International Monetary Fund

São Tomé and Príncipe and the IMF

Press Release:
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São Tomé and Príncipe: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Undersdanding

June 30, 2005

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

São Tomé, June 30, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

1. We enclose with this letter the Memorandum of Economic and Financial Policies (MEFP) that underpins our economic program and poverty-reduction strategy for 2005-2007, and sets out specific objectives and quarterly financial and structural targets for 2005.

2. To strengthen the efforts to alleviate poverty in São Tomé and Príncipe, we need a stable macroeconomic framework to revitalize growth while keeping inflation low and improving our external position. Given the importance of ensuring that the macroeconomic adjustment in the program is acceptable to the Sãotomean people, our government has made every effort to reflect social concerns in the program and conducted an ample news campaign to explain to the population at large the benefits of the proposed economic program. The increase in the monthly minimum wage from US$31 to US$40 in 2005 is one of the government's venues to address social demands, although we are aware that further wage increases of this magnitude would be unsustainable. Also, the government has submitted to the IMF and the World Bank its full poverty reduction strategy paper (*Estratégia Nacional para Redução da Pobreza*; PRSP), that was promulgated by the President of the Republic in January 2003 and an update of the strategy issued in January 2005.

3. The key components of the 2005–07 program are:

- A medium-term macroeconomic framework consistent with price stabilization and the PRSP's macroeconomic targets;

- A strong fiscal adjustment that will contain the growth of public expenditure and strengthen tax collections, while allowing increases in pro-poor government spending;

- Gradual use of the oil signature bonus on Block 1 (totaling US$49.2 million), which has been deposited into the government's National Oil Account held with the Federal Reserve Bank of New York, and the receipt of which is a prior action for the approval of the new PRGF arrangement, and;

- Structural adjustment measures in the areas of public enterprise reform, public expenditure management, banking sector prudential regulation, business climate, and central bank safeguards assessment implementation.

4. To support these objectives and policies São Tomé and Príncipe hereby requests a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), covering the period July 2005-July 2008, in a total amount equivalent to SDR 2.96 million (40 percent of quota), to be provided in seven semi-annual disbursements.

5. The Government of São Tomé and Príncipe believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take further measures that may become appropriate to this purpose. São Tomé and Príncipe will consult with the Fund on the adoption of these measures, and in advance of the revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. São Tomé and Príncipe will provide the Fund with the necessary data on a timely basis for monitoring purposes. During the program period, the government will not introduce or intensify any exchange rate restrictions or multiple currency practice that are inconsistent with Article VIII of the Fund's Articles of Agreement, or introduce or intensify import restrictions for balance of payments purposes. Consistent with its intention to keep the public informed about its policies and objectives, the government will publish the MEFP and will report periodically on progress under the program.

6. We propose that the Fund carry out reviews under the 2005 program in December 2005 and April 2006 based on the observance, respectively, of end-September and end-December 2005 quantitative performance criteria, and structural performance criteria, as established in Tables 1 and 2 of the attached memorandum.

7. We are confident that the program will deliver sustained growth and substantive poverty-reduction, and hence that it deserves the support of the international financial community.

Sincerely yours,

/s/

Maria do Carmo Trovoada
Prime Minister and Minister of Planning and Finance

SÃO TOMÉ AND PRÍNCIPE

Memorandum of Economic and Financial Policies for 2005–07

June 2005

I. INTRODUCTION

1. The Government of São Tomé and Príncipe has embarked on a medium-term program for poverty reduction and growth that can be supported by the International Monetary Fund and will give São Tomé and Príncipe access to further debt relief from the international community under the enhanced HIPC Initiative.

A. Program Objectives

2. The program centers around two principal objectives: (i) create the conditions for high and sustained economic growth over the medium-term; and (ii) contribute to a reduction in poverty. To achieve these objectives, the program will pursue rigorous financial policies and wide-ranging structural reforms, while safeguarding pro-poor spending, as envisioned in the government's Poverty Reduction Strategy (*Estratégia Nacional de Redução da Pobreza)*.

3. The government, conscious of the need to ensure that such a program is acceptable to Sãotomean public, will ensure that, in implementing fiscal adjustment, pro-poor spending would not be compromised. To this end, expenditure on health and education will increase during the course of the program. Moreover, the adjustment measures will be accompanied by reforms that will seek to strengthen good governance and transparency in the management of public resources. The program deserves the financial support of the international financial community, not only because of the courageous adjustment measures it contains, but more importantly because of its fundamental goal is to raise the living standards of the Sãotomean people.

B. Recent Economic Developments

4. Real GDP grew by 3.8 percent in 2004. Growth was less buoyant than initially envisaged, as expectations of a take-off driven by the oil sector did not materialize. A relaxation of macroeconomic policies helped maintain growth close to the 2003 level, but inflation edged up to 15.2 percent (end-of-year). Real GDP per capita has been increasing only marginally during the last five years; 54 percent of the population remain poor, with 15 percent of living in extreme poverty.

5. The overall fiscal deficit (on a commitment basis) remained very high in 2004, at 26.3 percent of GDP. The deficit was mainly financed by short- and medium-term external borrowing and central bank financing, while the anticipated receipt of oil signature bonuses lagged and the government sought to meet pressing demands for social spending. The

domestic primary deficit, which excludes from the overall deficit definition all foreign financed outlays and external interest payments, increased significantly between 2003 and 2004: from 11.7 percent of GDP in 2003 to 20.6 percent in 2004. External payment arrears to Paris Club and non-Paris Club member countries continued to accumulate in 2004. The government expects to reschedule its debts to the Paris Club, and benefit from debt relief under the Enhanced HIPC initiative from Paris Club creditors and other creditors, once the Fund arrangement is in place and other floating Completion Point triggers are fulfilled.

6. At the same time, throughout 2004, the central bank relied heavily on intervention in the foreign exchange market to avoid a depreciation of the dobra and mop-up excess liquidity stemming from large fiscal deficits and a very rapid expansion of bank credit to the private sector. As a result, gross official reserves declined from US$23 million at end-2003 to US$18 million at end-2004 (from 4.5 to 3.4 months of imports of goods and services).

II. Macroeconomic Framework for 2005–07

7. The program for 2005–07 aims at correcting widening macroeconomic imbalances and creating the conditions for high and sustained growth over the medium term. Annual GDP growth is envisaged to slow down in 2005 in response to tight financial policies, but pick up gradually during the next two years mainly on account of expanding economic activity in the services sector. End-year inflation is projected to drop to single-digit levels by end-2007. The framework envisages maintaining gross international reserves at around 3 ½ months of imports, and limiting the deterioration of the current account deficit.

8. The fiscal program will seek to secure medium-term fiscal consolidation while allowing for appropriate pro-poor spending as identified in the PRSP. To that end, it will aim at increasing tax revenue, reducing wasteful government expenditure, and eliminating government recourse to central bank financing after 2005. No new domestic or non-reschedulable external payment arrears will be accumulated during the program period.

