International Monetary Fund

Islamic Republic of Mauritania and the IMF

Islamic Republic of Mauritania: Staff-Monitored Program: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

March 14, 2006

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Nouakchott, March 14, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington, D.C. 20431

Dear Mr. de Rato:

Since August 2005, the transition government has put Mauritania on the road to transparency and a return to economic stability. It decided to solve the data issues that had adversely affected relations with the International Monetary Fund (IMF) since the beginning of 2004 and to proceed with the revision of the country's economic and financial data going back about 10 years. Over the past few months, the results of returning to fiscal discipline and maintaining a prudent monetary policy quickly became apparent. Inflation fell to under 6 percent at year-end and real GDP growth has continued in 2005 at a rate exceeding 5 percent. In 2005 the public deficit remained within the limits provided for in the supplementary budget law, adopted in November, and the government's domestic arrears were sharply reduced. The premium on the parallel exchange market practically disappeared and, in the course of 12 months, the central bank's foreign reserves were bolstered. Nevertheless, the external position and inflation control remain fragile; additional efforts are still needed, especially in order to strengthen the institutional framework for public financial management and to establish the instruments required for the optimal management of new oil resources.

The Memorandum on Economic and Financial Policies (MEFP) attached hereto presents the key elements of the government's program for the first half of 2006. This program aims at consolidating the good macroeconomic performance seen in the fourth quarter of 2005 by means of appropriate fiscal and monetary policies. The macroeconomic objectives for 2006 are to keep nonoil GDP growth at 6 percent at least and to limit the pace of end-year inflation to 8 percent. The program also establishes a framework for pursuing reforms, the major thrust of which will be to improve budget formulation, execution, and reporting; to establish a clear institutional framework for managing government oil resources, which will be used to accelerate the achievement of development and poverty reduction goals; and to complete the task of data verification and revision.

Fiscal policy will be based on strict implementation of the 2006 budget law. The law provides for a substantial increase in total revenue as a result of the start-up of the Chinguetti oilfield, good net earnings by the national iron ore company (SNIM), and the measures described in the MEFP. The law also establishes a significant increase in expenditure; in particular, a substantial wage increase (24 percent) was granted in January, in order to bring public employee salaries more in line with those in the private sector and boost morale in the civil service. Based on the assumption that the price of oil will be $60 per barrel, prudent and realistic budget estimates reveal a budget surplus of around 2.8 percent of nonoil GDP, which will allow the government to continue to reduce its arrears.

Monetary policy will be aimed at containing the inflationary pressures that could emerge as a result of the civil service wage raise and the increase in the tax burden on imports. For this reason, the central bank will pursue its current policy by refraining from granting financing to the Treasury. There will be no increase in outstanding bank credit to the government during the year as a whole. Nevertheless, the quarterly profile of revenue and expenditure will make monetary financing necessary during the first quarter.

The implementation of these policies should make it possible to attain, at year-end, the objective of building up sufficient central bank reserves to cover at least 1.2 months of imports. Strengthening the external position will pave the way for an in-depth reform of the foreign exchange market, consistent with a more flexible exchange rate, during the second half of the year.

The government plans to expedite the reforms of public expenditure management, specifically, the corrective measures required by the IMF Executive Board in order for Mauritania to qualify for the Multilateral Debt Reduction Initiative (MDRI). All these measures will be completed by May 2006. In particular, the preparation of a medium-term expenditure framework will be coordinated with work on the new Poverty Reduction Strategy Paper (2006–10).

The government has established an operational mechanism for the collection, management, and monitoring of the resources that it will derive from hydrocarbons. It will continue to implement the Extractive Industries Transparency Initiative (EITI), which Mauritania joined in October 2005. It further intends to work towards the publication of production-sharing contracts.

The government requests that IMF staff monitor the execution of this program during the first half of 2006. Following that period, the government intends to agree on a three-year economic program supported by the IMF under a Poverty Reduction and Growth Facility (PRGF) arrangement. The government will provide the IMF with the information required in order to monitor program implementation. A review of the progress made during the first three months will be conducted with IMF staff in late April/early May.

Very truly yours,

/s/

Zeine Ould Zeidane
Governor
Central Bank of Mauritania

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

January–June 2006

March 14, 2006

I. INTRODUCTION

1. On August 3, 2005, the Military Council for Justice and Democracy (CMJD) ousted the old regime and installed a transition government in Mauritania. The transition government's three main objectives are to restore democracy, reform judicial institutions, and establish good governance. In November 2005, the new government decided to resolve the data issues that had plagued Mauritania's relations with the International Monetary Fund (IMF) and the other development partners, and that had jeopardized the country's economic stability and the achievement of its development objectives.

2. The government decided to take all necessary corrective measures to restore full data transparency and to implement the policies that will ensure sustainable development of the Mauritanian economy and optimal use of oil resources, given the start of oil production. By adopting an IMF staff-monitored program (SMP) for the first six months of 2006, it also hopes to pave the way for a program under the Poverty Reduction and Growth Facility (PRGF) and prompt qualification for the Multilateral Debt Reduction Initiative (MDRI).

