is expected to be completed by end-June 2007 (structural performance criterion). Once this audit is complete, the government will begin to clear these payments arrears.

19. We plan to clear the payments arrears through a number of means: domestic resources, external financial assistance, negotiating discounts on some of the amounts due, and using debt-for-equity swaps, possibly involving land or other public assets, although this option will require technical assistance to implement. We will ensure the transparency of the terms of repayment to the various groups of creditors and endeavor to treat them all on an equal basis. During 2007, we expect to repay domestic debt equivalent to nearly 2½ percent of GDP. This will be accomplished by a repayment of commercial bank overdrafts and the clearance of some payments arrears (equivalent to 2 percent of GDP), financed largely by grants.

B. Public Financial Management

20. An important aspect of the government's structural reform agenda and efforts to enhance governance will come about through enhanced public financial management.

21. Indeed, the ongoing reform of tax and customs administration, a broadening of the tax base, and improving taxpayer compliance will help to bolster tax collection. The government introduced new tax measures during the past year or so and tax rates are now relatively high in the C.A.R. Consequently, the government deems it appropriate to pursue administrative reforms, rather than new tax measures, to enhance domestic revenue mobilization. In line with IMF technical assistance, the government will pursue the following tax administration reforms to tighten controls over large-taxpayers and extend the efforts to small- and medium-size enterprises: update the list of taxpayers (including public enterprises) and ensure the list covers all applicable taxes; reduce the rate of non-compliance of large enterprises through the effective implementation of disciplinary actions against delinquent taxpayers and further intensification of audits; apply the ceiling of CFAF 30 million turnover for the purpose of taxation of all businesses (individual and companies) without any exception and allow enterprises subject to the flat tax to opt out for the application of the regular tax regime; refrain from granting any new tax exemptions; and apply all the available mechanisms for recovering tax arrears. By end-December 2007, the government is determined to reduce the stock of tax arrears by at least CFAF 1 billion, net of uncollectible amounts (structural performance criterion).

22. With regard to customs administration, the government has recently taken action to address the persistent problems caused by the lack of training of customs officials and scope for corruption, which is evidenced by relatively poor revenue performance. Consequently, we have established a high level steering committee─Chaired by the President of the Republic─to design a reform, which will be implemented early next year. This reform will

lead to a unification of all activities involved in customs administration (by end-March 2007, structural performance criterion), and include bolstering the qualifications and training of customs officials, combating fraud and corruption, and facilitating customs clearance, which together, should lead to a significant improvement in customs receipts. The reform of the customs administration will also be informed by the external audit of the one-stop customs window in Douala (*Guichet Unique)*, which is due to be completed by end-February 2007 (structural performance criterion). The recently piloted valuation system, SYDONIA++, will be fully deployed starting in June 2007 and this will help improve customs valuation and limit discretion in this regard.

23. To enhance the monitoring and reporting of its fiscal activities, the government has recently adopted an Organic Budget Law which has guided the preparation of the 2007 budget. In the period ahead, we will adopt a new budget classification and nomenclature system and accounting rules that will strengthen the expenditure chain. In addition, we plan to:

- Put in place by end-March 2007 a formal procedure to audit and report on a quarterly basis all sources of revenue (tax and non-tax, including those for fees, licenses and permits in the natural resource sector) accruing to the state (structural performance criterion). These reports will be undertaken by the Inspector General of Finance and submitted to the Court of Accounts for verification and publication. We will begin an external audit (by end-September 2007) of all the sources of government revenue (collected through ministries and agencies) during the period July 2005 to end-December 2006 to help ensure that all revenues have been dutifully reported to the state treasury, and to clarify areas where reporting can be strengthened (structural performance criterion). We will follow-up on the findings and recommendations on both the internal and external audits. Also, we will accelerate our participation in the Extractive Industries Transparency Initiative.

- Accelerate the move to a treasury single account (TSA) and deposit all government receipts in the TSA, including proceeds from natural resources fees, licenses, and permits;

- Disburse public resources only to pay for budgeted expenditures and fully report all government expenditures through the budget;

- By end-June 2007, gain better control over expenditures by eliminating the issuance of (new) non-cash backed Treasury checks and eliminate by the same date the stock issued in 2005-06 (structural performance criterion); the government will publicly announce that such Treasury checks will no longer be valid after end-September 2007. We will also restrict the practice of using cash advances, and requiring the full reporting of ex post expenditures;

- Ensure that all revenues from the provinces are transferred fully and on a regular basis to the Treasury; and

- Implement (with the assistance of the World Bank) a new draft procurement code in line with international best practice.