9. The external current account deficits after grants will remain large during the program period owing mainly to growing imports of oil sector-related investment goods. These deficits will be largely financed by a mix of medium- and long-term borrowing, foreign direct investment (including by petroleum exploration companies), debt relief assuming the reaching of HIPC completion point in the first half of 2006, and the gradual use of revenue from the oil bonus payment on Block 1 to be received in late-June 2005. The remaining financing gaps, averaging less than US$0.5 million during 2006–07—down from US$18 million in 2005—could be covered by program grants and loans from donors and multilateral creditors for poverty alleviation and reforms of the public sector. The government will also seek additional support from donors in the context of the upcoming Donors' Round Table tentatively scheduled for October 2005.

10. The combination of domestic adjustment and external debt relief should lead to an improvement in the external debt indicators. Total external debt is expected to decline from

483 percent of GDP in 2004 to 308 percent in 2007. Domestic debt will remain insignificant over the medium-term.

III. The Economic Program for 2005

11. The program for 2005 will seek to: (i) reverse the upward trend in inflation registered in 2004; (ii) address the rapidly deteriorating fiscal situation; (iii) tackle the weakening central bank reserve position; and (iv) set the stage for a new external debt rescheduling agreement with the Paris Club. Achieving the 2005 macro objectives will require concerted implementation of fiscal and monetary policies, and of key structural reforms embodied in the PRSP. The government has decided to create an inter-ministerial commission by end-July 2005, that will monitor the implementation of the program.

A. Fiscal Policy

12. The 2005 budget envisages a large adjustment mainly driven by the need for fiscal consolidation and the limited sources of financing. The budget targets a reduction in the domestic primary deficit from 20.6 percent of GDP in 2004 to 17.5 percent in 2005; domestic financing of the deficit will be limited to 0.7 percent of GDP. The fiscal adjustment will be buttressed by: (i) tax policy reform aimed at increasing excise duties and reforming the personal and corporate tax codes; (ii) a major tax administration reform; and (iii) an austere spending envelope for goods and services and capital expenditure financed by the treasury. However, the government expenditure envelope accomodates an increase in the monthly minimum wage from US$31 to US$40 dollars which will help in addressing social concerns. To ensure macroeconomic stability, the wage increase will be implemented together with a reform of the public sector compensation system (see para. 16 below).

Tax policy reform

13. To simplify and provide for a more equitable tax system, and to place public finances on a permanently sound footing, the 2005 fiscal program includes measures to increase excise duties levied on imported goods and domestically-produced goods and services, as well as urban property taxes. The program also assumes that the government will submit to the National Assembly a thorough tax reform package[1] by end-July 2005 that will become effective in 2006. Overall, the measures already taken or contemplated for 2005 include:

- The (dobra-denominated) reference prices used to assess excise duties on a core group of nonfood imports were increased on January 7, 2005. Previous reference prices dated from the 1990s and their nominal values had become outdated due to the

[1] The tax reform package includes a new code on personal income tax, a new code on corporate taxation, a new tax procedural code, new guidelines on urban property taxation, and new legislation on inheritance taxes.

devaluation of the dobras in recent years. This measure is expected to yield an estimated dobras 9.5 billion, equivalent to 1.4 percent of GDP in 2005.

- The excise tax applicable to the provision of services will be increased effective July, 15, 2005, from 2 percent to 5 percent. This measure is expected to yield an estimated dobras 3.3 billion, equivalent to 0.4 percent of GDP in 2005. Also, the concession on excise duty on domestically-produced beer has been terminated, with the new ad valorem rate set at 25 percent. This measure is expected to yield an estimated dobras 1.5 billion, equivalent to 0.2 percent of GDP in 2005.

- The government's policy is to keep retail petroleum prices in line with world market prices. To this end, in November 2004, the domestic price of gasoline and gas oil were increased by 24 percent and 46 percent, respectively, to fully pass-through the rise in international prices that occurred last year. However, for 2005, and in view of the need for fiscal revenue, any decline in world market prices will not be passed-through to consumers, and instead the margin would accrue to the treasury, thus improving tax revenue beyond the program targets.

- Revenue from urban property taxes will be boosted in 2005 by an increase in coverage and tighter enforcement of regulations governing the collection of these taxes. It is expected that the coverage could be tripled from the current level of 4,000 registered dwellings, yielding dobras 800 million (0.1 percent of GDP) in additional revenue in 2005.

- The government will submit to the National Assembly by end-July 2005, a new personal income tax code that will become effective in 2006. The tax reform will involve broadening the tax base and introducing a progressive income tax system (structural performance criterion). New sources of income—including bonuses, other monetary premiums, and in-kind benefits—will be brought into the definition of taxable income. The minimum tax-exemption threshold will be updated, while new tax rate schedules will be adjusted to provide more progressivity to the system. Preliminary government estimates show that the reform will lower personal income tax revenues by 0.3 percentage points of GDP in 2006.

- The government will submit to the National Assembly by end-July 2005, a new corporate income tax code that will also become effective in 2006. The new code will seek to lower the average profit tax rate to the 25–30 range, which would bring the corporate tax rate more in line with international norms and should make the environment more conductive to the growth and development of new and old companies alike. The reform will also lead to a more equal treatment for businesses by limiting the granting of tax holidays—which currently benefit selected large businesses—to new licensed investors to a maximum of three years, with tax deductions only covering up to 75 percent of the profit taxes due (structural performance criterion). Preliminary estimates show a net revenue loss of 0.4 percent of GDP in 2006, which the government believes could be partially offset by the increased investment spurred by the more attractive tax framework in place.

Tax administration reform

14. The reform of tax administration has several objectives. First, it will aim at removing certain ambiguities in various tax laws. Second, a new tax code *(Codigo General Tributario)* and a new tax procedural code *(Codigo de Processo Tributario)* will establish, inter alia, (i) tax tribunals at different levels of government (regional and national level) to handle tax issues and disputes (structural performance criterion), (ii) penalties and fines for underpayment, late payment, and other tax violations (structural performance criterion), and (iii) more adequate resources for tax collection and enforcement agencies. Third, in the case of the urban property tax *(Contribuiçao Predial Urbana)*, the reform targets the development of new official registries of the quantity, value, and ownership of urban real estate used in apportioning taxes (structural performance criterion). And, fourth, taxes like inheritance taxes (structural benchmark), taxes on grants, and taxes on asset transfers will be simplified further, while broadening their taxable base and increasing their tax rates. In addition to the reforms above, the government will continue to enforce the use of taxpayer identification numbers (*cartao de identidad fiscal)* throughout the territory.

Wage bill and other government expenditure

15. Given the low level of minimum wages, the government has decided to increase the civil servants' minumum wage to US$40 per month in 2005. We are commited to avoid any other ad-hoc increases in wages to keep the wage bill sustainable in the medium-term.

16. At the same time, to correct distortions stemming from the current compensation system, including an obsolete wage grid, the 2005 fiscal program will seek to eliminate all selective salary increases and/or special wage regimes. The new policy framework will: (i) broaden the scope of wage negotiations to cover all government employees at the same time; and (ii) for purposes of wage negotiations, redefine the concept of remuneration to include the basic salary, overtime fees, supplementary salary payments, and other subsidies. With these measures in place, the increase in the nominal wage bill will be contained below the annual inflation rate in 2006 and 2007. In the case of embassies overseas, the wage bill for 2006–07 will be kept constant at the end-2005 euro values for embassies in European countries and US dollars for other embassies.