II. ECONOMIC DEVELOPMENTS IN 2005

3. Growth in 2005 was solid, sustained by the prospects for the oil sector. However, owing to the lack of control over public spending in the first part of the year—until August—the fiscal deficit widened, the external situation remained precarious, and inflationary pressures persisted. In the fourth quarter of 2005, following the adoption of a supplementary budget law in early November as well as several key measures (including the decision to stop all spending commitments as of November 20), the new government was able to contain expenditure and substantially reduce the stock of payments arrears. At the same time, the tightened monetary policy stance since mid-2004 finally paid off with the restoration of confidence in the ouguiya and a sharp decline in inflation over the last four months of 2005.

4. **Growth and prices**. According to preliminary estimates, GDP growth in 2005 exceeded 5 percent, owing in particular to the strong rebound in agricultural output (more than 50 percent over 2004) and job creation in the civil service (an increase of about 10 percent), and despite the slowdown in some sectors (notably, construction) in the latter part of the year. The average annual increase in consumer prices exceeded 12 percent, but on a year-on-year basis inflation declined from over 12 percent at end-August to less than 6 percent at end-December, reflecting the impact of monetary tightening during the second half of the year, as well as the government's actions against noncompetitive practices in the retail trade for consumer staples (meat and bread).

5. Mauritania's external position improved slightly, reflecting the favorable outturn in the underlying current account balance (excluding FDI-related flows in the oil and mining sectors). In particular, rising international prices for iron ore in 2005 boosted exports by the SNIM (the state-owned iron ore company), while fishing revenues posted a moderate increase. Inflation pushed the real effective exchange rate upward by 7.3 percent during the first eleven months of 2005, despite the slight rise in the official rate for the U.S. dollar on the official market since October. The decline in the premium on the parallel exchange market during the last quarter (it had disappeared in January 2006) reflected the impact of monetary contraction and increased confidence in the ouguiya owing to the imminent start of oil production.

6. **Fiscal policy**. The fiscal tightening undertaken by the transition government made it possible to keep the deficit, excluding grants, under 9 percent of GDP, thanks in particular to the fact that expenditure was generally kept within the envelope provided in the supplementary budget law. Good performance on the tax revenue side is explained by the taxes related to oil activity, but also to temporary factors (stepped-up releases of goods from bonded warehouses in December and the efforts to collect taxes from the SNIM). These results (combined with the large increase in treasury bills issues) made it possible to reduce the treasury float by more than 50 percent in 2005, to UM 10 billion. The overall figure for government arrears at end-2005 (of slightly over UM 40 billion or 8 percent of GDP) also includes other government liabilities to its suppliers (about UM 24 billion) and arrears on membership contributions to international organizations (almost UM 7 billion).

7. **Monetary Policy**. The growth in broad money (14.6 percent over 12 months) remained below GDP growth. This relatively modest increase is explained primarily by the decision of the BCM no longer to finance the budget deficit directly. In addition, the transfer to the BCM of public entities' deposits with commercial banks, contributed to a reduction in base money in 2005 and a mopping-up of bank liquidity. For their part, the commercial banks increased their foreign liabilities by mobilizing a large portion of the lines of credit put in place in 2005 to refinance imports of petroleum products, and used the counterpart in ouguiyas to absorb the increased treasury bill issues. The 23 percent growth in net credit to the government was facilitated by a substantial increase in the auction rates. Credit to the private sector grew slightly, by 7 percent, reflecting both the crowding-out effect of the treasury bills and the strengthening of bank supervision.

8. In the area of structural reforms, in line with the approach announced by the CMJD in August, action plans were adopted by the transition government to improve governance and the judicial system following discussions and consultations with civil society and the political parties. The reform process started with important decisions for improving the data reported by the BCM and the Treasury. Moreover, the government decided to join the Extractive Industries Transparency Initiative (EITI) in September 2005 and ratified the United Nations Convention Against Corruption in December. On the structural side, abolition of the roster system and transport office eliminated an oligopolistic practice that increased the prices of land transport significantly; the positive impact of this on the competitiveness of the Mauritanian economy should be felt shortly. Moreover, to prepare for the reform of the

exchange market, regulations on the organization of exchange bureaus were amended to professionalize the activity of foreign exchange dealers. An AML/CFT law was adopted on July 27, 2005 and a monitoring unit will be established.

III. Macroeconomic Framework for 2006 and the Medium Term

9. The macroeconomic objectives for 2006 and the medium term are continued growth, external position strengthening, and inflation control. On the economic policy front, the return to a more appropriate fiscal policy, maintenance of an adequate monetary stance, and introduction of a more flexible exchange policy will support these objectives, as will the start-up of oil operations. The new mining project (Akjoujt), major infrastructure construction programs (such as the Aftout-Saheli aqueduct), and the reforms under way should facilitate the achievement of the projected growth of at least 6 percent in 2006. Following an increase in consumer prices in early 2006 owing to rises in fuel prices and civil service salaries, as well as changes in the taxation of imports, inflation should settle at about 7 percent by the end of the year (on a year-on-year basis) and thereafter be kept below 5 percent. The near-term objective for the official reserves is to restore the import cover to at least 1.2 months by the end of the year.