C. Monetary and Financial Sector Policies

24. Monetary and exchange rate policy is conducted at the regional level by the Bank of Central African States (BEAC). The BEAC has been a source of stability for the C.A.R. and BEAC has been an important source of short-term financing in the past, although the cost has been relatively high. The government will avoid recourse to this financing, as well as reduce its net position toward the banking system over the program period.

25. Little progress has taken place in the C.A.R. in the recent past towards financial stability and development. Consequently, the banking sector remains weak and financial intermediation is among the lowest in the CEMAC region. In this regard, the authorities are making financial stability and development part of its Fund-supported program. This program proposes a national strategy for promoting financial development based on institutional reforms that could facilitate access to credit and remove obstacles to financial intermediation, and it has been informed by the recent Financial Sector Stability Assessment (FSSA) of the CEMAC. While it is acknowledged that the C.A.R.'s participation in the CEMAC implies that many institutional matters related to financial development are conducted by regional bodies and influenced by regional legal initiatives, it is also clear, as concluded in the regional FSSA, that there is considerable room for national initiative.

26. In 2007, the authorities intend to pursue:

- A legal and judiciary reform that could make credit collection more reliable, efficient and less costly. This would also involve by end-December 2007 the reform of commercial laws and civil procedures related to debt collection and bankruptcy, in line with the recommendations made by the recent regional FSSA (structural benchmark);

- The promotion of land surveys and modernization of the functioning of land and commercial registries, to facilitate the use of collateral for credit access;

- The implementation of an anti-money laundering/combating financing of terrorism (AML/CFT) framework outside the formal banking sector to prevent further disintermediation and informalization of financial services, in line with the recent regional Report on the Observance of Standards and Codes (ROSC, recommendations for AML/CFT); and

- In close coordination with the regional regulator (COBAC) (i) the adoption of measures that would enhance stability in the financial sector, in particular, initiating the process of reconciliation and validation of potential liabilities of state owned enterprises toward commercial banks with a view to establishing options for their repayments, and (ii) compliance with established procedures for the timely recapitalization─without contributing government resources─of the troubled commercial bank (structural benchmark).

D. External Sector Policies

27. The C.A.R. has experienced a significant decline in external trade over the past several decades despite maintaining a relatively liberal exchange and trade system. While the country's landlocked nature and poor transport network inhibits trade, the government recognizes the import role played by trade policy. In this regard, the government intends to work with its CEMAC partners in the coming year to seek a reduction in the common external tariff and to coordinate more closely on reducing administrative barriers to regional trade, particularly along the main trade corridor between Bangui and Douala. Also, we intend to draw from the recommendations of the World Bank's Diagnostic Trade Integration Study (to be completed early next year) and the findings of the World Trade Organization's review of our trade policies during 2007. These studies will help us develop identify measures to eliminate both internal and external constraints to trade, and establish trade policies consistent with our participation in regional and other preferential trade agreements, improve trade facilitation, and enhance key elements of the investment climate.

28. The C.A.R. is in debt distress so achieving external sustainability is a high priority in the period ahead. External payments arrears have been be cleared to the World Bank and we expect those to the African Development Bank to be cleared ahead of the Executive Board's discussion of our request for a PRGF arrangement; and we will approach the Paris Club and other bilateral and commercial creditors to request a debt rescheduling once the PRGF is approved by the Executive Board.

29. Looking forward, the government is fully aware of the need to ensure prudent external debt management. With the assistance of the African Development Bank, the government will improve its debt management and project evaluation capacity. The government will also pursue grant financing wherever possible and will restrict its foreign borrowing only to loans with a grant element of 50 percent or more.

E. Other Structural Policies

30. The government is determined to improve the management of the natural resource sector. In this regard, in the coming year we will review the regulatory regime in the forestry sector and the mining code (in consultation with the World Bank), with the aim of establishing clear and predictable rules that guarantee the rights of investors, while

maximizing the returns to the state. In the forestry sector, the legal and regulatory framework will be revised to strengthen management practices, enhance value added, adopt competitive and transparent criteria for attributing harvesting rights, and ensure that all public revenues from the sector are accounted for in the Treasury. In the mining sector, we will pursue efforts to upgrade the legal, regulatory and institutional settings, such as standardizing concession agreements, transparency over bonus payments, and full reporting of revenues from the sector in the Treasury. Also, in the coming year we will work to enhance the performance of state-owned enterprises, which suffer from poor financial and operating performance. One option being explored is the private-sector management of the water and electric utilities supported by tariff reforms and enhanced collections.