17. Outlays in goods and services are projected to decline from 15.2 percent of GDP in 2004 to 7.8 percent in 2005. While a reduction of 3.3 percent of GDP can be attributed to the exceptional expenditures stemming from the conference of Community of Portuguese Language Countries (CPLP) held in São Tomé in July 2004, the remaining spending cuts will be attained through a sharp decline in: (i) telecommunication spending of budgetary units, from 2.8 percent of GDP in 2004 to 1.3 percent in 2005, (ii) water and electricity consumption, from 4.0 percent of GDP in 2004 to 3.0 percent in 2005, and (iii) spending on official travel, from 1.5 percent of GDP in 2004 to 1.0 percent in 2005. Such cuts will be

enforced through the enactment of directives by the Ministry of Planning and Finance and the corresponding reductions in 2005 budget allocations for all affected budgetary units. Other categories of expenses in goods and services are projected to grow in line with inflation.

18. Domestically-financed capital expenditure will also be restrained. From dobras 51 billion in 2004 (equivalent to 8.0 percent of GDP), domestically-financed projects will be targeted at dobras 29 billion in 2005 (equivalent to 3.9 percent of GDP). While this reduction is necessary in view of our objective of fiscal restraint in 2005, the government will ensure that any disruption to its program of social spending is kept at a minimum by effectively prioritizing projects. In addition, part of the reduction reflects projects which had initially been earmarked for domestic funding, but for which the government now intends to fund through counterpart funds from the Japanese government.

19. Aggregate pro-poor spending, as defined in the government's Poverty Reduction Strategy (see also, paragraph 44, below), is budgeted at 29.3 percent of GDP, including HIPC financed expenditure. This compares with estimated pro-poor spending of 22.2 percent of GDP in 2004. At the same time, social safety mechanisms have been further strengthened to mitigate the cost of macroeconomic adjustment on the poorest sections of the population. Pro-poor spending on health will be substantially increased, as it is considered the sector with the highest impact on living standards, given the incidence of various tropical diseases affecting the population.

B. Public Expenditure Management

20. The government attaches the highest importance to the effective control and monitoring of public expenditure, as a means of ensuring that the spending priorities identified in the government's Poverty Reduction Strategy and reflected in our 2005 budget are implemented as planned. A number of steps have been taken or will be implemented shortly to improve public expenditure management:

- A PRSP unit has been set up at the Ministry of Planning and Finance, with the objective of ensuring the implementation and monitoring of the PRSP. Currently, the unit is updating some areas of the PRSP for which information had become outdated, such as recent developments in the domestic oil sector, including the adoption of the legislation for management of oil revenues. By end-September 2005, the unit will issue a report on the status of implementation of the PRSP.

- The PRSP unit, in coordination with the Directorate of Planning in the Ministry of Planning and Finance, has also the responsibility of monitoring grants. One key objective in this area will be to ensure that projects for which funds have been donated are executed adequately. Particular emphasis will be on implementation of pro-poor oriented projects. Information gathered by the unit will form the basis of reporting of pro-poor spending for the Ministry of Planning and Finance and eventually to the Fund. This would allow an effective monitoring of pro-poor spending in the context of the 2005-08 PRGF- supported program.

- With the support of the UNDP, the central government will review its payment system of wages and salaries, and develop a public employees' register. In particular, the reform will computerize wage and salary payments, and update information about the number of public sector employees, their job description, and their place of work within the sector. By September 2005, the government expects to have in place: (i) a computerized registry to be used for public sector human resource management; (ii) trained personnel to handle the registry; and (iii) the necessary hardware and other technical equipment. The rest of the project will be implemented no later than January 2006.

- During 2005, the government will implement the recommendations from the Auditor General's Office stemming from the review of the 2004 financial accounts of the central government. This report is expected to become available during the third quarter of 2005.

21. A fully integrated, computerized budget and public expenditure management system, developed with assistance from the Fund's Fiscal Affairs department (FAD) and the World Bank, will be launched in 2005. The government established a timetable in June 2005 that provides for the implementation of the integrated budgetary classification system by mid-2006 which would include, among other things, new budget classifiers and a double-entry method compatible with a new chart of government accounts (structural benchmark).

22. To improve the management of resources and avoid the re-emergence of domestic arrears the government will introduce an expenditure/cash management system underpinned by quarterly projections of government revenue. Specifically, expenditure commitments will be prioritized in line with expected revenue. This approach will allow the Budget Directorate at the Ministry of Planning and Finance to better identify and monitor the seasonality in revenues and grants, and adapt the expenditure path accordingly within the calendar year.

23. The government is also committed to improve the system of public procurement during the next three years. Key objectives are: (i) to establish guidelines for government accounting practices regarding the acquisition, transfer and consumption of goods and services; and (ii) update and computerize the cadastre of government assets. The World Bank's loan on Governance and Capacity Building Technical Assistance will be financing this project. The new procurement practices are expected to be in place by end-2005.

C. Monetary and Exchange Rate Policy

Monetary policy

24. Monetary policy will aim at reducing inflation to 15 percent by end-2005. To this end, the stock of net domestic assets of the BCSTP will be limited to dobras -82.9 billion at end-2005, while the floor on the stock of net international reserves (NIR) of the BCSTP will be set at US$14.9 million. This floor should allow end-2005 gross international reserves to remain at 3.4 months of imports of goods and services, and provide more than 100 percent

coverage of short-term liabilities, including base money. The improved fiscal stance expected for 2005 will facilitate meeting these targets.

25. The monetary program assumes a broadly stable velocity of money, which is consistent with broad money growth projected at 12.3 percent. This, in turn will be consistent with a slowdown in private sector credit growth from 116 percent in 2004 to 19 percent in 2005, while safeguarding the banking sector's NFA position. This path reflects a comfortable level of use of bank credit already achieved (that is, the stock of bank credit to the private sector is about 28.1 percent of GDP), as well as the tightening of liquidity conditions needed to reduce inflation as planned.

26. The BCSTP will also continue to work closely with the Fund's Monetary and Financial Systems Department (MFD) regarding the implementation of the technical assistance recommendations in the areas of implementation of indirect monetary instruments such as certificates of deposit and the special liquidity facility for banks. To actively manage liquidity, the BCSTP stands ready to rely on changes in reserve requirements, if necessary. Enhanced coordination of fiscal and monetary policies will be implemented to secure an effective use of the oil bonus.

27. The BCSTP is committed to the continuation of a flexible exchange rate arrangement, as already signaled by the recent introduction of foreign exchange auctions recommended by MFD. The scope and timing of the foreign exchange auctions will be consistent with the NIR targets set under the program.

D. Financial Sector Reform

28. To improve the soundness of the banking system, the BCSTP has been implementing a number of programs that include actions to improve regulation on the licensing of new banks and enhance prudential standards. The reform will also strengthen mechanisms to prevent money laundering and financing of terrorism and deter domestic financial crime.

Licensing of financial institutions

29. During the last sixteen months, in consultation with MFD, the BCSTP has been improving its instruments, as well as training its staff, on the procedures for licensing financial institutions and the criteria to be adopted by supervisors to approve or deny these licenses. The regulation on the licensing of financial institutions was approved in April 2004. As of end-December 2004, two applications had already been reviewed according to the new standards.