10. The government's economic objectives for the medium term will be established when the new poverty reduction strategy is adopted in July 2006. These objectives will include optimal management of oil resources, bearing in mind the limited life of the oilfield entering operation, future uncertainties about oil revenues, limited macroeconomic absorptive capacity, and the risks of a loss of competitiveness and slowdown of diversification that an excessive appreciation of the real exchange rate would entail for the economy. Economic development will also benefit from an ambitious investment program and the development of public-private partnerships, and key reforms in the areas of governance, the exchange market, the financial sector, fishing, and transport.

IV. Economic Policies in 2006

A. The Budget

11. Execution of the 2006 budget is a key tool for achieving the macroeconomic objectives for the year in progress. Based on conservative revenue assumptions and, for the first time, realistic spending projections, the budget will show a surplus, including oil revenues, of 2.8 percent of (nonoil) GDP,[1] assuming international oil prices of US$60 per barrel. The nonoil deficit will be kept to 7.0 percent of GDP, which will enable a reduction in both net bank financing (without recourse to financing by the BCM) and the stock of outstanding government arrears. The envelope of UM 22 billion provided for this purpose in the budget will be used following an audit to confirm the validity of these obligations by the Inspectorate General of Finance. A copy of its report will be provided to IMF staff. The

[1] Unless explicitly otherwise indicated, GDP used as the basis for ratios in this memorandum is nonoil GDP.

reduction in delays in the payment of government suppliers, along with improved public procurement procedures, should lead to substantial reductions in the prices of goods and services and reactivate some sectors of the Mauritanian economy, such as construction.

12. The budget calls for a substantial increase in revenues. Apart from oil receipts, which could exceed US$200 million in 2006, the government's revenues should increase by 11 percent thanks in particular to increased collections from the SNIM. For the tax on wages and salaries (ITS), which is excessively punitive for wage earners, the monthly standard deduction has been raised (from UM 18,000 to UM 21,000) and the maximum rate lowered (from 40 percent to 35 percent). The impact of these measures will be offset by greater rigor in the audit of corporate ITS returns.

13. Customs revenues will increase by approximately 0.6 percentage point of GDP following the government's decision to restore a transparent withholding system at Customs, and to replace the reference values previously used for most products with transaction values, which are substantially higher. To neutralize some of the impact on the prices of these products, the 2006 budget law has temporarily amended customs duty rates, the VAT and/or the rate of the statistical tax applicable to these products, and abolished excise taxes on tobacco, sugar, and tea. Aware of the risk of distortions caused by these adjustments, the government will endeavor to reform import taxation by end-2006 with technical assistance from the IMF and after consultation with the business community.

14. The government is planning a reform of taxes on fishing that will lead to better development of the sector, increased transparency in the granting of fishing licenses, and sustainable management of this resource. The preparation and implementation of this reform will be stepped up in the event that the negotiations under way on the fishing agreement with the European Union are unsuccessful so that sufficient substitute revenues can be identified during 2006.

15. The government also wishes to undertake a thorough modernization of the tax administration, in order to base collections and audits on more rational and equitable principles. A timetable for the implementation of these reforms will be prepared by April 2006. The key elements of this reform include the decree of February 27, 2006 reorganizing the large enterprise unit (DGE) so that it will henceforth deal only with enterprises whose annual turnover exceeds UM 30 million, wherever their corporate headquarters may be located. Moreover, an instruction was issued in February 2006 to establish a single tax identifier for enterprises, which will improve tax auditing by allowing crosschecking of data available in various administrations. For its part the General Directorate of Customs will enhance its import verification methods. Each quarter, the Office of the Minister of Finance will perform a reconciliation of discrepancies between import valuations by Customs and the values reported by the *Société Générale de Surveillance*. Moreover, Customs will develop a system for verifying oil exports.

16. The budget calls for a decrease in total noninterest expenditure of 0.3 percentage point of GDP. The government will not exceed the spending ceilings, even if revenues are

higher. On the wage side, it was deemed essential to introduce measures in the 2006 budget implying a civil service wage increase of about 24 percent in order to motivate civil servants and combat corruption. These measures include an initial increase in the base wage (*salaire indiciaire*) of 50 percent and an increase in the bonuses for qualified positions and certain government functions as part of the efforts underway to bring government wages in line with private sector wages, simplify the wage scales, and make them more transparent. The impact of the net creation of jobs in the civil service on the 2006 wage bill is limited to 0.1 percentage point of GDP. Moreover, the ongoing review of the payroll database will make it possible to identify and eliminate ghost workers.

17. A portion of the increase in the wage bill has been financed by savings elsewhere, particularly cuts in nonpriority spending (UM 3 billion), savings on the expenditures of embassies, and a freeze of supplementary appropriations for centralized expenditures at their 2005 levels, following their inclusion in the ministerial budgets. Moreover an amount of UM 9 billion, which has been provided to cover unforeseen expenditures, will not be committed in the first half of the year unless strictly necessary.