F. Program Monitoring for 2007

31. The program will be monitored through reviews based on biannual quantitative performance criteria for end-June and end-December 2007 (Table 1), and structural performance criteria and benchmarks for 2007 (Table 2). Detailed definitions and reporting requirements for all quantitative performance criteria and structural conditions are contained in the accompanying Technical Memorandum of Understanding (TMU, Attachment II). The government will make available to Fund staff all core data, appropriately reconciled and on a regular and timely basis, as specified in the TMU.

32. The government will implement one prior action ahead of the Executive Board's consideration of our request for a three-year arrangement under the PRGF. This prior action entails the issuance of an international competitive tender to undertake an audit for the validation of the domestic payments arrears accumulated between 1998-2004.

33. The first review under the PRGF arrangement is expected to be completed by September 28, 2007.

Table 1. Quantitative Performance Criteria and Benchmarks under the PRGF Arrangement, 2007

(In billions of CFA francs; cumulative from December 31, 2006; ceilings, unless otherwise indicated)

	End-Dec. 2006	End-Mar. Benchmark	End-June Performance Criteria	End-Sept. Benchmark	End-Dec. Performance Criteria
Floor on total government revenue 1/	...	21.3	42.1	61.2	81.0
Wages, salaries, and bonuses 2/	...	8.8	17.5	26.3	35.0
Floor on domestic primary balance 3/	...	2.5	4.7	6.4	8.7
Accumulation of new government domestic arrears on wages and goods and services 4/	...	0.0	0.0	0.0	0.0
Change in net claims of the commercial banking system on the government	...	-1.0	-2.0	-3.0	-4.4
New nonconcessional external debt 5/ 6/	...	0.0	0.0	0.0	0.0
Accumulation of government external payments arrears 6/	...	0.0	0.0	0.0	0.0
Indicative targets:					
NPV of external debt	455.4	...	...	...	457.9
Floor on poverty-related spending 7/	...	3.1	6.1	9.2	12.3
Domestic payments arrears 8/	95.6	95.6	95.6	86.5	77.5

1/ Domestic revenue, which excludes foreign grants and divestiture receipts (see the Technical Memorandum of Understanding, TMU, for more details).

2/ Including withholding taxes on government salaries (see TMU).

3/ The domestic primary balance (cash basis) is defined as the difference between government domestic revenue and government total expenditure, less all interest payments and externally-financed capital expenditures. An adjustor applies for any unplanned/or shortfalls of grants and loans (see the TMU).

4/ Wage arrears (including unpaid pensions and bonuses) and arrears on goods and services, excluding arrears on utility consumption. Arrears on goods and services include unpaid spending commitments vis-à-vis suppliers as well as deposit accounts of enterprises in the Treasury.

5/ Contracted or guaranteed by the government (see the TMU).

6/ These performance criteria will be monitored on a continuous basis.

7/ Total spending on health and education including wages and salaries and goods and services.

8/ End-2006 stock corresponds to the amount validated by the Domestic Arrears Validation Committee and is subject to an external audit; they include arrears which accrued during 1998-2004 and those which pre-date 1998.

Table 2. Prior Action, Structural Performance Criteria and Benchmarks Under the PRGF Arrangement, 2007

Measures

Prior action

- The issuance of an international competitive tender to undertake an external audit for the validation of domestic payments arrears, which accrued during the period 1998-2004.

Structural performance criteria

- By end-February 2007 complete the external audit of the operations of the one-stop customs window in Douala (*Guichet Unique)*.
- By end-March 2007, restructure (in consultation with Fund staff) the customs administration activities under a single entity, which will report to the Minister of Finance.
- By-end March 2007, implement a formal procedure to audit and report on a quarterly basis all sources of revenue (tax and non-tax, including those for fees, licenses, and permits in the natural resource sector) accruing to the State. The audits should be carried out by the Inspector General of Finance who will be given access to all relevant information to conduct the audits, and submitted to the Court of Accounts for verification and publication, no later than 2 months after the end of each quarter. The first of such audits should be published by May 2007.
- By end-June 2007 complete the external audit for the validation of the domestic payments arrears, which accrued during the period 1998-2004.
- By end-June 2007, eliminate the stock of treasury checks issued in 2005-06 and eliminate the issuance of non-cash backed treasury checks. The government will publicly announce that such treasury checks will no longer be valid after end-September 2007.
- By end-September 2007, begin an external audit of all the sources of government revenue (collected through ministries and agencies) during the period July-2005 to end-December 2006, to help ensure that all revenue has been dutifully reported to the state treasury, and to help clarify where reporting can be strengthened.
- By-end December 2007, implement a new petroleum product pricing formula with parameters set to ensure full recovery of all costs, distribution margins, and taxes, and that avoids the need for further budget subsidies.
- By-end December 2007, reduce the stock tax arrears by at least CFAF 1 billion, net of uncollectible tax arrears.