Prudential regulation and supervision

30. The strengthening of supervision and prudential regulations will provide the Directorate of Banking Supervision at the BCSTP with the instruments to guarantee that all financial institutions maintain healthy solvency and liquidity indicators. The main actions to be enacted during 2005 include:

- The implementation, by September 2005, of a consolidated reporting mechanism on financial conditions to be submitted by banks to the central bank on a quarterly basis. This "call report" will permit off-site surveillance of quality of assets, liquidity ratios, capital adequacy, profitability, interest rate and foreign exchange risk.

- Review of banking sector prudential regulation with emphasis on capital requirements, asset classification, auditing and internal controls, with a view to incorporate elements of Basel II recommended guidelines such as the standard approach for credit risk.

- Implementation of on-site examination guidelines to evaluate banks' credit portfolios, with emphasis on the credit policy soundness, loan classification, necessary provisions, examination procedures and remedial actions to be undertaken by bank supervisors.

- The establishment of a Credit Risk Bureau during the third quarter of 2005 that will permit global surveillance of the financial sector's credit risk.

- Keeping under strict surveillance by the monetary authorities the Banco do Equador, which ceased operations in 2001 but was authorized to open again in March 2004, following an initial recapitalization of the bank. In light of the bank's still difficult liquidity position, the BCSTP has agreed with the bank's shareholders on a plan for additional recapitalization effective March 2005.

31. The government of São Tomé and Príncipe is committed to have in place legislation to criminalize money laundering and the financing of terrorism. To this end, in consultation with the Fund's Legal department, the BCSTP will develop an action plan on the technical steps required for a successful submission to the National Assembly—by September 2005—of the proposed legislation criminalizing money laundering and financing of terrorism (structural benchmark). A formal request for technical assistance on this matter was submitted to the IMF in January 2005.

E. External Sector Policies

32. During 2005, the government will continue to seek technical advice from the international community in the context of the Integrated Framework for Trade-Related Technical Assistance. Topical areas in this regard include, in particular: (i) an in-depth analysis of the economic effects of free trade zones on São Tomé and Príncipe's economy; (ii) adoption by end-September 2005 of an action plan for streamlining the process of establishing businesses; and (iii) a review and update of the commercial code in consultation with the World Bank and other donors.

33. In coordination with the World Bank and other donors, the Ministry of Commerce will continue to assess major trade policy issues during 2005. In assessing São Tomé and

Príncipe's participation in bilateral and regional trade arrangements, the government will be mindful of the impact of these memberships on domestic tax revenue collections.

34. Regarding the trade regime, in 2005, the government will conduct a survey of existing customs exemptions with a view to their gradual elimination during the coming years, except for those exemptions contemplated in international agreements. At the same time, the existing non-tariff barrier related to the privately-managed (though partially state-owned) telecommunications company (CST) will be eliminated by end-December 2005. Existing regulations protecting CST from competition will expire on that date, opening the sector to new operators.

F. Governance and Structural Reform

Oil sector issues

35. The government is committed to zero-tolerance for all acts of corruption and, during 2005–07, it will strive to continue improving governance in São Tomé and Príncipe. In the oil sector, envisaged policies include:

- A further strengthening of the public information campaign launched in 2004 to disseminate basic information on the petroleum industry to the public. A National Forum with the civil society, which took place during June 16 to July 12, 2004, was well received by population, and was an effective venue to survey the expectations that the Sãotomean public has about the future of the country's economy, and in particular, the management of the petroleum revenues. In 2005, the government will continue this dialogue with the civil society. During February 28–March 1, 2005, a workshop marked the launching of a public information campaign on: (i) the content of the Oil Revenue Management Law (see paragraph 49 below); (ii) the status of contract negotiations on Block 1 and the most recent round of bids; and (iii) the setting of the National Petroleum Agency (ANP).

- The formulation of an overall strategy for petroleum sector development that would include plans for transparent, orderly, and well-managed sector development. The strategy, which is being developed in consultation with the World Bank and the UNDP, will address options for institutional settings regarding the development of the country's Exclusive Development Zone (EDZ), the country's possible participation in petroleum exploration and development activities either through the establishment of a national oil company and/or direct joint ventures with the international petroleum companies. The strategy will be finalized during the third quarter of 2005 and will be part of the referred public information campaign on the oil sector.

- Implementation of the Abuja Declaration, signed by the Presidents of Nigeria and São Tomé and Príncipe in June 26, 2004, concerning: (i) the alignment of publication and other information-transparency practices of the Joint Development Authority (JDA) with in the Extractive Industries and Transparency Initiative (EITI); and (ii) the implementation of appropriate amendments to the confidentiality clauses of the Joint Development Authority's Regulation for Petroleum Operations. The practices called for under the Abuja Declaration were adopted by the Joint Ministerial Council governing the JDA in November 2004.

- Implementation of the work plan, developed in consultation with the World Bank staff, on the setting and development of the National Petroleum Agency (ANP). Also, with financial support from the World Bank's EITI Trust Fund, the government intends to foster the production, publication, and dissemination of oil sector-related information. As a first step, emphasis will be placed in developing an efficient website, as well as in setting of effective internal controls and auditing practices for the national petroleum agency.

Public enterprise reform

36. The government believes that the financial position of the public water and electricity company (EMAE) should be strengthened as soon as possible. As a first step, EMAE will introduce a system of prepayment through electricity metering keypads for residential and commercial users, which would generate advance cash flow for utilities, eliminate customer debt, reduce fraud risk and lower the costs of meter reading and billing. To implement this system, EMAE will receive a bank loan, for which the government has agreed to grant a guarantee on the condition that EMAE develops a broader financial strategy to address its weak financial position, including a timetable for the reduction of outstanding payments arrears by electricity customers, no later than end-July 2005 (structural benchmark). At the time of the first review, the government intends to present a firm timetable for arrears clearing; it is expected that this timetable would provide a basis for proposing a new structural performance criterion in this area for end-December 2005.

37. Over the medium term, it is envisaged that electricity production will be in the hands of private sector investors with renowned technical capabilities. A contract with a reputable international electricity company was signed by the government in mid-2004 for the construction of a new hydroelectric plant. The contract also granted the refurbishing and exploration rights of the Contador hydroelectric plant to the same private investor. In addition, the government is currently considering granting exploration rights of the thermal electricity plant to another private foreign investor. EMAE will remain in charge of electricity distribution to final users.

38. The government is aware that privatization of public enterprises can play an important role in fiscal consolidation. On the one hand, it could raise revenue from the sale of state-owned assets. On the other, the transfer of state enterprises to private owners would allow the state to avoid pressures to subsidize public enterprises. In this context, the government intends to complete feasibility studies by end-2005 (structural benchmark) and decide on the privatization of the public enterprises administering airports (ENASA) and sea ports (ENAPORT).

Judicial sector reform and business climate

39. During 2005–07, with the support of the World Bank, the government will seek to address the most urgent needs for institutional reform and technical capacity building of the judicial system. Grant financing from the World Bank will support a work plan in four main areas: (i) an assessment of the justice sector's capacity, including potential costs and timetables of reform proposal, as the basis for a multi-year reform strategy; (ii) training for judges, prosecutors and court personnel on strategic issues, such as criminal, civil, commercial, labor, family and juvenile law, as well as judicial methods, management and research; (iii) review and modernization of the country's legal framework, including reforms of the civil, criminal, and commercial codes based on national experience and circumstances; and (iv) a review of the informal conflict resolution systems (that is, traditional or community-based mediation mechanisms) currently in place.