18. The amount allocated in the 2006 budget for social spending (education, health, and poverty reduction) has been increased by 26.5 percent in real terms over expenditure executed in 2005 and will represent 8 percent of GDP if this envelope is completely used.[2] Instructions will be given to all ministries concerned to ensure that such spending is given priority; a new definition of poverty-reducing spending will be introduced and these expenditures will be specifically tracked (see ¶31).

B. Monetary and Exchange Policies

19. The essential objective of monetary policy will be to rein in inflation while enabling a build-up of a more comfortable level of official foreign exchange reserves. It will be supported by a gradual move to a more flexible exchange policy. The projected 20 percent increase in money supply in 2006 is predicated on the strengthened confidence in the ouguiya. On average, the expansion of credit to the economy will remain modest in 2006, but the reduction in government arrears will give enterprises access to substantial additional resources.

20. The BCM is prepared to follow greater exchange rate flexibility and to limit the appreciation of the real effective exchange rate. The introduction of an auction market for interbank exchange transactions and for BCM interventions during the second half of 2006 should facilitate the achievement of these objectives. The exchange rate that will prevail in this market will determine the official exchange rate. The BCM plans to finalize draft regulations for the new market and a code of procedures by end-March 2006, which it will then discuss with IMF staff, including in the context of an IMF technical assistance mission.

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[2] This figure is approximately double the amount of debt relief that Mauritania will receive under the Enhanced HIPC Initiative.

At the time of the first staff assessment of the SMP, the BCM will propose a timetable for the introduction of foreign exchange market reforms, including the elimination of current foreign exchange rationing and the phasing out of the partial requirement to surrender fish export receipts to the BCM.

21. The authorities are aware that continued financial sector reform is essential to enhance its stability and its capacity to assist in the development of the Mauritanian economy. Measures have already been taken in this area, among others, to improve compliance with the banks' capital adequacy ratios. The BCM will prepare a draft monetary code that will entail a reform of the banking law, strengthening of banking supervision, and development of new financial products. The code will also encompass a revision of the central bank charter with a view to increasing the BCM's independence and its accountability to Parliament. The second FSAP mission, which took place during February 10–March 3, 2006, provided an opportunity for a detailed discussion of all the above-mentioned reforms needed in the financial sector area, and also the reforms in the payments system and microfinance. The recommendations of the FSAP report will be used as the basis for the introduction of an action plan during the second half of 2006.

C. Balance of Payments and External Financing

22. With the start-up of oil exports, Mauritania's exports will triple in 2006, but a significant impact on the external position is expected to be felt only in the second half of the year. The external current account balance will become largely positive in 2006. Excluding oil operations, however, the current account deficit will increase in 2006, owing to rising prices for imported fuel and the anticipated surge in imports resulting from the acceleration of the public investment program. From the point of view of external financing, good performance during the SMP should facilitate the mobilization of two tranches of balance of payments support from the Arab Monetary Fund from the second half 2006. The Islamic Development Bank has also offered the BCM a line of refinancing for foreign trade valued at approximately US$40 million, which will partially replace the refinancing of petroleum products imports granted in 2005 by two foreign banks. The government also hopes to receive budgetary support from the European Union and several countries to finance a portion of the expenses for the electoral process. Additional budgetary support remains to be identified for the second half of the year. This will come in addition to the impact of multilateral debt relief vis-à-vis the IMF, the World Bank, and the African Development Fund.

V. Staff-Monitored Program for the First Six Months of 2006

A. Economic Policies

23. The above-described policy context and annual targets will provide the framework for the government's actions during the first half of the year. The primary goal of fiscal and monetary policies during that period will be to avoid destabilizing the external position, which remains fragile, and to control the anticipated surge in inflationary pressure. The

government will take measures to ensure that the rhythm of budget execution remains compatible with the government's cash flow and a limited amount of treasury bill issues to the banking sector.

24. The BCM will maintain prudent policies aimed at consolidating the renewed confidence in the ouguiya and the elimination of the parallel market premium. Deeming the liquidity of the banks to be insufficient, the BCM reduced in early January the required reserves ratio on bank deposits in ouguiyas from 8 to 7 percentage points. Nowadays, the BCM's reference interest rates are positive in real terms and high enough to slow the progression of domestic credit within the program limits as specified in Table 1. Nevertheless, the BCM stands ready to raise these rates if necessary. It will maintain prudent management of bank liquidity, while modernizing its liquidity management instruments with technical assistance from the IMF. Meanwhile, with a view to meeting the temporary excess demand for liquidity and to the extent this will remain compatible with the strengthening of its own foreign exchange position, the BCM will refrain from sterilizing possible inflows of foreign exchange resulting from the sale to banks of foreign currency banknotes held by residents.

B. Institutional and Structural Reforms

25. In 2006, the government will implement the main pillars of its economic reform policy, the objective of which is to improve transparency and governance. A new Poverty Reduction Strategy Paper (PRSP) covering the period 2006–10 is being prepared. The PRSP will include a detailed stock-taking of the 2001–04 PRSP (including the analysis under way of the poverty profile based on the results of the 2004 survey), and the ongoing discussion on the optimal use of oil revenues. It will be finalized in June 2006, after discussions with the external partners and regional and national public consultations.