Structural benchmarks

- Continuous. The government will refrain from providing resources to recapitalize the troubled commercial bank.
- By end-December 2007, reform commercial laws and civil procedures relating to debt collection and bankruptcy in line with the recommendations in the regional Financial Stability Assessment Program completed in June 2006.

ATTACHMENT II: TECHNICAL MEMORANDUM OF UNDERSTANDING

November 30, 2006

1. This Technical Memorandum of Understanding describes the definitions that are intended to clarify the measurement of the quantitative performance criteria and indicators in Table 1 of the Memorandum of Economic and Financial Policies, 2007-09, attached to the authorities' Letter of Intent. It also specifies the periodicity and deadlines for transmission of data to the staff of the International Monetary Fund (IMF) for program monitoring purposes. Unless otherwise specified, all quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from December 31, 2006.

Provision of data to the Fund

2. Data with respect to all variables subject to performance criteria and indicative targets will be provided to Fund staff on a regular basis—with the timing indicated in Table 1 below—including any revisions, which will be transmitted in a timely manner. In addition, the authorities will consult with Fund staff on any information and data that become available, which are relevant for assessing or monitoring performance against the program's objectives but are not specifically defined in this memorandum.

Definitions and computation

3. Unless otherwise indicated, the **government** is defined as the central government of the Central African Republic (C.A.R.) and does not include local governments, the central bank, or any public entity with autonomous legal personality (i.e., wholly- or partially-owned state enterprises) not currently covered by the government consolidated financial operations table (*tableau des operations financiers de l'Éta*—TOFE).

4. **Government domestic revenue** is as reported in the TOFE and it includes offsetting operations in current revenue and expenditure—between the government and all suppliers of goods and services—excluding foreign grants and divestiture receipts. Government revenue includes all tax and non-tax revenue, as well as ear-marked revenue, checks for project-related customs duties, and withholdings from civil service wages and salaries actually paid.

5. **Government expenditure** is as reported in the TOFE and includes all earmarked spending, treasury operations, the domestic counterpart to foreign-financed projects, and offsetting operations. Poverty-related spending on health and education will be reported from the functional classification of government spending.

6. The **government wage bill** is monitored on a cash basis for all staff (permanent and temporary) of the civil service and the armed forces, including withholdings on behalf of the General Directorate of Tax Administration. The wage bill covers wages, salaries, and bonuses paid with a current lag of six months. For the purpose of the program, a lag length of

more than seven months would result in an accumulation of wage arrears, while a decline in the lag length would be reflected in a reduction of wage arrears.

7. The **domestic primary fiscal balance**, on a cash basis, is defined as the difference between **government domestic revenue** and **government expenditure**, excluding all interest payments and externally-financed capital expenditure.

8. The **accumulation of new government domestic payments arrears on wages and purchases of goods and services** (excluding arrears on utility consumption) correspond to unpaid salaries, wages, pensions, and bonuses of civil servants and other government employees committed up to seven months prior to the current period, and to unpaid payment orders to suppliers of goods and services issued two months prior to the current period. The change in government domestic payments arrears on purchases of goods and services includes the deposit accounts of enterprises at the treasury resulting from unpaid expenses on goods and services supplied.

9. The **end-of-period stock of net claims of the commercial banking system on the government** is defined as the difference between deposits held by the government in commercial banks and outstanding loans and overdrafts.

10. The performance criterion on the contracting of **new nonconcessional external debt** applies to both short (with an original maturity of one-year or less) and medium- and long-term (with an original maturity of more than one year) external debt, contracted or guaranteed by the government. Purchases from the IMF are excluded from this limit.

11. For the purposes of this memorandum, the definitions of "debt" and "concessional borrowing" are as follows:

- The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted by the Executive Board of the IMF on August 24, 2000 (Decision No. 12274-00/85, August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received. For purposes of these guidelines, the term "debt" is understood to mean a current, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided that the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair, or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

- Loan concessionality is assessed on the basis of the commercial interest reference rates (CIRRs) established by the Organization for Economic Cooperation and Development (OECD). A loan is said to be on concessional terms if, on the date the contract is signed, the ratio of the present value of the loan, calculated on the basis of the reference interest rates, to its nominal value is less than 50 percent (that is, a grant element of at least 50 percent, which does not apply to refinancing operations). For debts with a maturity exceeding 15 years, the ten-year reference interest rate published by the OECD is used to calculate the grant element. For shorter maturities, the six-month market reference rate is used. To both the 10-year and six-month averages of the reference rate, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–29 years; and 1.25 percent for 30 years or more.