40. To improve the business climate, the government will submit to the National Assembly by end-July 2005 a new investment code that will provide equal treatment for domestic and foreign investors operating in São Tomé and Príncipe (structural performance criterion). This new investment code, together with the new corporate income tax code (see paragraph 13), will rationalize preferential tax regimes. In the same vein, before end-July 2005, the government will revisit other relevant existing tax legislation with a view to close any possible tax loopholes. The new investment code will guarantee: (i) free and fair competition among investors; (ii) investors' rights to freely transfer abroad receipts and/or profits according to the law; and (iii) repatriation of capital. Benefits to be awarded under the new investment code include access to land for construction of investment premises and granting of user rights on urban or rural dwellings owned by the state that are deemed necessary for a successful implementation of the investment project. In light of the sensitivities connected with the granting rights over land and/or dwellings belonging to the state, the government will seek technical advice from the World Bank and other donors to analyze and best regulate this process.

41. In an effort to support broad-based economic growth over the medium-term, the government will develop by end-December 2005, the terms of reference for a study on land tenure, which would analyze, among other things, the economic effects of a lack of complete property rights for land-holders (structural benchmark).

Central bank safeguards assessment

42. A safeguards assessment of the CBSTP conducted by the Fund's Finance department in March/April 2004 found that the central bank had made progress in strengthening its safeguards framework since the completion of a transitional assessment in 2001. During the last twelve months, the government has been working steadily to address the remaining structural weaknesses identified in the assessment, particularly in the areas of legal, reporting, internal audit, and internal control measures. A number of specific measures have been implemented or will be implemented shortly in this regard:

- On May 31, 2005, a Letter of Commitment between the Governor of the BCSTP and the Minister of Planning and Finance was signed allowing the central bank to distribute only realized earnings to General Reserve and to the government.

- By end-August 2005 a protocol between the Governor of the BCSTP and the Minister of Planning and Finance will be signed to confirm the outstanding stock of government debt to the BCSTP and set: (i) the interest rate to be paid on such a debt and (ii) its amortization schedule.

- Necessary documentation was provided to the Fund staff confirming that the position of BCSTP Vice-Governor was filled in on September 20, 2004.

- On October 20, 2004 the BCSTP Board of Directors authorized the hiring of the firm BDO Binder Co. to audit the annual financial statements of the BCSTP with a three year term and a yearly renewal clause.

- By end-July 2005, the BCSTP will post in its internet website the 2003 and 2004 central bank's audited financial statements including the detailed explanatory notes together with the audit opinion. Publication of the audited financial statements will become a norm for the BCSTP from now on.

- During 2005, the BCSTP, in consultation with the Fund's Statistics Department, will start deriving the monetary statistics automatically from the central bank's accounting department's balance sheet. To this end, the BCSTP is working to generate the balance sheets of the central bank and the deposit money banks in an electronic format.

- In coordination with the Fund's Finance department (FIN), the BCSTP will seek to implement during 2005 any remaining technical recommendations included in the safeguards assessment of the BCSTP. These include recommendations on the early adoption of International Financial Reporting Standards (IFRS); implementation of a plan to modernize the central bank's internal audit function and financial risk analysis; and the development of formal investment guidelines of foreign reserves.

G. Statistical issues

43. The government is committed to the production of more timely and accurate statistics, in support of transparency and to allow better assessment of developments in the economy. To this end, the CBSTP will be working with the Fund's Statistics Department on the introduction of standardized forms for reporting monetary data to the Fund and the development of an integrated monetary database. Technical assistance provided by STA under the Fund's General Data Dissemination System (GDDS) Lusophone Project is viewed by the government as crucial in the authorities' efforts to revamp the country's statistical capacity. Ongoing work regarding the production of a revised system of national accounts for the period 1996–2002 and the development of new survey systems to compile national

accounts data by the National Statistics Institute (INE) is evidence of this policy commitment by the government. In addition, the outstanding World Bank Governance Capacity Building technical assistance credit also envisions supporting INE's capacity-building efforts.

IV. The Social Framework for the Program

44. The government's ability to implement the program will depend critically on the public support that can be assembled. To this end, it has been operating on a twofold social strategy, in addition to ongoing work towards attaining the HIPC goals:

- First, the full Poverty Reduction Strategy Paper (PRSP) includes a detailed account of critical social projects, a review of the PRSP implementation record to date, and the macroeconomic framework which is the basis for the economic program described in this Memorandum of Economic and Financial Policies (MEFP). Thus, the program's policies aim at responding to the needs of the population (and in particular the less privileged) as fully as financial resources permit without endangering fiscal sustainability.

- Second, in consultation with the World Bank and IMF staff, the government has made a preliminary identification of expenditure items—both current and capital outlays—that it believes best represent pro-poor spending. Current pro-poor spending consists of: (i) salaries of the ministries of Education and Culture, Health, and Labor and Solidarity; and (ii) spending on goods and services, and on transfers, of the Education and Culture, and of the Health ministries that have a direct impact on alleviating poverty. For capital outlays, pro-poor spending includes, inter alia, projects in the areas of: (a) provision of potable water and electricity to low-income communities; (b) education (e.g., building and furnishing classrooms); and (c) health (that is, equipping and provision of technical assistance for the main hospital in São Tomé). The government will review the categorization further to ensure accuracy in identifying pro-poor spending. A template agreed with Fund staff will form the basis of regular reporting in the context of the 2005–07 program.

V. Progress Towards HIPC Goals

45. The government considers attaining the HIPC Initiative completion point as one of its priorities. To this end, it has progressed steadily towards the implementation of policy reforms and social measures laid out in the HIPC decision point document. Notably, the sectoral strategies for health and education have already been developed and costed.

46. In the education sector, since 1999 the government has built most of the primary and secondary school classrooms agreed to as a HIPC completion trigger point. Furthermore, between 1999 and 2004, 134 primary school teachers and 174 kindergarten teachers where hired.

47. In the health sector, 7 health centers have been built during 1999–2002 and another 2 posts have been re-habilitated. Three of the newly built health centers have been equipped.

Vaccination of the children for major childhood diseases (DPT3, Polio, BCG and measles) has met or surpassed the HIPC completion triggers (set at 85 percent). As of 2002 the government had not yet succeeded in reducing the mortality of children (under 5) from malaria; however, the anti-malarial campaign launched in 2003 in Príncipe (education, fumigation, bed nets) and extended in 2004 to the island of São Tomé provides anecdotal evidence of a large drop in infections, and will reduce mortality rates, particularly that of children.

48. Regarding public expenditure management, the government has been active on several fronts, although it recognizes that more work is needed to fulfill these trigger points:

(i) To date, the government monitors closely the use of HIPC funds. These funds are included in the budget and supervised by the directorates of Treasury and Planning. The Ministry of Planning and Finance has undertaken internal and external audits.

(ii) Programming and execution of foreign-financed capital expenditure (loans) are under the control of the Ministry of Planning and Finance. At the same time, to streamline reporting and avoid execution inconsistencies with regards to some grants, the government has requested all development partners to help in bringing all externals assistance under the budgetary system.