26. The SMP will prepare the ground for the new PRSP through concrete measures in three areas: (a) reliability of economic and financial data, particularly BCM data; (b) public finance management; and (c) a mechanism for the collection and management of oil revenues.

27. As regards the verification of BCM data, implementation of the recommendations of the January 2004 IMF safeguards assessment mission will continue, particularly the recommendations relating to the improvement in the presentation of the central bank accounts. Preliminary audit reports on the BCM's financial statements for 2003 and 2004 have already been prepared. The auditor's opinion for the 2004 accounts is that the BCM's balance sheet as of end-2004 provides a true and fair view of the central bank's financial position, with several qualifications, some of which have been addressed in 2005. The BCM intends to deal with the bulk of the residual problems before the finalization of the reports by end-May 2006. Moreover, the audit of the BCM accounts for 2005 is already under way, confirmation of the end-2005 official reserves should be completed by end-March 2006, and the final audit report for 2005 will be available by end-June 2006. This report (and reports for future years) will be published on the BCM's official website. The monetary accounts will be

published monthly starting in July 2006. For 2005, the accounts of the commercial banks will be subject to an international audit, for which standard terms of reference will be prepared by the BCM in consultation with the banks by March 30, 2006.

28. The revision of the economic and financial data—government finance, balance of payments, and national accounts data—going back to 1992 will continue. A preliminary report, including the analysis of these revised data, will be prepared by an intergovernmental working group headed by the BCM by April 2006 and will serve as the basis for discussions with IMF staff during the next Article IV consultation. The National Statistics Council (CNS) called for by the Statistics Law of January 2005 was established by February 15, 2006, and the definitive report will be adopted by the CNS and published by June 30, 2006.

29. In the area of public finances management, the government intends to improve the formulation, execution, and tracking of the budget. The presentation of the 2006 budget shows a significant improvement over previous years. The budget includes all expenditures previously financed without budgetary appropriations. A substantial proportion of budget appropriations, previously allocated to centralized expenditures to create a pool of resources for granting discretionary supplementary appropriations, has been broken down by ministry, which allows for considerable improvement in line ministries' planning of their actions. Moreover, the budget document shows both operating and (domestically financed) capital expenditure for each ministerial department. Starting in early 2006, the government will undertake to prepare a comprehensive medium-term expenditure framework (MTEF) so that this exercise can be fully integrated in the preparation cycle for the 2007 budget and PRSP, and be available by June when the budget guideline letters are sent to the ministries.

30. On the budget execution side, the government intends to completely renounce the use of extrabudgetary spending and irregular public expenditure procedures, particularly automatic debit letters and spending by the BCM on behalf of the government, and to reduce by two-thirds the stock of payment obligations that have been acknowledged by the government. The Treasury float will be limited to UM 10 billion during the first half of the year. The supplementary period for 2005 was closed in February 2006 and the budget review law for 2005 will be adopted by the Council of Ministers by June 2006.

31. In the area of budget tracking, a monthly fiscal reporting table (TOFE) will be provided to the Minister of Finance with a maximum lag of one month. It will be based on the monthly Treasury balance, which will be reconciled with the Treasury accounts at the BCM and with the budget execution data based on the administrative accounts that shall be produced with the use of the RACHAD system when it becomes operational. Expenditures will be recorded on a payment order basis (see attached Technical Memorandum of Understanding). A functional classification of expenditure will gradually be deployed by end-April 2006 and will allow for monthly tracking of the execution of poverty-reducing expenditure. A detailed quarterly publication on such spending will be issued.

32. As regards the management of oil resources, the government is convinced that transparency and accountability at the various stages are essential to enable the Mauritanian

economy to derive the full anticipated benefit from the development of this sector. Upstream, a committee for the introduction of the EITI has been created to prepare an action plan by June 2006. Moreover the Ministry of Energy and Petroleum, in cooperation with the Ministry of Finance and the BCM, will prepare a monthly report on hydrocarbon production and sales, and the amounts and composition of oil revenues that the government and the Mauritanian Hydrocarbon Company (SMH) earn from this activity, starting with the first barrel of oil extracted. These data will be published on the Internet on a quarterly basis. The government also intends to make public all existing and future production sharing contracts and any amendments to them.

33. The government passed on February 15, 2006 an ordinance that sets up an institutional mechanism for the collection and management of Mauritania's oil revenues, as described below:

- A Treasury fund, the National Hydrocarbon Revenue Fund (FNRH), will be created and will receive all government oil revenues (including, but not limited to profit oil, taxes paid by all enterprises in the sector, signature bonuses, and dividends paid by the SMH).

- The FNRH will be established with a custodian bank abroad and its administration will be delegated to the BCM, which will prepare quarterly reports for the Minister of Finance. The FNRH accounts will be audited at least at the end of each year by an independent auditor of international reputation, and the audit reports will be posted on the Internet and published in national newspapers. The FNRH annual report will also be audited by the Audit Office and appended to the budget review law.