12. The concept of government for the purpose of the indicator on external debt includes government as defined in paragraph 3, administrative public institutions, public enterprises authorized to contract, guarantee, or accommodate nonconcessional borrowing, scientific and technical public institutions, professional public institutions, industrial and/or commercial public institutions, and local governments.

13. **External payments arrears** are deemed to accrue when undisputed interest or amortization payments of the government are not made within the terms of the contract, or in conformity with any future deferral agreed with the Paris Club or other bilateral and commercial creditors.

14. The **net-present-value of external debt** is estimated using the IMF's external Debt Sustainability template for Low-Income Countries.

15. The **domestic payments arrears** are understood to include those validated by the external audit undertaken during the first part of 2007 which accrued during 1998-2004 and those which pre-date 1998. These domestic payments arrears include wages and salaries and supplier's credits.

16. The **program exchange rate** for the purposes of this memorandum is CFAF 655.957 per Euro and US$ 1.47 per SDR.

Adjuster

17. The floor on the domestic primary fiscal balance (cash basis) will be adjusted downward to reflect the full amount of any unprogrammed foreign grants and/or external budget support (in the form of concessional loans with a grant element of at least 50 percent). This floor will adjusted upward by up to CFAF 3 billion per period, with a cumulative annual ceiling of CFAF 6 billion, for any shortfall in programmed foreign grants and/or external budget support. The net domestic financing for such a shortfall will be provided only through the regional central bank (BEAC). The projected foreign grants and external budget support for 2007 are detailed in Table 2 below. Quarterly differences between projected and actual foreign grants and external budget support will be converted to CFAFs at the average quarterly exchange rate during the period in question and cumulated to the test date.

Table 1. Data Provision to the IMF Under the PRGF Arrangement

Monthly evaluation report of quantitative and structural indicators; within two weeks after each month's end.
Monetary survey, central bank and commercial bank accounts on a monthly basis; within six weeks of the end of each quarter.
Net claims of the banking system on the government disaggregated (including and excluding IMF resources) and commercial banks; within ten days of the end of each month.
Table on monthly operational cash flow; within four weeks after the end of each quarter.
Government budget operations (TOFE); within four weeks after the end of each month.
End-of-period stock of domestic arrears on goods and services and wages, including unpaid pensions and bonuses; within four weeks after the end of each month.
End-of-period stock of external arrears; within four weeks after the end of each month.
Breakdown of cash outlays for current and capital expenditure, domestically financed and foreign financed; within four weeks after the end of each month.
Summary report and actual spending in priority sectors, including health, education, and security; within four weeks after the end of each quarter.
Breakdown of revenue by institution and economic classification; within four weeks after the end of each quarter.
Breakdown of external debt-service and arrears, including by interest and principal, and by principal creditor; within two weeks after the end of each quarter.
Amount of new nonconcessional and concessional external debt contracted or guaranteed by the government; within two weeks after the end of each month.
Actual disbursements of project and program external financial assistance, and external debt relief granted by external creditors; within four weeks after the end of each quarter.
Amount of paid and outstanding Treasury checks; within four weeks after the end of each month.
Stock of tax arrears and amount paid; within four weeks after the end of each month.
Indicators to assess overall economic trends, such as the household consumer price index, and oil product consumption; within four weeks after the end of each month.
Import/export flows (in volume and value), activity in the forestry and mining sector; within four weeks after the end of each quarter.
A review of the implementation of structural measures (see Table 2 below), including supporting documentation; within two weeks after the end of each quarter.
A monthly report on the structure of petroleum prices; within two weeks after the end of each month.

Table 2. Foreign Grants and Budget Support, 2007
(In billions of CFA francs, cumulative from December 31, 2006)

	End-Mar.	End-June	End-Sep.	End-Dec.
Grants	7.7	7.7	7.7	12.3
Concessional loans 1/	0.0	0.0	0.0	0.0
Total	7.7	7.7	7.7	12.3

Sources: C.AR. Authorities; development partners; and Fund staff estimates.
1/ Consisting of concessional loans with a grant element of at least 50 percent.