(iii) The country does not yet have a medium term expenditure framework (MTEF). However, the government is committed to develop such a framework within the next three to four years with the support from the World Bank and IMF staffs. Ongoing work on the development of a computerized budget and public expenditure management system (see paragraph 21 above) would be fundamental in this endeavor.

49. The government has implemented several of the governance HIPC completion trigger points:

(i) In the petroleum sector, the Oil Revenue Management law was approved by the National Assembly in December 2004.The institutional framework for developing the national petroleum policy and to supervise and to regulate the sector became operational in the first half of 2004. This framework includes the National Committee on Petroleum (NCP)—headed by the President of the Republic and including the Prime Minister, other senior government officials, as well as representatives from NGOs and the private sector—and the National Petroleum Agency (NPA), which absorbed the small technical petroleum unit already functional since 2002.

(ii) The Auditor General's Office (*Tribunal de Contas*) has been functional since mid-June 2003. However, the tribunal of arbitration of business and contract matters has not been made operational yet.

VI. Challenges with Oil Sector Development

50. The government sees the development of the oil sector as a key element in its economic growth and development strategy. Progress with the auctioning of the oil fields in the Joint Development Zone confirms the country's potential in this regard. The government is fully aware, however, of the consequences of ineffective management of oil revenue and the possible distortions to the non-oil economy of a booming capital-intensive energy sector. Against this background, the government is committed to foster transparency and accountability in the management of oil revenue. At the same time, an effective implementation of the PRSP should raise the productivity of today's Sãotomeans through increases in basic health and education services, as well as higher physical and human capital called for in the poverty reduction strategy. With a better-trained labor force, the country would be ready to absorb future high-tech, capital-intensive, enterprises that might develop in the future, such as oil-sector related activities (that is, manufacturing and services enterprises supporting the development of the oil sector), offshore fishing, trans-shipment entrepôt services, specialized agriculture, and eco-tourism.

VII. Program Monitoring for 2005

51. **Technical Memorandum of Understanding (TMU)**. The program will be monitored using the definitions, data sources, and frequency of monitoring set out in the accompanying TMU. The government will make available to the Fund all necessary data, appropriately reconciled and on a timely basis, as specified in the TMU.

52. **Prior Actions**. The government will undertake actions prior to the IMF Board meeting to consider the request for a three-year arrangement under the PRGF, in order to ensure effective implementation of the economic strategy described in this memorandum (Table I.2).

53. **Performance criteria**. Table I.1 shows the quantitative performance criteria set for September and December 2005. Structural performance criteria and benchmarks for 2005 with corresponding dates are identified in Table I.2. In addition, the nonaccumulation of external payment arrears (as defined in the TMU) will constitute a continuous performance criterion, as will the standard injunctions against imposing or intensifying restrictions on current payments introducing or modifying multiple currency practices, concluding bilateral payments agreements that are inconsistent with Article VIII, or imposing or intensifying import restrictions for balance of payments reasons.

Table I.1. São Tomé and Príncipe: Performance Criteria for 2005

(In billions of dobras, unless otherwise specified)

	2005	
	end-Sept. Perf. criteria	end-Dec. Perf. criteria
1. Floor on domestic primary balance (as defined in the TMU; cumulative from beginning of year)	-84.4	-130.6
2. Ceiling on domestic primary spending (cumulative from beginning of the year) 1/	223.9	329.4
3. Ceiling on changes in net domestic financing of the government (cumulative from beginning of year, in billions of dobras at program exchange rate) 2/ 3/	-27.6	0.8
4. Ceiling on changes in net domestic assets of the central bank (cumulative from beginning of year, in billions of dobras at program exchange rate) 2/ 3/	-18.5	9.9
5. Floor on changes in the net international reserves of the central bank (cummulative from beginning of the year, in millions of U.S. dollars) 4/	4.8	0.9
6. Ceiling on central government's outstanding external payment arrears (stock, in millions of U.S dollars) 5/	0.0	0.0
7. Ceiling on the contracting or guaranteeing of new non-concessional external debt with original maturity of more than one year by the central government or the BCSTP (cumulative from the beginning of the year, in millions of euros) 6/ 7/	1.7	1.7
8. Ceiling on the outstanding stock of external debt with original maturity of less than one year owed or guaranteed by the central government or the BCSTP (cumulative from the beginning of the year, in millions of U.S. dollars) 8/	15.0	15.0
Memorandum items:		
Oil signature bonuses (in millions of U.S. dollars)	49.2	49.2
Official external program support as defined in the TMU (in billions of dobras)	10.4	21.6

Sources: São Tomé and Príncipe authorities; and staff estimates and projections.

1/ Equal to government domestic expenditure, as defined in the TMU, excluding all interest payments.
2/ The ceiling will be adjusted downward (upward) by the cumulative negative (positive) deviations in external debt service and the cumulative positive (negative) deviation of actual from projected disbursements of external program support. The downward adjustment of higher than programmed external program support will not take place to the extent that the additional support is used to accommodate higher capital outlays of the government, up to US$1 million.
3/ The ceiling will be adjusted downwards by the amount of accumulated domestic arrears.
4/ The floor on net international reserves will be adjusted upwards (downwards) by the cumulative negative (positive) deviation in external debt service, and the cumulative negative (positive) deviation of actual from projected disbursements of external program support. The upward adjustment of higher than programmed external program support will not take place to the extent that the additional support is used to accommodate higher capital outlays of the government, up to US$1 million.
5/ This is a continuous performance criterion.
6/ This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received.
7/ With a grant element of less than 50 percent.
8/ The term “debt” has the meaning set forth in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000.

Table I.2. Prior Actions, Structural Performance Criteria and Benchmarks for 2005

Prior actions for approval of new PRGF arrangement

- Obtain parliamentary passage of a 2005 budget with aggregate revenues, expenditures, and net domestic financing that are consistent with the MEFP.

- Receipt of the oil signature bonus on Block 1 (totaling US$49.2 million) and deposit of these funds in the government's National Oil Account held with the Federal Reserve Bank of New York.

Structural performance criteria

By end-July 2005, submit to the National Assembly a new tax code on personal income taxation broadening the tax base (to include bonuses, monetary premiums, and in-kind benefits) and updating the tax rate schedules to provide progressivity to the personal income tax system (MEFP, para. 13);

By end-July 2005, submit to the National Assembly a new code on corporate taxation that limits the granting of tax holidays to new licensed investors to a maximum of three years, with tax reductions only covering up to 75 percent of profit taxes due (MEFP, para. 13);

By end-July 2005, submit to the National Assembly a new tax procedural code establishing tax tribunals at different levels of government (regional and national) to handle tax issues and disputes, as well as penalties and fines for underpayment, late payment, and other tax violations (MEFP, para.14);

By end-July 2005, submit to the National Assembly a new investment code that provides equal treatment for domestic and foreign investors and is consistent with the new code on corporate taxation (MEFP, para. 40).

Structural benchmarks

By end-July 2005, establish a timetable for the reduction of outstanding payments arrears to the water and electricity company (EMAE) (MEFP, para.36).

By end-December 2005, complete feasibility studies on the privatization of ENASA and ENAPORT (MEFP, para. 38).

By end-July 2005, submit to the National Assembly new guidelines on urban property taxation to support the development of new official registries of the quantity, value, and ownership of urban real estate used in apportioning taxes (MEFP, para.14);

By end-July 2005, submit to the National Assembly new legislation on inheritance taxes that clarifies the tax rate and tax base applicable (MEFP, para.14).