- The FNRH will not borrow and its assets may not be pledged or subject to any encumbrances. The FNRH will adopt a prudent management profile, which will be defined in the management contract between the Ministry of Finance and the BCM in March 2006. Income earned on FNRH assets will be reinvested. Subsequent budget laws will include projections for this account and the underlying assumptions.

- The resources of the FNRH will either be saved or used to finance part of the (nonoil) fiscal deficit. Withdrawals for this purpose will exclusively take the form of monthly transfers to the Treasury account at the BCM, within the annual limits set out in the budget laws and upon joint authorization of the Minister of Finance and the Governor of the BCM. The SMP foresees that the withdrawals during the first half of the year will be capped at UM 15.7 billion (equal to one-third of the annual limit set in the 2006 budget law). This amount will be reduced by revenues paid directly to the Treasury current account at the BCM before the oil account is opened, which are projected at UM 1.3 billion for the first quarter.

34. The government has decided to create a commission open to representatives of civil society to prepare a draft law on the management of oil resources. This law will define a permanent institutional framework and the principles that should guide the optimal

management of these resources and determination of the FNRH's annual contribution to the financing of the budget.

35. The government has decided to establish the SMH as a public entity responsible for managing the government's investments in the oil sector so as to encourage the development of national competencies in this sector. The SMH will be subject to regular tax laws. Starting in 2007, the SMH budget will be adopted as an annex to the budget law.

36. Downstream of the sector, the government will ensure application of the existing decree on the setting of retail prices for fuel products. Specifically, (a) the structure of these prices will be adjusted every two months starting in February 2006 to reflect international prices, and (b) the margins intended to reduce the shortfalls resulting from the postponement of past adjustments will be maintained or increased so that the time required to make up for these shortfalls will be gradually reduced.

VI. PROGRAM MONITORING

37. To ensure the success of the program the government has taken the following prior actions:

- Submission to the IMF staff of the preliminary audit report for the BCM accounts for 2003 and 2004.

- Adoption by the Council of Ministers of the draft ordinance establishing an oil fund for the collection and management of oil revenues, as described above.

38. To monitor program execution, the government has set quantitative benchmarks (Table 1) and structural benchmarks (Table 2). Implementation of the program will be assessed quarterly in cooperation with Fund staff. The first staff assessment of the program will take place at end-April 2006.

39. The attached Technical Memorandum of Understanding defines the quantitative benchmarks and automatic adjustors in case of unforeseen factors, and lists the data that will be reported to IMF staff for program monitoring purposes, within the indicated time frames.

Table 1: Quantitative Indicators Proposed for end-March and end-June 2006 1/
(cumulative change from end-December 2005, unless otherwise indicated)

	2005	2006	
	End-December	End-March	End-June
Quantitative targets			
Net international reserves of the BCM (floor); in US$ million	-164.2	-17.0	0.9
Net domestic assets of the BCM (ceiling); in UM billion	107.4	7.2	7.2
Balance of government nonoil operations (floor); in UM billion	…	-10.0	-15.4
Treasury float (ceiling); in UM billion	10.1	0.0	0.0
Medium- and long-term nonconcessional borrowing contracted or guaranteed by the government (continuous ceiling); in US$ million	…	0.0	0.0
Payments arrears on the official external debt (continuous ceiling); in US$ million	…	0.0	0.0
Reference projections for the adjustors (in US$ million)			
Net external assistance	…	**-0.8**	**-9.4**
Disbursement of foreign currency loans and grants (budgetary aid; excluding HIPC and project grants)	…	4.1	4.1
Official external debt service (cash; including interest on foreign liabilities of the BCM)	…	4.9	13.5
Impact of any additional debt relief obtained after December 31, 2005	…	0.0	0.0
Transfers from the National Hydrocarbon Revenue Fund to the budget	…	4.8	58.5
Memorandum items			
UM/US$ exchange rate (program)	268.6		

1/ For definitions see the attached Technical Memorandum of Understanding.

Table 2: Structural Indicators

	Date
• Transmission of the monthly TOFE to IMF staff with a lag of one month, based on the Treasury balance and reconciled with the central bank accounts on a monthly basis, cumulative data from the start of the year.	End-March TOFE available at end-April 2006 1/
• Transmission to Fund staff of the preliminary report on the analysis of the revised economic data for 1992–2004.	End-April 2006
• Transmission to Fund staff of the final audit report on the BCM accounts for 2003 and 2004.	End-May 2006

1/ Subsequent monthly reports will be submitted to Fund staff on a monthly basis.

Table 3: Other Corrective MDRI-related Public Expenditure Management Measures

1. *Updating of the MTEF and its integration in the budget cycle:*

- A preliminary version of the comprehensive MTEF should be prepared in time for preparation of the sectoral MTEFs and budget guideline letters (May 2006)

2. *Elimination of all extrabudgetary spending:* there will be no spending not provided for in the budget (continuous)

3. *Sufficient progress in the elimination of payments arrears and regularization of the public accounts:*

- compliance with the arrears reduction targets included in the TOFE
- production of the final balance of the Treasury accounts for 2005 (end-April 2006)

4. *Improvement of public expenditure tracking (including poverty-reducing expenditure) using an expenditure classification*:

- tracking of poverty-reducing expenditure in budget execution (annexed to the TOFE) (end-April 2006)

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets out the definitions of the quantitative targets for the period of January 1, 2006–June 30, 2006, which are set forth in the associated Memorandum of Economic and Financial Policies (MEFP) for program monitoring purposes and reported in Table 1. It also establishes the content and frequency of the data to be provided for monitoring the program. For the purpose of this memorandum, the government is defined to include only the central government.