By end-September 2005, submit to the National Assembly proposed legislation criminalizing money laundering and financing of terrorism (MEFP, para. 31).

By end-December 2005, develop the terms of reference for a study on land tenure, which would analyze, among other things, the economic effects from a lack of complete property rights for land-holders (MEFP, para. 41).

São Tomé and Príncipe

Technical Memorandum of Understanding

1. This technical note contains definitions and adjuster mechanisms that are intended to clarify the measurement of items in Table I.1, Quantitative Performance Criteria, PRGF Arrangement, 2005, attached to the Memorandum of Economic and Financial Policies. Unless otherwise specified, all quantitative performance criteria and benchmarks will be evaluated in terms of cumulative flows from December 31, 2004.

Provision of Data to the Fund

2. Data with respect to all variables subject to performance criteria and indicative benchmarks will be provided to Fund staff on a monthly basis with a lag of no more than four weeks for data on the net domestic assets and net international reserves of the Central Bank of São Tomé and Príncipe (BCSTP), and eight weeks for other data. The authorities will transmit promptly to Fund staff any data revisions. For variables that are relevant for assessing performance against program objectives but are not specifically defined in this memorandum, the authorities will consult with Fund staff as needed on appropriate measurement and reporting.

Definitions

3. **Government** is defined for the purposes of this memorandum to comprise the central government. The central government includes all governmental departments, offices, establishments, and other bodies which are agencies or instruments of the central authority of São Tomé and Príncipe. The central government does not include the operations of state-owned enterprises.

4. **Government domestic revenue** comprises all tax and non-tax revenue of the government (in domestic and foreign currency), excluding foreign grants, the receipts from the local sale of crude oil received from Nigeria as in-kind grant, and any gross inflows to government on account of oil signature bonus payments. Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and Directorate of Treasury in the Ministry of Planning and Finance.

5. **Domestic primary expenditure** comprises all government spending assessed on a commitment basis, excluding: (i) foreign-financed capital expenditure, (ii) expenditure under the overseas scholarship program that are externally-financed, and (iii) other foreign-financed current expenditures, for which data are reported by the Directorate of Budget and Directorate of Treasury. Reporting of government domestic expenditure will be based on the state budget execution prepared every month by the Directorate of Budget and Directorate of Treasury in the Ministry of Planning and Finance.

6. Within the above total, **pro-poor expenditure** refers to government outlays that, as it has been agreed with the IMF and World Bank staffs, have a direct effect in reducing

poverty. These expenditures, which includes both current and capital outlays, are defined as follows:

a. **Pro-poor current spending**: These cover the following ministries and expenditure categories (by budget code) as described in the matrix below, with items marked with an "x" representing social expenditures by the referred ministries.

Code	Description of current expenditure	MINISTRY OF EDUCATION AND CULTURE	MINISTRY OF HEALTH	MINISTRY OF LABOUR AND SOLIDARITY
01.00.00	Despesa com Pessoal	X	X	
02.01.05	Outros bens duradouros	X	X	
02.02.02	Combustíveis e lubrificantes	X	X	
02.02.04	Alimentação		X	
02.02.05	Medicamentos	X	X	
02.02.06	Roupas e calsados		X	
02.02.09	Outros bens não duradouros		X	
02.03.01.01	Agua e energia	X	X	
02.03.02	Conservação de bens		X	
02.03.06	Comunicações	X	X	
04.01.01	Orçamento do estado		X	
04.02.01	Instituições particulares		X	X
04.03.01	Particulares		X	X
04.04.02	Outras transferências para exterior			X
06.01.00	Ensino e formação	X		
06.04.01	Custos recorrentes de projectos	X	X	
06.04.04.02	Outros Diversos	X	X	

Expenditures on "combustiveis e lubrificantes" (fuels and lubricants) that are effected for administrative purposes are excluded. Likewise, "alimentacao" (food) and "roupas e calsados" (clothing and shoes) supplied to administrative staff are excluded.

b. **Pro-poor capital spending:** This covers selected projects, which are deemed to have a direct impact on alleviating poverty in the following sectors: education, health, social safety nets, agriculture and fisheries, rural development, planning and finance, youth and sports, provision of potable water, and electrification.

c. **Reporting Requirements:** Data on execution of pro-poor current and capital spending will be provided on a quarterly basis to the staff by the Directorate of Budget (for current expenditure) and by the Directorate of Planning (for capital expenditure) at the Ministry of Planning and Finance.

7. The **domestic primary balance** is defined as the difference between government domestic revenue and noninterest government domestic expenditure. This balance for the year 2004 was assessed at dobras -128.1 billion, broken down as follows:

Government domestic revenue:	Db 165.0 billion
Less: government primary expenditure, excluding foreign-financed investment, foreign-financed scholarships, and transfers to the JDA:	Db 293.1 billion
Equals: Domestic primary balance:	Db -128.1 billion

8. **The program exchange rate** for the purposes of this memorandum will be Db10,104 per US dollar, which corresponds to the simple average of the buying and selling rates for the BCSTP for December 31, 2004. The exchange rate of the dobra against the euro at end-December 2004 was 12,314 and against the SDR was 15,558.

9. **Net domestic financing of the government** is defined as the change in net credit to government by the banking system—that is, the stock of all outstanding claims on the government held by the BCSTP, less all deposits held by the central government with the BCSTP, plus the stock of all outstanding claims on the government held by deposit money banks (DMBs)[2], less all deposits held by the central government with DMBs--as they are reported monthly by the BCSTP to the IMF. All foreign exchange denominated accounts will be converted to dobras at the program exchange rate. At end-December 2004, outstanding net credit to the government was assessed at dobras 35.8 billion, broken down as follows:

BCSTP credit, including use of IMF resources:	Db 83.6 billion
Less: government deposits with BCSTP:	Db 41.0 billion
Equal: Net credit to government by the BCSTP:	Db 42.6 billion
Plus: DMBs credit:	Db 0.0 billion
Less: government deposits with DMBs (including counterpart funds):	Db 6.9 billion
Equals: Net domestic financing of the government:	Db 35.8 billion

[2] Deposit money banks (DMBs) refers to Other Depository Corporations as stated in the Monetary and Financial Statistics Manual.

10. **Base money** is defined as the sum of currency issued—which consists of currency outside banks and cash in vaults—and bank reserves. Bank reserves refer to reserves of commercial banks held with the central bank, and include reserves in excess of the legal reserve requirement. At end-December 2004, base money was assessed at dobras 119.2 billion, calculated as follows:

Currency issued:		Db 67.2 billion
Of which:	Cash in vaults:	Db 7.2 billion
	Currency outside banks:	Db 60.0 billion
Plus: Bank Reserves:		Db 52.1 billion
Equals: Base Money:		Db 119.2 billion

11. **Net international reserves** (NIR) of the BCSTP are defined for program monitoring purposes as short term-term foreign assets of the BCSTP minus short-term external liabilities. All short-term foreign assets that are not fully convertible external assets readily available to and controlled by the BCSTP (i.e., they are pledged or otherwise encumbered external assets, including, but not limited to, the HIPC umbrella SDR account, and assets used as collateral or guarantees for third party liabilities) will be excluded from the definition of NIR. All values are to be converted to U.S. dollars at actual market exchange rates prevailing at the test date. At end-December 2004, NIR was assessed at dobras 169.2 billion, calculated as follows:

Net Foreign Assets:		Db 189.3 billion
Less:	Other foreign assets:	Db 49.5 billion
Plus:	Other liabilities:	Db -29.4 billion
Equals: Net International Reserves:		Db 169.2 billion
Of which:	Gross reserves:	Db 197.1 billion
	Short-term liabilities:	Db - 27.9 billion

12. **Net domestic assets** of the central bank of São Tomé and Príncipe are defined as the difference between base money and net foreign assets of the BCSTP. All foreign denominated accounts will be converted to dobras at the program exchange rate. At end-December 2004, net domestic asset was assessed at dobras -70.0 billion, calculated as follows:

Base Money:	Db 119.2 billion
Less: Net Foreign Assets:	Db 189.3 billion
Equals: Net domestic assets of the BCSTP:	Db -70.0 billion

13. The performance criterion on **short-term external debt** refers to the outstanding stock of external debt with original maturity of one year or less, including overdraft positions and debt owed or guaranteed by the government or the BCSTP.[3] At end-December 2004, the stock of short-term external debt stood at US$1.0 million.

14. The performance criterion on **nonconcessional medium- and long-term external debt** refers to the contracting or guaranteeing of external debt with original maturity of more than one year by the government of BCSTP.[4] [5] Debt reschedulings and restructurings are excluded from the ceilings set on nonconcessional borrowing. Medium- and Long-term debt will be reported by the Debt Management Unit of the Ministry of Finance and Planning and (as appropriate) by the BCSTP, measured in US dollars at current exchange rates. The government of São Tomé and Príncipe will consult with Fund staff before contracting obligations if it is uncertain as to whether those obligations are included in the performance criterion limits. At end-December 2004, nonconcessional medium- and long-term external debt stood at US$15 million.

[3] The term "debt" is defined in accordance with point 9 of the Guidelines on Performance Criteria with respect to Foreign Debt (Decision No. 12274-(00/85) August 24, 2000).

[4] This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 but also to commitments contracted or guaranteed for which value has not been received.

[5] The concessionality of loans is assessed according to the reference interest rate by currency published by the Development assistance Committee of the Organization for Economic Cooperation and Development (OECD). For loans of terms of no less than 15 years, the ten-year average of commercial interest reference rates (CIRR) for the currency in which the loan is denominated will be used. For loans of shorter terms, the six month average will apply. A loan is deemed to be on concessional terms if, on the initial date of disbursement, the ratio of the present value of the loan, calculated on the basis of the reference interest rate, to the nominal value of the loan is less than 50 percent (in other words, a grant element of at least 50 percent, excluding Fund resources). For currencies with no available reference interest rates, the SDR rate will be used.

15. The nonaccumulation of new **external payment arrears** is a continuous performance criterion. Government external payment arrears are defined as all unpaid external public debt obligations, according to the data established by the Debt Management Unit of the Ministry of Planning and Finance and (as appropriate) by the BCSTP, with the exception of arrears pending rescheduling arrangements. Debt would be deemed to be in arrears when it has not been paid by the time it is due, unless the definition of an arrear has been otherwise contractually defined. The performance criterion relating to external arrears does not apply to external arrears pending the conclusion of a debt-rescheduling agreement with the Paris Club. The outstanding stock of external arrears pending debt-rescheduling agreement at end-December 2004 stood at US$18 million.

16. **Official external program support** is defined as grants and loans provided by foreign official entities that are received by the budget—**excluding project grants and loans**—and other exceptional financing. Amounts assumed in the program consistent with this definition are shown in the memorandum item entitled "external program support" of Table I.1. For 2004, official external program support totaled US$7.1 million, being the sum of non-project grants (US$2 million) and program loans (US$5.1 million).

Adjusters

17. **Deviations in official external program support** from the amounts programmed in Table I.1. will trigger adjusters for domestic financing of the government, net domestic assets of the BCSTP and net international reserves as indicated below. These and other adjusters as set out below will be measured cumulatively from December 31, 2004.

18. **Ceilings on net domestic financing (NDF) of the government and net domestic assets (NDA) of the BCSTP.** Monthly differences between projected and actual official external program support and external debt service payments in foreign exchange will be converted to dobras at the actual monthly exchange rate and cumulated to the test date. The ceilings on NDF and NDA will be reduced by the sum of: (i) excess official external program support; and (ii) the shortfall in external debt service payments. Both ceilings will be increased by 100 percent of any cumulative shortfall in official external program support or excess in external debt service. The downward adjustment to NDF and NDA for higher than programmed official external program support will not take place to the extent that additional external program support is used to accommodate higher capital outlays by the government, up to US$1 million, converted to dobras at actual exchange rates, as indicated in Table I.1.

19. **Floor on net international reserves (NIR) of the BCSTP.** Quarterly difference between projected and actual official external program support and external debt service payments will be converted to U.S. dollars at the actual exchange rates prevailing at the test date. The floor on NIR will be raised by the sum of: (i) excess external program support and (ii) any shortfall in external debt service payments. The upward adjustment to NIR for higher than programmed official external program support will not take place to the extent that additional external program support is used to accommodate higher capital outlays by the

government, up to US$1 million, converted to dobras at actual exchange rates, as indicated in Table I.1.

Data Reporting

20. The following information will be provided to the IMF staff for the purpose of monitoring the program. Except for net domestic assets and net international reserves, which data are to be provided by the BCSTP within four weeks at the end of each month, other monetary data will be furnished within eight weeks after the end of each month for monthly data, within eight weeks after the end of each quarter for quarterly data, and within eight weeks after the end of each year for annual data.

i. Fiscal data

The Directorate of Budget at the Ministry of Planning and Finance will provide to IMF staff:

- Monthly data on central government operations for revenues, expenditure and financing
- Monthly detailed tax and non-tax revenues
- Monthly detailed current and capital expenditure data
- Quarterly data on official external program support (non-project)
- Quarterly data on the execution of the public investment program (PIP) and sources of financing
- Quarterly data on project grant disbursement (HIPC and Non-HIPC)
- Quarterly data on project loans disbursement

ii. Monetary data

The BCSTP will provide the IMF staff:

- Weekly data on exchange rates
- Monthly data on interest rates
- Monthly balance sheet data of BCSTP (in BCSTP and IMF formats)
- Monthly balance sheet data of individual deposit money banks (in BCSTP and IMF formats)
- Monthly consolidated balance sheet data of deposit money banks (in BCSTP and IMF formats)
- Monthly monetary survey (in BCSTP and IMF formats)
- Monthly central bank foreign exchange balance (Balança cambial)
- Latest position of NIR and Liquid Reserves of the BCSTP (last available; monthly)

iii. External debt data

The Debt Management Unit at the Ministry of Planning and Finance will provide the IMF staff:

- Monthly data on amortization of external debt (HIPC and Non-HIPC)
- Monthly data on paid interest on external debt (HIPC and Non-HIPC)
- Monthly data on disbursements external project and BOP support loans

iv. National accounts and trade statistics

The National Institute of Statistics will provide the IMF staff:

- Monthly consumer price index data

Monthly data on imports as reported by Customs (value and import taxes collected) Monthly commodity export values