2. The quantitative targets are defined as ceilings or floors for cumulative changes from the beginning of calendar year until the end of the month indicated.

I. DEFINITIONS

3. **Net international reserves** (NIR) of the Central Bank of Mauritania (BCM) are defined as reserve assets of the BCM (defined as those external assets that are readily available to and controlled by the BCM as per the fifth edition of the IMF's *Balance of Payments Manual*) less all foreign exchange liabilities of the BCM to residents and nonresidents. Performance with respect to the quarterly NIR floors will be monitored excluding valuation effects on gold holdings, which will be evaluated at the gold price in effect on December 31, 2005 (US$487 per oz.). The U.S. dollar value of reserve assets (other than gold) and foreign exchange liabilities will be monitored by converting their non-dollar components into U.S. dollars using **program exchange rates**: the end-December 2005 exchange rates between the ouguiya and the U.S. dollar (268.6), and the cross-rates between the U.S dollar and the SDR (1.4293), the Euro (1.1797), and other non-dollar currencies as published in the IFS.

4. **Net domestic assets** (NDA) of the BCM are defined as reserve money minus net foreign assets (NFA) of the BCM. Reserve money is defined as the sum of: (a) currency in circulation (currency outside banks and commercial banks' cash in vaults); and (b) deposits of commercial banks at the BCM). NFA is defined as gross foreign assets of the BCM, including the assets excluded from the definition of NIR, less all foreign liabilities of the BCM (i.e., NDA = Reserve Money – NFA, based on the BCM balance sheet). NFA will be measured at the **program exchange rates** as described in ¶3.

5. **Government balance** is defined for program monitoring purposes as non-oil central government basic balance excluding grants equal to **nonoil government revenue** (excluding grants) less **government expenditure** (excluding foreign-financed investment expenditure and interest due on external debt). Performance with respect to the quarterly floors for the so-defined government balance will be measured based on Treasury data. Revenue will be monitored on a cash basis (*recettes encaissées par le Trésor*) excluding the revenue related to oil- and other hydrocarbon-related activities and transfers from the National Hydrocarbon Revenue Fund (FNRH) to the budget, and privatization proceeds. Expenditure will be monitored on the basis of the registration of payment orders by the Treasury (*la prise en charge par le Trésor*) including the interest on domestic debt (paid by the Treasury or automatically debited from the Treasury account at the BCM, including but not limited to discounts on Treasury bills held by banks and nonbanks and interest charges on the consolidated debt of the government vis-à-vis the BCM).

6. **Treasury float (*Instances de paiement au trésor*)** is defined as the outstanding stock of payment orders registered at the Treasury and not yet executed by the Treasury.

7. **The contracting or guaranteeing of nonconcessional medium- and long-term external debt** by the government or the BCM includes foreign currency debt, with maturities of one year or longer, contracted or guaranteed by the government or the BCM with a grant element (NPV discount relative to face value) of less than 35 percent, based on the currency- and maturity-specific discount rates reported by the OECD (commercial interest reference rates). This definition applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85) August 24, 2000, see Annex) but also to commitments contracted or guaranteed for which value has not been received. Although this definition excludes borrowing by public enterprises (without government guarantee), such borrowing should be avoided except in exceptional circumstances and after consultations with Fund staff.

8. **External payments arrears** are defined as arrears on external debt contracted or guaranteed by the government or the central bank, excluding bilateral debt subject to rescheduling or debt forgiveness (i.e., the non-Paris Club debt toward Algeria, China, Iraq, Kuwait, Libya, and United Arab Emirates).

II. Program Adjustors

9. **NIR, and NDA targets** are derived based on (a) the projected amounts of **net international assistance** defined as cumulative disbursements of official loans and grants (budget support; excluding HIPC assistance and project-related loans and grants) in foreign currency net of cumulative amounts of external cash debt service payments (including interest on foreign liabilities of the BCM) plus the impact of any additional debt relief obtained after December 31, 2005; and (b) the projected amounts of **the FNRH contribution to the budget**.

10. In case **net international assistance** or **contribution of the FNRH to the budget** exceeds (falls short of) the amounts projected in Table 1, the floor for NIR will be adjusted upward (downward) and the ceiling on NDA will be adjusted downward (upward) by the amount of the excess (shortfall). The cumulative downward adjustments to NIR will be limited to US$10 million. The cumulative upward adjustments to NDA will be limited to the ouguiya equivalent of US$10 million at program exchange rates.

III. Reporting Requirements

11. The authorities will provide the IMF with all necessary economic and financial statistical data to monitor economic developments and program performance including, but not necessarily limited to, the following specific information.

BCM

- The monthly balance sheet of the BCM, and monthly data on (a) the BCM's gross foreign exchange reserves (at program exchange rates and at actual official exchange rates), (b) the balances of the FNRH, inflows and outflows (transfers to the Treasury account) and their timing, and (c) on external debt service including changes in arrears and rescheduling operations, data on debt service due and debt service paid in cash, HIPC debt relief provided by multilateral and bilateral creditors, and showing the amount of HIPC debt relief provided to the government in the form of grants within two weeks following the end of each month.

- The monthly monetary survey, the consolidated balance sheet of the commercial banks, and monthly data on foreign exchange positions of individual commercial banks by currency and on a consolidated basis at actual official exchange rates within three weeks from the end of each month.

- Data on treasury bills auctions within a week following each auction.

- Monthly data on exports by main product (iron ore and fish), customs data on imports by main product categories, data on SNIM operations, monthly list of medium- and long-term public or publicly guaranteed external loans contracted during each month, identifying, for each loan: the creditor, the borrower, the amount and currency, the maturity and grace period, and interest rate arrangements within one month following the end of each month.

- Quarterly complete balance of payments and data on the outstanding stock of external debt (by creditor, by debtor and by currency) within one month following the end of each quarter.

Ministry of Finance

- Monthly Treasury data on budget operations, revenues (including transfers from the FNRH), expenditures, and financing items, data on operations of special accounts (including the operations of the new funds set out in the 2006 Budget Law), data on the execution of the domestically-financed part of the investment budget (including the data on capital spending, spending on goods and services, and salaries included in the investment budget), and Customs' and Tax Department's monthly revenue collection reports (*Rapports mensuels des recettes*) within two weeks following the end of each month.

- Monthly reports on oil- and other hydrocarbon-related production and financial flows, including data on oil sales and repartition of oil revenue among all partners involved in oil production within one month from the end of each month. Reports will be compiled based on data provided by all hydrocarbon industry operators, including oil- and other hydrocarbon-producing companies, and the authorities. Data on government revenue from oil- and other hydrocarbon-related activities will include all tax and nontax revenue derived from oil and hydrocarbon exploration and production including but not limited to the government part of profit oil, bonuses, tax and nontax revenue from the Mauritanian Hydrocarbon Company (SMH), taxes on profits of foreign oil companies, and presumptive taxes on the activities of their subcontractors (*régime forfaitaire*). This information shall be prepared in cooperation with the Ministry of Petroleum and Energy, the BCM, and the SMH.

Ministry of Economic Affairs and Developments

- Monthly data on the execution of the foreign-financed part of the investment budget based on the summary presentation included in the Consolidated Investment Budget document (*Budget Consolidé d'Investissement*) and data on foreign grants and loans received by the government, its agencies, and by public enterprises by creditor and by currency of disbursement within three weeks following the end of each month

National Statistical Office

- Monthly consumer price index within two weeks following the end of each month.

12. All data will be transmitted electronically. Any revisions to previously reported data accompanied by an explanatory note shall be promptly communicated to the staff.

IV. CENTRAL GOVERNMENT OPERATIONS TABLE

13. The Treasury will prepare a monthly budget execution report in the format of a Central Government Operations Table (TOFE). In the preparation of the table, the following definitions shall be used for grants, domestic bank financing of the government deficit, domestic nonbank financing of the government deficit, domestic arrears, and external financing:

- **Grants** are defined as a sum of foreign project grants (grants used in the execution of the foreign-financed investment projects) included in the central government and the *EPA* parts of the consolidated investment budget (*parties BE et BA*) and foreign program grants for budget support including the multilateral HIPC debt relief on the government external debt and HIPC debt relief on the external debt of BCM and SNIM (including the part of the *Agence Française de Développement/Banque de France* debt relief on Cologne terms).

- **Domestic bank financing** of the government deficit is defined as a change in the net credit to the government from the banking system, defined as claims on the government less deposits of the government with the banking system (excluding the deposits of public establishments and other administrative units (*EPA*) with the BCM but including the HIPC account).

- **Domestic nonbank financing** of the government deficit is defined as a net change in holdings of treasury bills by nonbanks.

- **Domestic arrears** are defined as a net change in the Treasury float and in the stock of domestic claims on government acknowledged by the Ministry of Finance (including but not limited to accumulated payments arrears to public enterprises and international organizations, and those related to procurement contracts and court orders).

- **External financing** is defined as a change in the sum of the net position of the FNRH, net disbursements of foreign loans, and exceptional financing (including (a) the accumulation of external payments arrears and the accumulation of overdue payments on the debt subject to rescheduling or forgiveness and (b) the relief on government external debt that is not treated as **grants**).

ANNEX: DEFINITION OF DEBT SET FORTH IN NO. 9 OF THE GUIDELINES

The definition of debt set forth in No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt reads as follows: (a) for the purpose of this guideline, the term "debt" will be 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. Debt can take a number of forms, the primary ones being as follows: (i) loans, that is, advances on 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' creditors) 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 which 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 top of 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. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt. Failure to make payments on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.